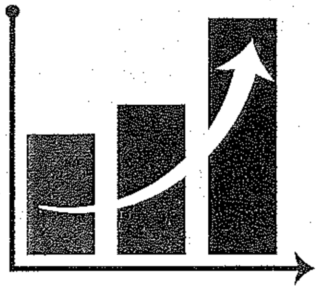
Getting started

Personal finance involves understanding why money is important and how managing your money can help prevent future financial difficulties. Write down a list of future medium- and long-term wants. Discuss why you will need to be able to manage your money to achieve these goals.



A Understand the importance of managing personal finance

You will make important financial decisions throughout your life. The choices you make will not be without some risk and need to be taken very carefully. This unit will help you understand how to manage your personal finances and make informed decisions to help prevent future financial difficulties.

▶ What do you think are the three biggest financial decisions you will ever make in your life?

Functions and role of money

Money flows in two directions, into your ownership and out. Money comes in from various sources including wages, gifts and savings. Money goes out to pay for necessities and wants. The same is true in business – money comes in from sources, including sales and bank loans, and goes out to pay day-to-day expenses and fund expansion. Therefore the ability to handle money received, and to control money paid, is a fundamental requirement for personal and business success. The starting point is to understand what 'money' is.

Discussion

What is money? Can you write a definition? What forms can money take? In small groups, discuss what you think money is. Write a definition of money and produce a spider diagram showing the different forms that money can take. Feed back to the rest of the class and discuss your results. Can you all agree on the best definition of money?

The functions of money

The functions of money are the jobs that it performs. These are outlined below.

- Unit of account
  - It allows us to place a monetary value on goods and services.
  - The price of goods and services show the unit of account, for example a chocolate bar is 60p or a new car is £30,000.
- Means of exchange
  - It allows us to trade.
  - Businesses and customers can buy and sell goods and services using money, for example when you purchased your lunch yesterday or paid to go to the cinema.
- Store of value
  - It allows us to use it in the future as it keeps its value.
  - You might have money saved in a bank account or 'piggy bank' which you can then use to buy goods and services in the future.

- Legal tender
  - It is a legaly recognised form of payment.
  - Money is widely recognised and used for all sorts of transactions from buying an ice cream or getting a haircut to paying a deposit on a house and receiving your wages.

Research

Did you know that the Royal Mint sets rules on what is legal tender? If you owed £100 and wanted to pay off your debt in 2p pieces would this be legal tender? Take a look at the guidelines on the Royal Mint website. Why do you think these guidelines exist?

Role of money

Different people will have different attitudes to money. An individual may also change their attitude to money based on the situation they find themselves in. The role of money is affected by a wide number of factors, including those outlined below.

- Personal attitudes
  Individuals will vary in their attitude to risk and reward as well as saving and borrowing. You may be risk averse so you will try to avoid risk, or you may be willing to take more risks and may even enjoy risk taking as you are incentivised by the potential rewards. Equally, you may be more or less likely than others to save your money rather than spend it. This can, in part, depend on your family's attitude to money, for example whether you were brought up being told savings were good and encouraged to save for a rainy day. You will also be influenced by your attitude to borrowing. You might like to live within your own means and only buy what you can afford. Alternatively, you might be happy to buy goods and services on credit or to borrow money in order to get what you want sooner rather than later.
- Life stages
  As you grow up from childhood to adulthood, your financial needs change. Each stage of your life has different implications that will affect not just your needs but also your attitude to money, as discussed above. Table 3.1 shows the common financial needs and implications of each stage.
- Culture
  Different cultures, affected by tradition, religion and ethical beliefs, will have different attitudes to money. The older generation of Chinese people, for example, have a culture of saving. However, as the country becomes wealthier, young people are more willing to spend and even buy on credit.
- Life events
  Events throughout your life will impact on your attitude to money. These events may be within your control, for example going to university, travelling abroad, getting married or starting a family, or may be outside your control, for example illness, financial gains or losses.
- External influences
  Factors outside your control, including the state of the economy, will have an impact. For example, the state of the economy will impact on wages, availability of jobs and the prices of goods and services. Decisions by the government will affect the amount of tax you pay or the amount you receive in benefits. These all directly affect your ability to spend and save.
- Interest rates
  When **interest rates** are low you may be more willing to borrow money or spend on credit. When interest rates are high there is more of an incentive to save.

Key term

Interest rate – the cost of borrowing money or the reward for saving money.

Table 3.1: Financial needs and implications at different life stages

Life stage	Financial needs	Implications
Childhood	• Limited needs • Mainly reliant on parents • May want to buy sweets or toys	Money received from presents may be spent as attitude will be that this is to buy things you want May be encouraged to save or parents or grandparents may set up a savings account for you into which they make regular payments May rely on pocket money
Adolescence	• Want to be more independent • Slightly less reliant on parents as want to socialise away from family	May look for a part-time job Still partially reliant on pocket money More likely to receive cash as gifts and may be willing to save up smaller amounts in order to make bigger purchases
Young adult (This is a very big stage which can encompass a wide range of different scenarios depending upon life choices)	• University or starting a career • Looking to be more independent • Buying a car and buying or renting a flat or house • Looking to settle down and maybe get married or start a family	May take a student loan if going to university Borrow money to pay for a car or purchase one on a finance deal May be looking at taking out a mortgage Need to earn money to support self and others Eligible for credit and debit cards
Middle age	• Support family • Start saving for children's futures, e.g. university, weddings, etc. • Look to improve own lifestyle, e.g. new car or move house • Enjoy having access to additional money to spend on luxuries such as foreign holidays	Savings accounts for specific purposes Paying a mortgage Planning for own future through pensions and retirement plans Likely to be the stage of life when income peaks but matched with high expenditure
Old age	• Fewer dependents • May downsize, e.g. move from family home to a smaller retirement home • Fewer financial needs for assets but may be higher for services such as health care	Mortgage payments stop or become lower Less income as reliant on a pension rather than a salary

Planning expenditure

When planning expenditure, that is, money paid out, it is important to consider a number of common principles. These are important to ensure that you avoid over spending which will put you at risk of financial difficulties both now and in the future. You should look to control costs in order to avoid getting into **debt** in the future. If your spending is too high, this may mean more money is going out than coming in which will lead to the build-up of debt. Debt is expensive as interest will be charged on money owed. If debts are not paid or not paid on time, this will affect your **credit rating**. A poor credit rating will affect your ability to borrow in the future. In extreme cases, an individual may be declared **bankrupt** if their debts have spiralled out of control.

To remain **solvent**, you should set financial targets and goals. These should consider how much money you want to earn and place limits on how much you will spend. If you save some of your income, this can help generate future income as money saved will earn interest. Savings will also help provide a safety net for the future, for example to provide insurance against loss or injury. What would happen if you could not work in the future? Sometimes you will also want to save to fund future purchases, for example to buy a car or pay a deposit on a house.

Inflation is a general rise in prices. This leads to the value of money falling, that is, £10 today is worth less than £10 ten years ago. Expenditure now can help counter the effects

Key terms

Debt – money owed.

Credit rating – a score given to individuals on how likely they are to repay debts based upon their previous actions.

Bankrupt – when an individual or organisation legally states its inability to repay debts.

Solvent – the ability to meet day-to-day expenditure and repay debts.

Reflect

In pairs discuss:
- How would you rate your own attitude to money?
- Do you take risks?
- Can you think of a time when your attitude to money was irresponsible?
- How could you have behaved differently?
- What factors influence your attitude to risk?

As a group draw a spider diagram of factors influencing people's attitudes to risk.

of inflation. For example if you spent £150,000 buying a house today the value of the house would increase. If you left £150,000 in a savings account the amount would go up because of inflation but the spending power of your savings would go down.

The common principles to be considered in planning personal finance are summarised in Figure 3.1.

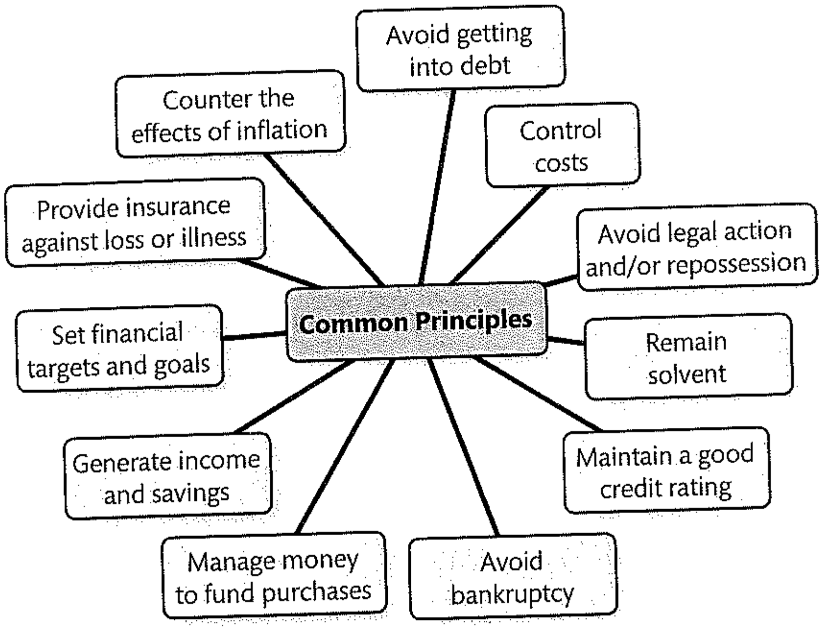


Figure 3.1: How important are each of these principles in planning your own personal finances?

PAUSE POINT

Can you explain the functions and role of money?

Hint: Close the book and draw a concept map about the factors affecting the role of money. Think about both personal factors and external factors.

Extend: What do you think are the short- and long-term consequences of bankruptcy?

Different ways to pay

One of the functions of money is as a means of exchange. This means you can use it to pay for things. There are, however, a number of ways of paying for things – not just with notes and coins. Therefore any method of payment is classed as money. Table 3.2 shows methods of payments.

If you wanted to buy a car what are the different ways you could pay for it?

Table 3.2: Methods of payment

Method of payment	Explanation/features	Advantages	Disadvantages
Cash	Notes and coins in a wide range of denominations	Most widely accepted form of exchange Physical not virtual Consumers feel confident when using Makes budgeting easier	Can be lost or stolen Threat of counterfeit Only really appropriate on purchases up to a certain amount Cannot be used online
Debit card	Issued by banks with payments for goods and services being deducted directly from a current account	No need to carry cash Secure method of payment with low risk of theft Widely accepted Offers a degree of protection on purchases Suitable for online transactions	Short time lapse between making the transaction and the money being withdrawn from the customer's account may result in overspending Not accepted or appropriate for small transactions
Credit card	Issued by financial institutions allowing customers to delay payments for goods and services	Allows a period of credit that is interest free, e.g. one month Most cards are widely accepted Loyalty schemes are often offered, e.g. collect points or cash back Offers a degree of protection on purchases Suitable for online transactions	Interest is charged on balances not paid off within a month Can encourage a customer to overspend and get into debt Interest is charged on cash withdrawals A limit will be set on the amount of credit allowed
Cheque	A written order to a bank to make a payment for a specific amount of money from one person's account to another account	Low risk form of payment as the cheque can only be cashed by the named payee Widely accepted for face-to-face and postal transactions No need to provide change as can be written for an exact amount	Expensive for the consumer if the bank refuses to clear the cheque, i.e. it 'bounces' The time delay between writing the cheque and it being cashed could cause a consumer to go overdrawn Viewed as old fashioned Easy for the consumer to make errors when writing the cheque which will create problems for both the consumer and the recipient
Electronic transfer	Payment is transferred directly from one bank account to another	Almost instantaneous Provides a record of payment No additional costs incurred Easy to use for one-off and more frequent transactions	Risk of loss if the transfer is incorrectly set up Not appropriate for face-to-face transactions
Direct debit	An agreement made with a bank allowing a third party to withdraw money from an account on a set day to pay for goods or services received, e.g. pay a gas bill	An easy way to make regular payments, e.g. utility bills Amount paid can vary to ensure the payment matches the amount required by the vendor Quick and easy to set up	If the payer makes a mistake and takes too much it is the payee's responsibility to claim back the money The payer determines the amount paid each time making it difficult for the payee to plan and budget
Standing order	An agreement made with a bank to transfer a fixed sum of money to a third party account on a set date on a regular basis, e.g. pay £30 for a phone contract each month	The same amount is paid each time making it easier for the payee to plan and budget Easy both to set up and to cancel No need to remember to make regular, standard payments	Payments are taken regardless of the customer's balance which could lead to the unplanned use of an overdraft facility Payments will continue to be made unless cancelled

Table 3.2: – *continued*

Method of payment	Explanation/features	Advantages	Disadvantages
Pre-paid card	Money is uploaded onto a card with transactions then being withdrawn to reduce the balance	Can set a budget in advance to avoid overspending If lost or stolen the loss is limited to the remaining balance An effective way of controlling the amount spent by children and where money is spent, e.g. upload money for school lunches or transport	No protection if lost Sometimes requires an initial fee to purchase or set up the card, e.g. Oyster travelcards
Contactless card	Cards containing antennae allow money to be transferred when the card touches a contactless terminal	Gaining in popularity Secure method of making payments	Often only accepted for relatively small transactions Still not widely accepted as seen as new technology
Charge card	Issued by financial institutions allowing customers to delay payments for goods and services for a short period of time; the balance must be paid off in full when a statement is issued	Reduces risk of running up debts Allows a short period of credit Avoids the need to carry cash Often offers additional perks	Must be paid in full each month Often an annual fixed fee is applied
Store card	Issued by a retail outlet so that customers can delay payments for goods and services (similar to a credit card but only accepted by stores specified)	Allows a short period of credit that is interest free, e.g. one month Often offer loyalty schemes, discounts and special promotions or privileges	Only accepted in issuing store or linked associations Interest is paid on outstanding balances Can encourage overspending and result in a consumer getting into debt – particularly if they hold multiple cards
Mobile banking	The ability to carry out financial transactions using mobile devices such as phones or tablets	Convenient as can be used at any time and place Secure	Features are still limited and hence mobile banking does not offer all of the functionality of Internet banking
Banker's Automated Clearing Service (BACS) Faster Payment	A system that allows the transfer of payments directly from one bank account to another	Faster payment allows almost instant transfers that are guaranteed within 2 hours Can be accessed in a number of ways including in a branch, over the telephone and online No additional costs	Faster payment is not offered by all banks or branches and the customer may therefore have to default to BACs which can take three days to transfer payments A limit is set on the amount that can be transferred in any single transaction
Clearing House Automated Payment Systems (CHAPS)	A system that allows the transfer of payments directly from one bank account to another	Transfers can be made the same day assuming instructions are received prior to a set time, e.g. 2 pm at Barclays There is no limit on the amount that can be transferred in a single transaction	Normally, there is a fixed charge per transaction regardless of the amount transferred

Discussion

In pairs discuss:

- Which of the payment methods in Table 3.2 do you use regularly or semi-regularly?
- Which of these methods do your parents use regularly or semi-regularly?
- Does your payment method depend upon the product you are buying?

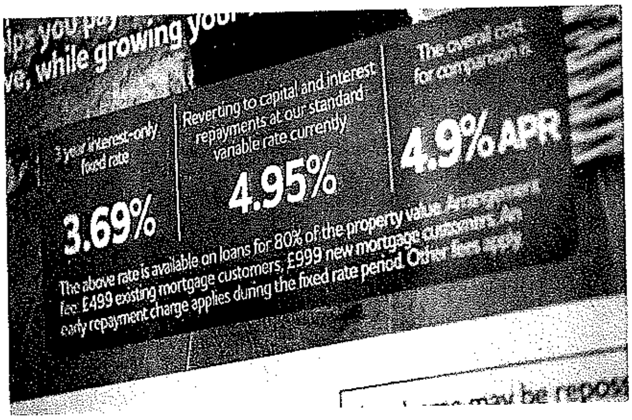
As a class, draw a mind map to show when each method of payment is suitable. Justify your decisions.

Current accounts

A **current account** is an account with a bank or building society that is designed for frequent use. Money can be paid in and withdrawn on a daily basis without the need to give notice. Most people will use a current account to get wages paid into, to pay cheques into and out of, pay bills and other frequent expenses, and to withdraw cash.

In the same way as a business changes the features of its products to try and be competitive and attract customers, banks will try to attract customers by changing the features of their accounts. The features of a current account will include:

- rate of interest paid on any positive balance
- rate of interest charged on a negative balance
- **overdraft** limit
- charges on unauthorised overdrafts
- additional incentives.



- What would you look for when choosing a bank to open a current account with?

Types of current account are outlined below.

- Standard
  This is the normal account offered to customers with a reasonable credit rating. It includes standard features such as the ability to pay and withdraw money, cheque book, debit card, interest payments on positive balances and a pre-agreed overdraft limit.
- Packaged, premium
  This account offers additional features to a standard account, for example car and house insurance, credit card protection, breakdown cover and cash back on certain transactions. The bank may have additional charges for these accounts so it is important that you check whether you are being offered a good deal or not.
- Basic
  This account offers only limited features designed for those customers who may otherwise find it difficult to open a bank account due to poor credit ratings. A basic account will not offer an overdraft and will not pay interest on positive balances.
- Student
  This account is designed specifically to meet the needs of learners. Common features include an agreed overdraft limit and incentives to join the bank, for example free rail cards or cash. Banks are keen to attract learners because once a young person has joined a bank they tend to stay with that bank for life. However, this is less often the case now due to the availability of information on the Internet and the ease with which banks can be changed.

The advantages and drawbacks of different account types are summarised in Table 3.3.

Key terms

Current account – an account with a bank or building society designed for frequent use, e.g. regular deposits and withdrawals.

Overdraft – the ability to withdraw money that you do not have from a current account.

Table 3.3: Advantages and disadvantages of different types of current account

Type of current account	Advantages	Disadvantages
Standard	No charges on credit balances Offers the holder a wide range of facilities including a cheque book, debit/cash card and possibly an overdraft facility Convenient for receiving regular payments, e.g. wages and making regular withdrawals	Potentially high charges on the use of an overdraft facility Standard features only, i.e. no additional perks
Packaged, premium	No charges on credit balances Offers the holder a wide range of facilities including a cheque book, debit/cash card and possibly an overdraft facility Convenient for receiving regular payments, e.g. wages and making regular withdrawals Offers the holder additional perks at a packaged price cheaper than acquiring them individually (standard additional features include things such as holiday/travel insurance, break down cover and phone protection)	Additional monthly charge is frequently applied The package offered may not offer value for money or meet the needs of the individual account holder
Basic	Available to customers with a low credit rating Offers an easy first step for individuals to gain access to basic banking facilities, i.e. the ability to pay in and withdraw cash	Limited facilities, e.g. no debit card or overdraft facility
Student	Course fees and student loans can be easily handled Bonuses offered are designed to meet the needs of learners, e.g. discounts on travel or small lump sum cash payment	Overdraft facilities could encourage overspending Charges for overspending are high Limited facilities

Research

Look at the student accounts currently being offered by banks. As well as visiting individual bank websites, you could also look at comparison websites. Which bank do you think is currently offering the best deal to learners?

Case study

Which account?

Gabriella has just finished sixth form and is looking forward to starting at Birmingham University in October. During the summer, she starts to look at which student accounts are available. She is surprised to see that they vary so much between different high street banks. To help her decide which account is best, she summarises her findings in a table

Managing personal finance

Few businesses have just one product. They have a range of products to meet the needs of different customers. A car manufacturer, such as Ford, will have cars to match different incomes, lifestyles, family size and preferences. This is also true of banks, building societies and other providers of financial services. They will all offer a range of products to match the needs of different individuals. Financial services will include borrowing.

Different types of borrowing

These are outlined below.

- Overdraft
  - This allows you to withdraw money that you do not have from a current account.
  - It may be suitable to meet short term needs, for example a shortage of cash just before payday.
- Personal loan
  - This gives you the ability to borrow a set amount of money, normally for a specific purpose, to be repaid in regular instalments with interest.
  - It may be suitable to fund the purchase of a high price item such as a car or to make home improvements.
- Hire purchase
  - This allows you to have use of an item immediately but pay for it in regular instalments. The item remains the property of the seller until all instalments have been made.
  - It may be suitable for one-off or infrequent purchases, for example a TV or fridge freezer.
- Mortgage
  - This is a long-term loan to fund the purchase of assets, normally paid back over a long time, for example 25 years. It is secured against an item, for example a house.
  - It is suitable for assets that will maintain value for a long time and cannot normally be paid for outright.
- Credit card
  - Goods are paid for by card and can be paid for either at the end of a set period, normally a month, when a statement is issued or over time with the card provider stating a minimum payment each month. The minimum payment will be a percentage of the balance on the credit card.
  - It may be suitable when buying high price goods or services, for example a holiday, or at times when expenses are higher than usual, for example Christmas, to spread the costs of spending.
  - It may also just be used for convenience and safety as an alternative to using cash.
- Payday loan
  - This is a short term source of finance used to bridge the gap between now and next receiving a wage. It will normally only available for relatively small amounts at very high rates.
  - It may be suitable in an emergency to meet cash shortages.

The advantages and drawbacks of the various types of borrowing are summarised in Table 3.4.

Table 3.4: Advantages and disadvantages of different types of borrowing

Type of borrowing	Advantages	Disadvantages
Overdraft	Interest is charged only on the amount outstanding Can be paid off without penalties An overdraft facility can be prearranged and only used if needed Provides a short term solution to cash flow problems	When used, interest charges are often high Additional penalty charges for going over a pre-arranged limit are often very high Not the cheapest form of borrowing The ease with which these can be obtained could encourage overspending
Personal loans	Regular, pre-agreed payments make planning and budgeting easy As a general rule these would only be issued to individuals who can prove their ability to make the repayments Useful when looking to purchase a specific item of medium to high value, e.g. a car or home improvement	May have to be secured against an asset which means if payments are missed the asset may be taken to cover the outstanding debt Not really suitable for short term loans
Hire purchase	Spreads the cost of an expensive item over a period of time Credit is secured against a specific item Often allows a customer to afford something now that they could not otherwise afford, e.g. four years' interest free on furniture	Interest charges may be higher than other traditional loans Ownership of the asset may legally be kept by the seller until the final payment is made Agreements can be manipulated to make a purchase seem deceptively appealing
Mortgages	Allows the customer to spread the cost of expensive items over a long period of time, e.g. the purchase of a house is often spread over 25 years Interest rates, depending upon the mortgage deal, can sometimes be fixed or tracked against a standard rate of interest reducing the risk of fluctuations	Interest payments, although sometimes fixed for a short period of time, can vary – this seriously affects the borrower's ability to repay or meet other expenses Failure to meet repayments may lead to a loss of a home and seriously affect an individual's future credit rating Penalties may be applied to early repayment
Credit cards	The credit card holder can pay above the minimum rate if they wish and hence speed up the rate of repayment and reduce interest incurred Can be used for items of multiple sizes and value, to a limit, without the need to secure against an asset Provides some protection on purchases	Can encourage overspending, sometimes on unnecessary purchases, and can lead to debt problems Interest rates are often higher than on a personal loan
Payday loans	Help solve immediate short term cash flow problems Relatively easy to secure	Interest rates are very high and the cumulative amount to be repaid can quickly spiral out of control

Different types of saving and investment

Managing personal finance can also include saving and investment. These options are open to you when you are earning or receiving more money than you need to cover your **expenditure**. Even when income and expenditure are the same or similar, it can be wise to take advantage of opportunities to save and invest to increase future wealth. Different types of investments are outlined below.

- Individual savings accounts (ISA)
  This is a type of saving account where the holder is not charged income tax on the interest received.
- Deposit and savings accounts
  These are accounts where interest is paid on the balance and normally the holder needs to give notice before withdrawing funds.

In what ways might a new business pay for its office equipment?

Key terms

Expenditure – the amount of money you need to cover all your expenses/outgoings, e.g. your mortgage and bills.

Shareholder – someone who has invested in a company in return for equity, i.e. a share of the business.

- Premium bonds
  A government sheme that allows individuals to save up to a set amount by buying bonds. The bond holder does not receive interest on their savings but each bond is placed into a regular draw for cash prizes.
- Bonds and gilts
  These are fixed term securities where the lender (the individual) lends money to companies and governments in return for interest payments. The money is invested for a specified period of time.
- Shares
  Shares involve investment in a business in return for equity, i.e. the **shareholder** becomes a part owner of the business. The shareholder will receive dividends from the company's profits and will also want the value of the shares to increase.
- Pensions
  These are long-term savings plans where individuals make regular contributions, called premium payments, throughout their working life. This is then repaid as either a lump sum, regular payments or a combination of the two upon retirement. Pensions can be state, company or private.

The advantages and drawbacks of the different types of savings and investment are summarised in Table 3.5.

Table 3.5: Advantages and disadvantages of different types of saving and investment

Type of saving and investment	Advantages	Disadvantages
Individual savings accounts (ISAs)	Tax is not charged on interest earned allowing the saver to keep all of the rewards for saving Interest rates are sometimes slightly higher than in alternative savings accounts	Notice is often required to make withdrawals and according to the agreement there may be a limit set on the number of withdrawals made If the saver makes more withdrawals than set out in the agreement then the penalty may cancel out the tax savings There is a limit set on the annual amount that can be placed in an ISA
Deposit and savings accounts	Interest is earned on positive balances Accounts sometimes require regular deposits of a set amount forcing the saver to follow a savings plan	Interest earned is taxed The percentage rate of interest paid on savings is likely to be lower than interest to be paid on borrowing, therefore the benefits of savings are lost if the customer is borrowing at the same time
Premium bonds	Chance of winning substantially more than could be earned in interest Can be easily withdrawn with no loss or penalty	No guaranteed return on investment Maximum amount reviewed annually by the government The amount invested, assuming zero or low returns, loses value due to inflation
Bonds and gilts	Regular fixed returns Spreads risk across a range of markets	Risk of losing some or all of the value of the investment if the bond or guilt value falls Interest payments may not be received if the issuer is unable to make payments
Shares	Share prices fluctuate offering a potential high reward Shareholders' returns can include dividend payments and an increase in share value As part owners in a business there may be additional benefits including discounts and special offers For some investors share ownership is more than just a way of saving – it is a pastime and creates interest	Share prices fluctuate offering a potential high risk There is no guarantee of any reward or return as all of an investment can be lost

Table 3.5: - *continued*

Pensions	Encourages individuals to save throughout their working life for retirement Depending upon the policy, an individual's savings may be boosted by an employer's contributions increasing the final value of the saving Regular payments are deducted, sometimes at source, meaning the individual is tied into making the regular contributions	Movement between jobs may mean that one policy stops and another starts, thus reducing the overall cumulative value of the savings Final outcome is difficult to predict If compulsory payments are deducted this may affect short-term living standards

PAUSE POINT Can you explain the difference between saving and investment?

Hint: Draw a concept map about different methods of saving and investment. For each method, weigh up the risk versus the reward and award the method a mark out of with 10, 10 being highest risk and 1 lowest risk.

Extend: Which method of saving or investment do you think offers the lowest risk at the highest reward? Justify your answer.

Risks and rewards of saving versus investment

Saving and investment both involve forfeiting current spending in the hope of gaining greater wealth in the future. **Saving** involves placing any extra money in a secure place where it will hopefully grow as it gains interest. If you are saving your money, it is often with a view to buying a specific good in the future or to support a planned future lifestyle. Many parents will start to save when a child is born to pay future college fees or to support the child as he or she grows up. **Investment** involves making a commitment to a project in the hope that it is successful and a healthy return is made on the investment. This could involve investing in the shares of a business.

The risks and rewards of saving versus investment are summarised in Table 3.6.

Key terms

Saving – placing money in a secure place so that it grows in value and can be used in the future.

Investment – speculative commitment to a business venture in the hope that it generates a financial reward in the future.

Table 3.6: Risks and rewards of saving versus investment

	Risks	Rewards
Saving	• Low or zero risk as money saved is guaranteed to be available in the future • Inflation can reduce the spending power of money saved	• Interest payments • Financial security/peace of mind
Investment	• Investments can go wrong and all or some of the value may be lost • No guarantee of a return	• If successful, there is potential for a high financial return (significantly higher than could be earned in interest) • Can be exciting! Some people will invest in shares, antiques, art or foreign currencies, for example, in the hope of high returns

Research

Work in pairs. You have £2500 and must invest or save it for at least five years.

- Mind map all the options – showing risk versus potential rewards.
- Identify your preferred saving method. Find an account that offers the highest return.

How much would your savings be worth in five years?

You read about a new form of investment called crowd funding. Visit one of these websites as part of your research.

- Choose one or more businesses to invest in. Calculate your expected return on your £2500 in five years' time.
- Present your saving and investment options to the rest of the class.
- As a class, try to reach an agreement on what would be the best use of the money.

Key terms

Insurance – an agreement with a third party to provide compensation against financial loss in line with the conditions laid down in the policy agreement.

Premiums – regular payments made by an individual or company to an insurance provider in return for protection.

Different types of insurance products: their features, advantages and disadvantages

Insurance is a form of protection. Specific items as well as individuals and pets can be insured. Insurance policies cover the cost of loss, damage or illness up to prearranged levels in return for regular payments called **premiums**. Figure 3.2 illustrates some of the different types of insurance that are available.

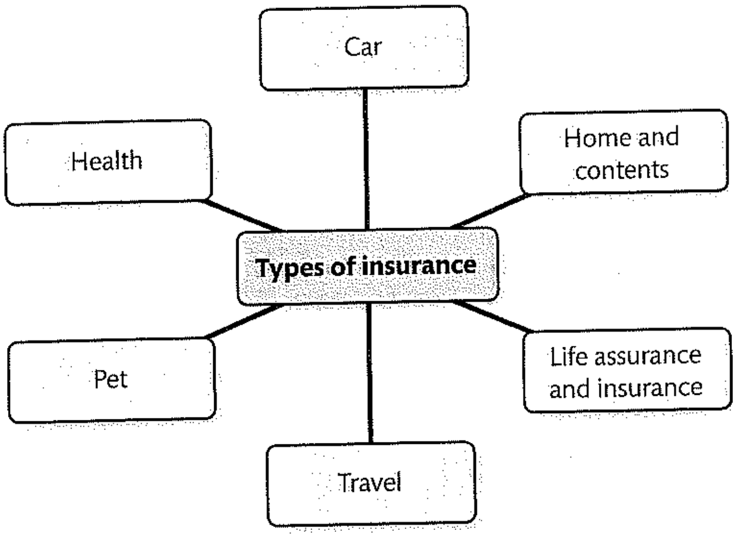


Figure 3.2: What items of worth do you have insured? Is your mobile phone insured?

Insurance can be taken out against anything deemed to have a worth or where there is a risk of financial loss. A common type of insurance now is against mobile devices such as your mobile phone. The premium paid will vary depending upon the amount of cover provided and the amount of risk as assessed by the insurance provider. Types of insurance are outlined below.

- Car
  - It is a legal requirement to insure any car that is on the road – this covers theft as well as accidents.
  - The degree of cover will vary depending upon whether the policy is third party or fully comprehensive.
  - It protects the driver, passengers and other road users.
- Home and contents
  - Home insurance covers the physical building, for example against fire.
  - Contents insurance covers the physical items in the house including electrical equipment, furniture and personal items. If there are individual items of high value, for example a diamond ring, then they may need to be specified on the policy.
  - Items can be insured when a person is using them away from home as well as when inside the house.
- Life assurance and insurance
  - Life assurance is an ongoing policy to pay a lump sum upon death.
  - Life insurance is a policy for a set period of time to pay a lump sum if you die within that time period.
  - Mortgage lenders often insist upon life insurance for the same period as the mortgage to secure repayment of the mortgage if the holder dies while monies are still owed.

- Travel
  - This protects individuals or groups while abroad. Policies can be purchased to cover a specific trip, multiple trips or for all trips within a year.
  - Cover will generally include loss or theft of property, illness, cancellation and emergencies up to predetermined limits.
  - Specific types of holiday or activities, for example skiing or extreme sports, will require additional cover due to the high level of risk associated.
- Pet
  - This protects the owners of pets against some or all of the expenses associated with treating ill or injured pets, i.e. vets' fees.
- Health
  - This covers individuals, families or employees against medical expenses including assessments, treatments and loss of earnings.
  - In the UK the National Health Service provides free medical care but individuals may wish to take out insurance to receive payments if, for example, time is spent in hospital, or to receive private treatment.
  - Health insurance can include payment plans to cover routine visits such as to the dentist or optician with a percentage of expenses paid.

The pros and cons of different types of insurance are summarised in Table 3.7.

Table 3.7: Advantages and disadvantages of different types of insurance

Type of insurance	Advantages	Disadvantages
Car	Meets legal requirements Protects self against theft or damage Protects against damage caused to a third party	Premiums can be high depending upon assessed level of risk, e.g. expensive for young drivers Normally there is an excess that must be paid, e.g. first £500 of all damages is still the responsibility of the car owner
Home and contents	Protects against damage which may otherwise be too expensive to repair resulting in the loss of a home Contents are protected both when inside the house and outside	Premiums are an additional expense to home ownership Some items cannot be replaced due to a value beyond the financial worth, e.g. a painting or inherited piece of jewellery
Life assurance and insurance	Provides peace of mind to family following the bereavement of a homeowner	If the policy holder does not die within the period of life insurance no payment is made (could be seen as an advantage!)
Travel	Provides protection for personal belongings when away from home Covers medical costs when on holiday Protects against cancellation and sometimes delays	The person suffering the loss is likely to have to pay upfront to replace items or cover medical costs and then reclaim later An additional cost when travelling abroad
Pet	Avoids expensive vet fees If vet fees are too high, there may be no alternative to having the pet put down – insurance can avoid this	An additional monthly expense to protect against the unexpected
Health	Some compensation is provided when ill which can reduce the financial burden and stress allowing the patient to concentrate on recovery rather than financial worries If used to fund private care, this often results in quicker treatment and better facilities	Paying for something that you hope you will not use Premiums can be expensive depending upon the degree of cover required Will not cover pre-known conditions