

BUDGETING: HOW PREPAID HELPS DELIVER PERSONAL FINANCIAL SUCCESS

A white paper by i2c, Inc., in association with Gx



1300 Island Drive
Suite 105
Redwood City, CA 94065
USA
+1 650-593-5400
sales@i2cinc.com
www.i2cinc.com





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Introduction

If we want to control and optimize our finances, we really have to know and understand them. Gaining control means knowing what resources we have and how those resources should be allocated and utilized. This is all part of the incredibly important concept of budgeting.

Knowledge is power

– Francis Bacon, 1597

The readers of this paper most likely have extensive experience with budgeting in a business context. What is surprising is the difficulty people have budgeting in their personal lives. This is most true for those who struggle economically; where the costs of not budgeting may have the most severe negative consequences. The purpose of this white paper is to lay out the case for budgeting and demonstrate how features of prepaid products can make budgeting easy and successful.

Just being a good thing does not mean people will embrace budgeting. In this paper, we look at the underlying challenges to adoption that need to be addressed to get people to start, and keep using, budgeting tools. Towards this end, we discuss how new prepaid technologies help consumers overcome some of the natural tendencies that inhibit use of budgeting and get them well-positioned on the road to financial success. Understanding this will help financial institutions and program managers develop the right product and service offerings to help consumers along this path. The budgeting tools discussed offer the tactical means to increase customer engagement, enhance customer stickiness and develop long-term customer value.

The Importance of Budgeting

The experts in personal financial management are in complete agreement on budgeting; no matter what your economic status, you should be doing it. But while the magnitude of dollars involved is different for people like Bill Gates, the stakes are highest for those who are lower on the economic ladder. Here, missteps in financial management can have serious and often long-term consequences. Budgeting, at its most basic level, is a way to help minimize that risk.

The benefits of budgeting generally revolve around goals, risk reduction, and self-control. In addition, for those who have family responsibilities, good budget practices also suggest and facilitate better communications about money, which help keep households on the same page financially.



Goal Directed

The first step in budgeting is the need for an explicit prioritization of the individual's goals. These goals may be just getting through the next few months without getting further in debt, or they may be much more ambitious, such as saving for a down payment on a home or the education of a child. The important factor is that once in the budget, there is an explicit acknowledgment of that particular objective.

The goal-setting exercise also produces additional benefits. Laying out priorities and deciding how to pay for them forces us to consider exactly where we are at with our finances, which necessitates the organization and systematic evaluation of our financial information. If nothing else, what personal finance Guru Suze Orman calls “standing in the truth”¹ reveals how exactly we are spending our money. This is often the most surprising and insightful aspect of the budgeting process, as it can present a set of viable, positive modifications to current behavior.

"Would you tell me, please, which way I ought to go from here?"

"That depends a good deal on where you want to get to," said the Cat.

"I don't much care where--" said Alice.

"Then it doesn't matter which way you go," said the Cat.

- Lewis Carroll, 1865

Risk Reduction

Even though there are inevitable economic up and downs, peoples' generally optimistic views mean that they probably are not adequately prepared when problems do occur. Experts insist that budgets include the goal of accumulating a reasonable amount of money to be used as a contingency fund, as savings is the only sure hedge against a long-term change for the worse. Still, even with the current uncertain economic environment, Americans save only about 5% of their incomes, lower than most developed countries. And while those in worse financial shape like the idea of saving, it is obviously very tough to do when constantly short of money.²

Self-Control

Related to the explicit formulation of a path to a goal, budgeting is instrumental in keeping our feet on the path. The budget serves as a reminder that both maintains objectives at the top-of-mind and continually reinforces our own set priorities.

"Bind me as I stand upright, with a bond so fast that I cannot possibly break away."

(Ulysses to his crew) - Homer, 800 BC

1. Suze Orman, The Money Class, 2011

2. <http://www.gallup.com/poll/166643/saving-popular-among-lower-income-americans.aspx>



In a society where someone is always, often very persuasively, trying to sell you something, an extraordinary amount of will-power is needed to constantly say “no.” Budgets, and the people and tools that help us stick to them, stiffen our resolve to resist temptation. As we progress through the budget cycle we are able to monitor the progress being made. Deviations and exceptions are noted much earlier and corrective action is possible before small problems become major issues.

Adopting Budgeting

People need to understand how useful budgeting can be. This is a message that is voiced loudly by a few influential experts, however the reality is not everyone hears the call. Budgeting is part of basic “financial literacy” but many people are quite deficient in the basics of personal finance.³ Younger consumers especially are often not exposed to financial concepts until they have made some serious financial missteps. While the root of the problem is debatable, increased availability of the tools that help people manage their finances provides a “learn-by-doing” approach that effectively teaches the benefits of budgeting.

One roadblock to overcome is the belief that it is enough to just do our budgeting in our heads. It is very true that we have developed “mental accounts”⁴ to keep track of and make some sense of our personal finances. We talk about “rent money” as if it is different than other types of funds. We set aside money for entertainment and for gas. According to University of Chicago Professor Richard Thaler, everyone does this to a certain degree. Unfortunately, mental accounts in our head are not nearly as reliable as accounts that are explicit. Things like mood and social pressure can have dramatic effects on boundaries established only in mental accounts. For example, if you have had a bad day at work, a friend might suggest a nice dinner out “to take your mind off things.” Likewise if you have had a great day at work, you may be in an expansive mood and readily agree to “celebrate the moment.” In the absence of a real budget, mood tends to trump self-control.

The Role of Prepaid and the New Tools that Lead to Budgeting Success

Because they are pre-funded, prepaid cards by their very nature offer much of the necessary functionality that is sought by those wishing to create budgets. In addition, new features of the cards, such as real-time account alerts and spending purses, provide additional benefits which both make adoption of budgeting easier and make the prepaid products more effective for those trying to budget.

3. Schmeiser and Seligman, *Journal of Consumer Affairs*, 2013

4. Thaler, *Marketing Science*, 1985t



The market for prepaid cards and especially General Purpose Reloadable (GPR) cards has been growing impressively. Mercator Advisory Group estimates that approximately \$71.6 billion was loaded on the cards in 2013, an annual growth rate of nearly 11%⁵. Driving this increase is the recognition by many consumers that prepaid products are excellent personal finance tools.

The primary benefit of prepaid products is that they create some de facto budget constraints because the money that is available for use is restricted to the money already on hand. Overspending is not possible. Credit, on the other hand, is costly. And it becomes even more costly as financial circumstances deteriorate and the risks of providing credit increase.

If budgeting is perceived as difficult, then few will undertake the challenge even when faced with economic problems. Prepaid cards, however, are readily accessible, easy to activate, widely accepted, and simple to use. This simplicity gets consumers over the initial adoption hurdle.

“Spend what you have today, not what you hope to have tomorrow”

- Suze Orman, 2011

A prepaid card is just one step, however. To have a true budget, additional features must be available. One important tool was foreshadowed in the 2008 New York Times Bestseller, *Predictably Irrational* by Duke behavioral scientist Dan Ariely. In the book, Ariely calls for the creation of a “self-control credit card,” which would help consumers stick to a budget. He suggested that the “user could decide in advance how much money they wanted to spend in each category, in every store, and in every time frame.”⁶

This is precisely the functionality made available for use with some prepaid cards. Cards with a multi-purse feature allow cardholders to set up accounts for different categories of purchases.

Cardholders begin with a simple set of decisions about how much they want to spend on any number of categories of purchases.

The very act of explicitly setting up these budgetary limits makes us more aware of our spending habits. The technology then aids the self-control mechanism by restricting spending to the user-set limits in each category.

“Consumers are asking others to help themselves develop self-control because so many companies are not showing any restraint.”

- John Leland, New York Times,
February 18, 2007

5. Mercator Advisory Group, 2013

6. *Predictably Irrational*, pg. 153



Steps to Help Consumers Thrive Financially

As discussed in this paper, budgeting has many benefits for consumers including:

- helping with setting and maintaining progress towards goals
- providing a platform for better planning
- educating those that lack financial management skills
- sustaining self-control by earmarking funds for certain categories of spending

For financial institutions and program managers, offering prepaid products that assist in the development of budget awareness and utilization can be a significant way to attract and retain customers. Enhanced engagement creates the opportunity for positive customer interactions and customers that are helped through difficult times remember the assistance they received and tend to be strong loyalists. In short, these products assist in creating meaningful connections with customers and foster long-term (read “more profitable”) relationships with them.

"Annual income twenty pounds, annual expenditure nineteen [pounds] nineteen [shillings] and six [pence], result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."

- Mr. Micawber in David Copperfield, Charles Dickens, 1850

Prepaid products are tailor-made for building these engaged relationships. Advances in the technology have led to the development of many important tools that can aid consumers in making budgeting easier to adopt, more likely to be sustained in use, and more effective. Functions like multiple purses that let customers set and stick to goals, real-time text alerts that maintain focus, and financial buddies who help when self-control is flagging, all create strong benefits that meet real customer needs. Combined, these offerings go a long way to helping customers make sure their spending is both planned and paid for. The result, as Dickens suggested so long ago, is very positive.



About the Author

Dan Horne (Ph.D., University of Michigan) is one of the world's leading experts on how consumers make payment choices, an area he has studied since 1992. He has completed major studies on consumer payments in the US, Canada, the UK, France, Germany, Italy, Turkey, South Africa, Tanzania, Kenya, India and Australia. He has served as an adviser to governmental authorities in the US and Canada and his writings appear regularly in top academic and practitioner journals. Horne is an Associate Professor at the Providence College School of Business, where he teaches Consumer Research, and the Co-Founder and Chief Knowledge Officer of the London-based research and advisory company, Gx.

About i2c, Inc.

From its Silicon Valley headquarters, i2c provides the infrastructure financial institutions, corporations, brands and governments around the world need to launch and manage prepaid and next-generation commerce products. i2c's global, cloud-based platform supports virtually any prepaid, debit or credit program in plastic, virtual or mobile form. It offers a range of features that help consumers manage their finances effectively, including multiple purses, event-driven communications, consumer-appointed financial buddies and mobile apps. When used together, these features combine to create a personal financial management solution for consumers that is real-time, responsive and actionable. For more information, visit www.i2cinc.com.