FACTFILE:
GCSE ECONOMICS
UNIT 3.3
FINANCIAL CAPABILITY – MONEY AND FINANCIAL PRODUCTS

Rewarding Learning

Money

Learning Outcomes

Students should be able to:

- explain the functions that money performs in the economy;
- describe how people pay for goods and services;
- evaluate the following as means of payment:
  – cash;
  – cheques;
  – credit cards
  – store cards; and
  – electronic fund transfers.
- demonstrate knowledge and understanding of the following and make comparisons between alternatives, discussing risk and return:
  – savings;
  – personal and business loans;
  – bank overdrafts;
  – mortgages;
  – insurance products;
  – pension products; and
  – shares.

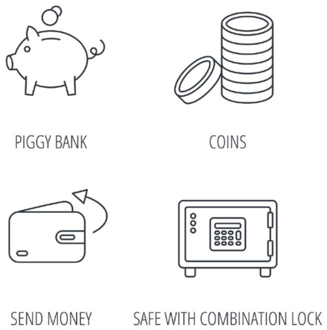
Money:

Definition:

Money can be defined as a collection of notes and coins which, when taken together, form a medium of exchange (often referred to as cash). This allows individuals to exchange cash in return for goods and services.

Functions of Money:

- Unit of Account – this function allows an individual to measure the value of goods/services, since they are usually stated in money terms, e.g. you might want to compare the prices of a new mobile phone and then decide how much you are willing to pay for it, depending on how much cash you have available.
- Store of Value – this function means that money must hold its value over time, so that an individual can use the money to buy goods/services at a later date, rather than in the short term, e.g. you might book a summer holiday in October, but only pay for it in June, a few weeks before departure – therefore money must hold its value to allow you to pay for the holiday at the price you booked it.
- Medium of Exchange – this function allows individuals an easily accessible and common way of exchanging goods/services in return for a cash payment, e.g. Caterpillar produces and sells excavators, generators and items of clothing – all of which can be paid for by all its customers, using cash.
- Standard for Deferred Payment – this function means that if an individual purchases something on credit, it can be paid for at a later date using money, e.g. if you use a store card to purchase a mobile phone, this means you can use the phone immediately, but pay for it at a later date, since the retailer is satisfied that the cash will be received to settle the outstanding balance.



Means of Payment:

Individuals can choose to pay for goods/services using a variety of payment methods. Two categories are commonly found:

- Cash-based methods;
- Non Cash-based methods.

There are various means of payment including:

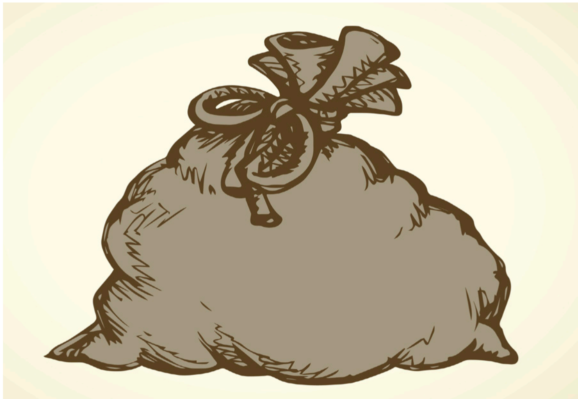
- **Cash**
  This is actual notes/coins used to complete a transaction, e.g. you might buy a voucher costing £10 to top-up your mobile phone at a local retailer. This method is convenient, however it means that you must carry cash at all times.
- **Cheques**
  These are paper documents, stating a promise to pay the holder the amount stated on the cheque when presented to a bank for payment. This method is convenient for the payment of large sums of money, however due to the increasing risk of default (i.e. non-payment) cheques are currently being used less frequently.
- **Debit Cards**
  A plastic card related to an individual's bank account, containing key personal information which when presented for use at an automated terminal, allow the user to transfer funds to/from a bank account immediately, e.g. you might buy a pair of jeans at a High Street retailer – by presenting your debit card to the cashier your purchases can be paid for immediately in return for the transfer of funds electronically from your bank account to the retailer's bank account. This method is convenient, however it is easy for an individual's spending habits to go out of control.
- **Credit Cards**
  A plastic card related to an individual's credit account (loan facility provided by a financial institution), containing key personal information which when presented for use at an automated terminal, allow the user to transfer funds to/from a credit account immediately, e.g. you might buy a concert ticket from an online booking agent, to go and see your favourite pop star – by entering your credit card details securely online, to the agent, your ticket can be paid for immediately in return for the transfer of funds electronically from your credit card account to the agent's bank account. You then pay the credit card company at a later date using cash, to settle the outstanding balance. This method is convenient, however, it can be costly since interest is added to the initial purchase cost therefore increasing the amount to be paid in total.
- **Store Cards**
  A plastic card related to an individual's credit account (loan facility provided by a retailer), containing key personal information which when presented for use at the specific retailer's automated terminal, allow the user to transfer funds to/from a credit account immediately, e.g. you might buy a new laptop computer from a large High Street retailer – by presenting your store card to the cashier, your computer can be paid for immediately in return for the transfer of funds electronically from your store card account to the retailer's bank account. You then pay the store card company at a later date using cash, to settle the outstanding balance. This method is convenient, however, it can be costly since interest is added to the initial purchase cost therefore increasing the amount to be paid in total.
- **Electronic Funds Transfer**
  A system of automated payments/receipts operated by many banks facilitating the electronic transfer of funds between bank accounts, e.g. you have a mobile phone which you purchased from a well-known mobile phone retailer. In order to use it, you are required to pay for it on a monthly basis. To do this, the retailer will ask you to set up a direct debit facility to enable the transfer of funds from your bank account to the retailer to pay for the services provided on a regular basis – typically monthly, e.g. calls, texts, downloads and ownership of the device. This method is convenient, however, it does permit a retailer to take a variable amount of money from your account at a time of their choosing which may not suit your financial needs.

Financial Products:

A range of financial products/services are available to allow individuals/businesses to meet their financial needs. These include:

- **Savings**
  This is money which an individual has which remains unspent – i.e. a situation where the income is greater than the financial outgoings. Many banks and financial services providers provide accounts for individuals who wish to 'save' money, such as savings accounts, credit union deposit accounts and ISA's. For example, Tom (a 16-year old student) receives £10 per week pocket money. He decides to save £2 per week in a local credit union, therefore any money saved by Tom can be used at a later date.

- **Loans**
  This is money provided to an individual from a bank/financial services provider to enable a person to pay for something immediately, however, it is repaid in smaller amounts (with interest charges) over a period of time in the future. For example, Mary (an 18-year old university student) might get a loan of £500 to buy a car to allow her to get to/from university. She will then repay a total of £600 (includes interest charges) over the next 3 years in regular instalments.
- **Mortgages**
  A mortgage is a long term loan, normally granted to allow an individual to purchase property. The principle is that a large lump sum is provided to an individual to purchase the property, which is then repaid at regular intervals (with interest) to the lender over a period of time (usually on a monthly basis) – normally up to 30 years. For example, David is 30 years old and works as a car salesman. He bought an apartment costing £60,000 in Bangor. The building society provided him with a mortgage of £48,000 to purchase the property. David will then repay this to the building society in equal monthly instalments, over the next 25 years.
- **Insurance products**
  An insurance policy is a legal contract which enables the policy-holder to pay a fee (premium) in return for being protected against financial loss in the future. For example, James (a 45-year old accountant) might insure his house (valued at £150,000) against the risk of a fire – in the event of a fire, he will then be able to ask the insurance company to rebuild his house to the condition it was in prior to the accident – i.e. insured against financial cost (£150,000) of rebuilding the house.
- **Pension products**
  A pension is a source of income payable to individuals of retirement age. It is basically a long-term savings plan, which can be used to provide an income to pensioners – small amounts of money are paid each month by individuals and employers into the plan over a long period of time (20–40 years) to allow the fund to increase. The money for the pension is paid for by a combination of stakeholders – including employers, employees and managers who manage the pension fund. It is the role of the pension fund managers to ensure sufficient money is received into the fund to allow pensions to be paid to the pensioners.
- **Shares**
  A share is a certificate documenting part-ownership of the share capital in a limited company. The holder of these shares is normally entitled to a return on them – referred to as a 'dividend'. A company can only pay a dividend if it has the money to do so. When an individual wishes to dispose of their shares, they can be sold to other investors at an agreed market price in the future. For example, Anne bought 10,000 shares in Sainsbury's twelve months ago costing £20,000. She decided to sell them earlier today and received a total of £22,000.



Summary:

Money has a number of functions – the most common of which is that it allows individuals to pay cash in return for goods/services which we choose to consume.

The means of payment available to an individual in order to pay for goods and services are varied – individuals will tend to use those which suit their needs best.

Different financial products are available to individuals to meet differing financial needs over time – these include savings products, products which allow individuals to pay for goods/services and provide income at a future date.

Review Questions:

1. Define the term 'money'.
2. Define the term 'financial product' using one example to support your answer, if the objective is to provide an income for yourself when you reach retirement age.
3. Using (i) a basic savings account; and (ii) shares, explain how the concept of 'risk and return' might apply to each financial product. Which is the more riskier financial product? Why?