A1
FUNCTIONS AND ROLE OF MONEY

Did you know?

The World's first paper money was created in China 1,400 years ago
More Monopoly money is printed every year than real money
At a spending rate of $1 million a day, it would take Bill Gates 218 years to spend all his money
Until World War 2, tea bricks were used as money in Siberia
Sea shells were once commonly used in many parts of the world as money
The 100 richest people in the world earned enough money in 2012 to end global poverty 4 times
The first transaction of Bitcoins was to buy pizza for 10,000 Bitcoins, which later increased in value to over US$12 million

FUNCTIONS AND ROLE OF MONEY

Functions and role of Money

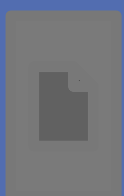
The ability to handle money received, and to control money paid, is a fundamental requirement for personal and business success. This success relies on understanding what "money" is.

In this topic you will learn about

- Functions of money:
  - Unit of account
  - Means of exchange
  - Store of value
  - Legal tender
- Role of money is affected and influenced by a number of factors:
  - Personal attitudes towards risks and reward, borrowing, spending and saving
  - Life stages (childhood, adolescence, young adult, middle age, old age), key features of each stage, financial needs and implications at each stage
  - Culture, including religious and ethical beliefs
  - Life events can vary the personal life cycle from individual to individual
  - External influences/trends and the financial-related effects
  - Interest rates, cost of borrowing versus rewards of saving
- Planning expenditure, common principles to be considered in planning personal finance
  - To avoid getting into debt
  - To control costs
  - Avoid legal action and/or repossession
  - Remain solvent
  - Maintain a good credit rating
  - Avoid bankruptcy
  - To manage money to fund purchases
  - Generate income and savings
  - Set financial targets and goals
  - Provide insurance against loss or illness
  - Counter the effects of inflation

Functions of Money

Money has four core functions.



Are noodles money?

Unit of account

- As a unit of account, money serves as the common base of comparison that people use to present prices and record debts
- Money also provides a measure by which we can value different goods and services

Means of exchange

- In today's economy, we use notes and coins as money, rather than barter as a medium of exchange
- Money enables goods and services to be exchanged, transactions to be settled and debt to be paid
- Money avoids the problems of barter, principally the double coincidence of wants, which is inefficient and would stifle specialisation and division of labour

Store of value

- Money acts as a store of value over time
- It enables individuals to transfer spending to future time periods secure in the knowledge that it will have a future value

Legal tender

- Accepted to buy goods and services
- Money allows individuals to pay for goods and services later, despite their consumption taking place now
- Because money is an accepted medium of exchange, it enables credit to be offered so payment can take place at a future date

Factors affecting the role of money

Take the test – what is your attitude to money?

- What are your attitudes to money?
  - If you were given £100 today what would you do with it?
  - What if it was £1000 or £10000
  - Would the answers be the same if we asked a parent or elder relative?
  - What about your teacher?
  - When you were younger and maybe given money as a gift what did you do with it?
  - If you wanted to buy a new car would you save for it or be willing to go into debt?
- Why do different people have different attitudes to money?

Factors affecting the role of money

- Personal attitudes towards risk and reward, borrowing, spending and saving
  - Risk averse or risk taker
    - some people are willing to take more risk e.g. to gamble or spend all of their money
    - others will be more cautious and want to save money to ensure security in the future
  - Rewards can be immediate e.g. buying a new pair of shoes or long term e.g. earning interest on savings or saving for a big commitment such as buying a house or car
  - Borrowing can allow for immediate rewards but will incur a cost as money borrowed will be paid back with interest, whereas saving will see the value of money grow

Interest rates are the cost of borrowing or the reward for saving.

In pairs explain the relationship between borrowing, saving and spending in both the short and long run.

Factors affecting the role of money

- Life stages (childhood, adolescence, young adult, middle age, old age), key features of each stage, financial needs and implications at each stage

Life stage	Features	Financial needs	Implications
Childhood	Zero or low income e.g. pocket money, gifts Savings maybe set up by relatives Piggy bank!	Most needs are met by parents e.g. food, clothes, toys	Likely to spend money received Planned savings by parents
Adolescence	Want greater independence May start to earn e.g. a part time job Looking to future e.g. saving for driving lessons or university	Higher expenditure patterns e.g. buying more expensive items or going out with friends	Conflict between wanting to spend now and save for the future Still heavily reliant on parents

Factors affecting the role of money
Homework

Are millennials the best at saving?

Millenials - Anyone under the age of 38

- Fill in the table for young adults. Consider yourself and your peer group

Features	Financial needs	Implications

Factors affecting the role of money

Life stage	Features	Financial needs	Implications
Middle age	Settling down, may be buying a house, having a family Hopefully earning a good wage Self sufficient with dependents	Support self and family Maybe buying a house or moving up the property ladder Regular incomes and expenditure	Need to earn Difficult to save for the future but concerned over security at retirement Likely to spend the majority of income on short to medium term items e.g. food, clothing, home, family holiday
Old age	Loss of income Reliant on pension No longer have dependents	Day to day expenditure Comfortable life style e.g. enjoy leisure time	Spending savings More careful with expenditure e.g. may downsize house or shop around for groceries

Factors affecting the role of money

What is the Chinese attitude to money? Is this still true?

- Culture, including religious and ethical beliefs
  - Culture can influence our attitudes to money
  - Different societies will have different opinions on what is right and wrong
  - Some societies will talk openly about money, earnings and wealth whilst others are more reserved or secretive
- Consider the following questions and how the response might be influenced by religion, culture or ethics
  - Is it OK to show off your wealth with flash cars and expensive jewellery?
  - Should the rich give back to society, either through higher taxes or voluntary donations?
  - Do you talk about money with your family? Do you know how much your parents earn or how much is owed on the mortgage or other debts?
  - Is money a good gift? If you gave money as a wedding gift would you tell others how much you gave?
  - Is it OK to keep spending on credit cards?
  - Should all children have a savings account?

Factors affecting the role of money

- Life events mean that the personal life cycle varies from person to person
- Consider how each of the following life events would impact on borrowing, saving and spending:
  - Start or end of a long term relationship
  - Having a baby
  - Going to university
  - Getting a promotion at work
  - Taking a year off to travel
  - Being made redundant
  - Illness of a loved one
  - Starting up a business

Factors affecting the role of money

Recap. Write a definition of interest rates.

Savers 'devastated' in August as rates fall below 0.5%.

- External influences/trends
  - External influences are outside of the control of the individual i.e. you can not determine them
  - When the economy is in decline the spending power of individuals tends to fall, maybe as a result of job losses
  - People are less willing or able to spend
  - Uncertainty about the future encourages savings
  - Banks may be less willing to lend
- Interest rates
  - Low interest rates encourage borrowing and therefore spending
  - Low interest rates may encourage more people to buy on credit
  - The reward for saving is low therefore making it less attractive

Planning expenditure, common principles to be considered in planning personal finance

How do you plan your expenditure?

Do you set a budget i.e. a maximum amount to spend when going shopping with friends or buying a present?

Have you ever got to the end of a week or half way through a month and wondered how you managed to spend so much?

How can you control costs?

Expenditure is the spending of money i.e. an outward flow.
These are the common principles, or guidelines, to consider when planning personal finance:

- To avoid getting into debt
  - Debt is when you are spending more than you have i.e. expenditure is greater than income
  - This may be spending on credit cards, hire purchase, using an overdraft or borrowing from the bank
  - Debt will increase your costs i.e. it will have to be repaid with interest
- To control costs
  - By setting budgets you can control your expenditure to ensure it doesn’t spiral out of control – assuming you stick to it!
  - Shop around for the best deals, this has been made significantly easier as a result of the internet e.g. price comparison websites
  - Planning in advance can often save money e.g. buying tickets early rather than at the last minute

Homework for tomorrow (deadline-Friday 28th June)

Find an article which demonstrates the effect of debt.

Planning expenditure, common principles to be considered in planning personal finance

Top tips from the money saving expert on credit ratings.

9 rich and famous people who have filed for bankruptcy.

- Avoid legal action and/or repossession
  - If you fail to make agreed payments the creditor can take legal action, this will be expensive and can damage your reputation
  - Loans taken out against an asset e.g. a house. If payments are missed the bank can repossess the asset i.e. take the house from you
- Remain solvent
  - To be solvent means to be able to meet your debts i.e. to have enough assets, things you own, to cover your liabilities, things you owe
  - If a creditor calls in their debt at short notice and a person is not solvent they would have to sell their assets e.g. home or car to meet their debt repayment
- Maintain a good credit rating
  - Whenever you apply for credit, whether it be a bank loan or to buy a car on hire purchase, the creditor will review your credit rating
  - This assesses the degree of risk i.e. how likely is it you will be able to repay the debt
  - Based on history, earnings, other debt etc.
- Avoid bankruptcy
  - Bankruptcy is when an individual legally declares themselves as unable to repay their debts
  - Effects ability to achieve future credit
  - Loss of all assets
  - Damage to reputation
  - Restrictions such as the ability to become a director of a company

Planning expenditure, common principles to be considered in planning personal finance

How can you better plan to fund your summer holiday?

- To manage money to fund purchases
  - There will nearly always be a time gap between income and expenditure e.g. we don't get paid on a daily basis
  - Expenditure needs to be planned so that purchases such as food can still be afforded at the end of the month, quarterly bills such as electricity can be paid every three months and there is some money put aside for birthday gifts or holidays
- Generate income and savings
  - Interest is paid on savings and therefore generates income, the size of savings therefore increases. However, interest rates are currently very low!
  - Money can be invested to generate income e.g. buying shares. However, this is not guaranteed
  - Income may be invested in assets that will appreciate e.g. we expect a house to increase in value over time. This affects wealth

Planning expenditure, common principles to be considered in planning personal finance

Have you heard of the expression "saving for a rainy day"?

Insurance will be covered in more detail in A4.

- Set financial targets and goals
  - A target or a goal is something you want to achieve at a set point in the future
  - These can help encourage regular savings and good spending practices as you have something to work towards
  - Examples include to save a set amount each month, or to achieve a consistent bank balance over a set time period
- Provide insurance against loss or illness
  - Money can be kept as insurance e.g. saving so that you can maintain your current life style even if for some reason your income falls
  - Being able to replace lost items
  - This may involve paying into an insurance policy now to protect you against future loss or illness
- Counter the effects of inflation
  - Inflation is a general rise in prices or a fall in the value of money. In other words, the fact that for every £1 we have now, we can buy less over time
  - Money invested that is index linked will go up in line with inflation so the spending power of our money stays the same
  - Money left under the mattress will fall in value!

5 MINUTES – TEST YOURSELF

1. List 4 functions of money.
2. List 4 factors that influence the role of money.
3. List 4 common principles to be considered in planning personal finance.

End

Draw the table onto A3 paper and complete for yourself

Principle	High, medium or low importance to you?	Comment – why and will this change over time?
To avoid getting into debt		
To control costs		
Avoid legal action and/or repossession		
Remain solvent		
Maintain a good credit rating		
Avoid bankruptcy		
To manage money to fund purchases		
Generate income and savings		
Set financial targets and goals		
Provide insurance against loss or illness		
Counter the effects of inflation		

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