# How to Let Kids Fail their Way to Financial Success

by

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For parents, the instinct is to protect children from making mistakes -- especially costly financial flubs. But knowing how to handle mistakes can mean the difference between an error becoming a learning opportunity or a bad habit.

"When your child makes a mistake, it can be useful to let him suffer the consequences," says Brette McWhorter Sember, author of "The Everything Kids' Money Book."

Of course, financial education ideally starts before any mistakes are made. Children begin picking up clues about money from a young age. According to a May 2013 study published by the U.K.'s Money Advice Service, children as young as 7 already recognize the value of money and what it means to earn it.

That's why it's good to start early with the fundamentals: giving kids an allowance so they understand the power of earning, and then teaching them to set goals and budget toward those goals.

Katherine Bateman, author of "The Young Investor," recommends encouraging children to save half of their earnings for long-term goals and half for everyday splurges and short-term goals. "Each of those halves teaches children something very important about money," says Bateman. "I still remember saving for a bicycle."

Helping them open an interest-bearing savings account is a great way to keep children inspired to save. Who doesn't like to see "free" money added to their account? "If you keep setting aside half, your money is going to grow -- not just by adding to it, but also by compound interest," Bateman says.

Michael E. Staten, director of the Take Charge America Institute at the University of Arizona's Norton School of Family and Consumer Services, agrees. "Whether it's saving for a bicycle, an iPhone or college, the most important thing is setting up the structure," he says. "You can get more sophisticated as kids get older."

**Monitor savings withdrawals**

As savings grow, should your child have unfettered access to all of the money they earn? "Absolutely not," says Sember. "You have to sign off on any withdrawals from a bank and there's a good reason for that. A friend could talk your child into withdrawing everything for a 'loan' that your child will never recoup."

Instead, Sember says, make a rule that your child needs to discuss any withdrawals from the account with you. That gives you the right to ask questions and steer your child in the right direction. This is especially important for kids who show less responsible behavior. "If you have a child who has chosen to mess up all through high school for one reason or another, then I certainly wouldn't give him or her their savings book and say 'Here, do with it what you want.'"

On the other hand, if your child has earned your trust by making good grades, managing her money well and otherwise being a good citizen of the family and school, then it's OK to go ahead and allow access to the funds, Sember says. But you should still have monthly meetings to balance the account and discuss the child's spending choices.

**When to let kids fail**

When kids do make bad decisions, think twice before rescuing them, especially if the fallout is relatively minor. For instance, if they spend all their money on candy and now don't have enough for a movie, then it's probably best that they don't go, says Sember. "This can be an excellent way to show cause and effect and teach your child not to always live in the moment."

By experiencing real world consequences, "kids will learn to designate money for certain things that are important -- do I want a cashmere sweater or do I want to fritter my money away and not know where it went?" Bateman says.

Accompany these lessons with an "admit, fix, prevent" mindset, says Manisha Thakor, founder and CEO of MoneyZen Wealth Management. For example, say your child blows his entire allowance, leaving no pocket money for an upcoming field trip. "Turn that experience into a teachable moment by walking through the alternate scenario of how the funds could have been better budgeted and then letting your child experience the field trip without extra spending money," Thakor says. "That can be super powerful. Without the teachable actions, however, the whole exercise falls flat."

**When to put the brakes on**

Some consequences are much more lasting than a snack-free field trip, though. Those are the ones you want to head off if possible. "It's one thing for your kid to save up to buy a toy you know is a piece of junk that will soon break or he will tire of," Sember says. It's another to let them blow their entire savings -- especially if it's for something that involves ongoing costs, such as a pet that a child can't take care of.

"In some families, children's savings accounts are earmarked as college money, so that's not something to be handled lightly," says Sember. "Let children make their own decisions and fail, within reason."

When to step in depends in part on family finances. Think about how much you can afford to lose in the name of financial education. "In some families, $20 might be a lot of money," says Sember. "In others, it's a drop in the bucket."

The type of mistake is also relevant. If it's going to harm the child's long-term financial track record, it's time to step in. For example, ignoring debts could affect the child's credit score, which will could in turn affect her ability to get a job, apply for college or get financial aid, Thakor says.

She says a mistake that will hurt others -- such as not repaying money owed to a friend -- is another cue for you to come to the rescue.

**Teach by example**

Finally, it's not just what you say -- it's what you do. Another study by the U.K.'s Money Advice Service showed that more than two-thirds of young people from families who are able to save for emergencies also have a regular savings habit themselves -- contrasted with less than half from families who are not able to save for emergencies.

"Kids are like sponges and they will mimic the financial behavior they see," Thakor says. "If you do not proactively teach them to save with the very first dollar of earnings, they will understandably think 100 percent of earnings can be spent."

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