FOCUS ON FINANCE

Finance 101: Start Education Early, At Home

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As parents, there is an ingrained sense within all of us to watch over our children, and ensure that they greet adulthood as prepared as possible. During troubled economic times such as these, the need grows for children to be financially prepared as well.

That does not necessarily mean money in their bank accounts — although the importance of savings cannot be overstated — but also how to use and understand credit cards, or how to borrow money. Kids now more than ever need to learn the fundamentals of financial responsibility.

Fortunately for those that are reading this, this applies to every parent regardless of their child's age. It truly is never too early to begin teaching children about savings, and from there moving on to the finer points.

With that in mind, I have provided some common questions, in addition to some creative suggestions for preparing the next generation for financial discipline.

Why is a financial IQ important for my child?

It is by no means rare to be asking this question. Why does my 7-year-old daughter need to be learning to literally save her pennies, when the prospect of owning a home or using a credit card is (hopefully) more than a decade off?

There are, of course, many answers to this question, but for starters, a child's financial knowledge will set them up for long-term success.

Knowing how to manage one's finances certainly aids in maintaining personal stability, and can also be a building block for succeeding professionally.

Conversely, the lack of this knowledge will ensure difficult times in both realms as well. How can someone successfully run a business if money management is not second nature?

Second, ensuring a high financial IQ in one's children will pay off for parents as well. Responsibility here is about self-sufficiency: what does a child need to know in order to relieve their parents from the burden of financial support? Moreover, some parents live with the expectation that their children will provide them support after they retire. This underscores the importance of money management, for how can parents expect support in return if their children have not grown up with a proper savings plan?

At what age is it appropriate to start teaching kids about finances?

It's safe to wait until kids can talk effectively, but beyond that it is never too early to instill the fundamentals of savings in our kids.

One friend of mine started working with their child at age four, but truthfully just starting is key. That parent instituted a homemade ticket system, where their child was encouraged to save up tickets and redeem them for privileges such as staying up later, watching a movie, or buying a DVD. Simple privileges yes, but the activity underscores the importance of long-term savings. Others will use more common toys, such as a coloring book or using play money. The medium of instruction is less important than the lesson itself. So long as the instruction is provided so the child can carry it with them, the act will pay dividends down the road.

As children get older, parents can then move on to more complicated lessons such as the importance of a budget. Obviously providing an allowance is important here (they have to have something to save to start with), but the key to teaching a budget to kids lies in making money finite. For this lesson, financial discipline is just as important for the parents as it is for the children, who have to know that a constant stream of cash is not guaranteed in life.

I allow my own daughter to keep the spare change when we go grocery shopping, and encourage her to save her birthday money in her piggy bank. When a school field trip came up, she was able to pay for it herself. Obviously no child is thrilled to deplete their savings (like any of us), but she felt better knowing that she was able to pay for something important, and did so on her own. A sense of accomplishment originated out of her ability to be self-sufficient.

Regardless of their kids' ages, parents can include them in major household purchases, such as TV's or vehicles. Events such as these reinforce the need for smart purchases, but they also prepare children for their own turn at the car dealership, an event that is anxious for many of us when doing it for the first time.

What do they need to know?

In addition to these critical lessons, it is also important for kids (teens in particular) to be well informed on the financial world around them.

Know your credit score. Just as we have grown up knowing that our Social Security numbers continually follow us, kids today need to understand the same about their credit score, because of its role in many important events throughout our lives. Employers will conduct a credit report before hiring someone. The federal government will do the same before approving a security clearance. Banks, of course, conduct their own analysis before they provide a loan for a car or a house. Finally, insurance companies use credit scores in determining one's home insurance and auto insurance rates. With so many events riding on a solid credit score, parents should be instructing their kids on what goes into a credit score, how they can build their credit, and how they can maintain it.

Know your statements. Regardless of whether your child will receive them online or in the mail, they will receive statements over the course of their lives. Be it a credit card bill, mortgage statement, or a report from their 401k, these documents contain information vital to their financial health, and they have to know how to read them properly. This is important first because banks do make mistakes, and in those instances it is incumbent upon the individual to catch them. In addition, having the confidence to properly analyze a financial statement forces one to actually monitor their finances on a periodic basis.

Know your savings rate.As a society, we have struggled generationally to determine the right amount to save, as a percentage of our gross income. I grew up knowing that 10 percent was a good rule of thumb, although my own parents drove me to save more. As a nation, we are now averaging roughly 6 percent, a number which needs to climb — if even back to 10 percent.

More than strict savings, those just starting out need to be looking to retirement and doing so early. Maxing out contributions to a 401k in addition to contributing to a Roth IRA are both vital steps for young adults in the workplace. Parents can encourage this by educating their children on the beauty of 50 years worth of compounded interest, and how a relatively small amount of savings left untouched can ensure a happy retirement.

Know your financial advisor. Granted, kids will really only need to see a financial advisor when they get truly serious about saving and investing, a decision made at different times for different people. Once that decision has been made however, parents should still be counseling their children on the need to make sacrifices. A financial advisor can provide a great deal of insight on achieving economic prosperity, but unless their client is prepared to match their financial goals with a realistic lifestyle, that prosperity may not arrive.

Know how to shop for money. Yes, knowing how to seek out bargains at the grocery store is important, and certainly should be included in the lessons. But financial "shopping" can be just as important. It is likely that all of us will borrow money at some point in our lives, and while it may be uncomfortable for many, it doesn't have to be.

Think of financial shopping the same way you would clothes shopping. Here, the price of your item is going to be the interest rate, and different lending institutions are going to offer a higher or lower rate. But just as clothing quality differs, so does the quality of a lender. An honest, quality lender will provide you a competitive rate, but it is important to know the right questions to be asking, such as about prepayment penalties, variable vs. fixed rates, etc.

By no means is this a complete guide for parents and their kids, but it should be a good start. But teaching the basics to financial responsibility requires that the teachers themselves be comfortable with the idea. If some of these questions spark anxiety about your own finances, fear not because you are hardly alone, but the time is now to begin finding answers to those questions. Once you've done so, start a conversation with your child, regardless of their age. They'll surely thank you later on.

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