2.8 The role of financial markets

Key Words

Money	Anything that is generally accepted as a means of payment for goods and services
Medium of exchange	Anything that sets the standard of value of goods and services acceptable to all parties involved in a transaction
Financial sector	Network of institutions that link borrowers and lenders including banks, building societies and insurance companies
Banks	A financial institution that takes deposits or savings from customers and turns them into assets for the banks
Building societies	A mutual financial institution that is owned by its members. It primary objectives are to receive deposits from its members and to lend money for members to purchase property
Insurance companies	Financial institution that guarantees compensation for specified loss, damage , illness or death in return for an agreed premium
Interest rates	The cost of borrowing money. Ie that which is paid to the lender. It is also the reward for saving
Borrowing	Receiving something of value in exchange for an obligation to pay back something of usually greater value at a particular time in the future.
Investment	The purchase of capital goods that are used to produce future goods and services.
Borrowing	Is receiving money in exchange for an obligation to pay it back at a specified time in the future

The role of money

What is money?

Anything that is accepted as a means of payment for goods & services. Consists of notes and coins (legal tender) and bank deposits in current accounts and savings. Cheques, debit cards and credit cards are NOT money but they allow money to be transferred between buyers and sellers.

What is a debit card?

Transfers money from your current account to the seller. If you do not have enough money in your current account you cannot buy the product

What is a credit card?

Enables you to buy goods and services whether or not you have money in your account. If you cannot pay this short term loan back within 30 days you are charged interest on it. Retailers are charged for allowing you to use credit cards as a form of payment.

What is meant by the medium of exchange?

Anything that sets the standard of value of goods and services to all parties in a transaction. Money is the common form of medium of exchange.

Role of Insurance Companies

Insurance companies play an important role for individuals and businesses in managing risk

Insurance companies give cover for loss from unforeseen events and hence reduce the impact of an event

Life insurance - pays out in the event of someone's death

Car insurance - covers you in the event of an accident

Individuals or businesses pay a premium for the insurance and will receive money if they make a claim on the policy

Insurance companies allow people to share their liability by pooling risk

Pet insurance - covers you for the cost of treatment at the vets if your pet is ill

Building Societies

Building societies are not companies but **mutual** institutions. Their **members** (the people who have money deposited) **own** them. Mutuals exists with the purpose of raising funds from its membership or customers which can then be used to provide common services to all members of the organisation. There are no external shareholders to pay dividends to.

Building societies offer saving products and mortgages for their members as well as other financial services. They are different to banks as banks are often listed on the stock exchange and are therefore owned by shareholders. Many building societies have now converted to banks following changes in the law.

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The impact of interest rates on investment

If interest rates rise

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It is more expensive for businesses to take out loans

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Investment is expenditure on capital goods. These are often expensive projects for businesses to finance and in many cases they will need a loan for financing.

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The higher cost of loans will lead to a lower level of investment

Evaluate the importance of the financial sector for consumers

A vital role of the financial sector is to facilitate transactions. This means that the financial sector has a system for enabling customers to pay for goods and services.

To provide a place to deposit savings

To provide mortgages to enable customers to purchase a house

To lend money to consumers and allow the purchase of products/services including providing an overdraft when needed

To overcome financial uncertainties through insurance

For some consumers the financial sector may be of little importance. Eg some homeless people would not be able to access such facilities without a permanent address

Evaluate the importance of the financial sector for producers

To lend money to producers and therefore facilitate investment to grow their business/ remain competitive / solvent

Other options available for raising funds eg crowdfunding

To lend money to consumers so that they are able to purchase goods from producers

Financial sector at times have been reluctant to lend to businesses (eg after financial crash)

Insurance- To mitigate against losses that might be incurred

Evaluate the importance of the financial sector for the government

To increase consumer confidence and make them more likely to purchase goods thereby helping economy to grow

Economy rests on the confidence of the financial sector to enable transactions and provide a safe haven for money

To lend money to government

As a source of employment in the economy.

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