Cheat Sheet Module 4

Essential Concepts

What is Money

Money serves three basic functions:

- **Medium of exchange**: because you can use it to buy the goods and services you want, everyone’s willing to trade things for money.
- **Measure of value**: it simplifies the exchange process, because it’s a means of indicating how much something costs.
- **Store of value**: people are willing to hold on to it because they’re confident that it will keep its value over time.

Virtual currencies, such as BitCoin, are using the traditional concept of “money” but as an alternative to the established Federal Reserve System. Although gaining in popularity, these virtual currencies are unregulated and pose some serious risks to those using this medium of exchange.

Cashless payment systems such as Google Wallet and ApplePay allow consumers to carry their “cash” in their mobile devices. As more retailers move to “tap to pay” or scanning QR codes to complete transactions, the need to carry conventional paper money and coin diminishes. The question raised by this technology is not whether it will lead to a cashless society, but rather which mobile payment service will rise to the top and capture the market.

The U.S. Banking System

The government uses two measures to track the money supply: M-1 includes the most liquid forms of money, such as cash and checking-account funds. M-2 includes everything in M-1 plus near-cash items, such as savings accounts and time deposits below $100,000.

Financial institutions serve as financial intermediaries between savers and borrowers and direct the flow of funds between the two groups. Financial institutions offer a wide range of services, including checking and savings accounts, ATM services, and credit and debit cards. They also sell securities and provide financial advice.

A bank holds on to only a fraction of the money that it takes in—an amount called its reserves—and lends out the rest to individuals, businesses, and governments. In turn, borrowers put some of these funds back into the banking system, where they become available to other borrowers. The money multiplier effect ensures that the cycle expands the money supply.

Most large banks are members of the central banking system called the Federal Reserve System (commonly known as “the Fed”). The Fed’s goals include price stability, sustainable economic growth, and full employment. It uses monetary policy to regulate the money supply and the level of interest rates. To achieve these goals, the Fed has three tools:

- it can raise or lower **reserve requirements**—the percentage of its funds that banks must set aside and can’t lend out;
- it can raise or lower the **discount rate**—the rate of interest that the Fed charges member banks to borrow “reserve” funds;
- it can conduct **open market operations**—buying or selling government securities on the open market.

Financing Business Operations

The four main ways that businesses raise financial capital are:

- **Early-stage capital**: business owner uses his/her own money or seeks money from an angel investor or venture capital firm
- **Profits**: profits from the business are reinvested in equipment, structures, research and development, etc.
- **Bonds**: a way to raise capital through borrowing, used by corporations and governments; an investment for the bondholder that creates return through regular, fixed, or floating interest payments on the debt and the repayment of principal at maturity; traded on bond exchanges through brokers
- **Stocks**: a way to raise capital by selling ownership or equity; an investment for shareholders that creates return through the distribution of corporate profits as dividends or through gains (losses) in corporate value; traded on stock exchanges through member brokers

Career Connection: Critical Thinking

Critical thinking is a problem-solving skill that involves using logic, reasoning, and creativity to analyze issues, make decisions, and overcome problems, which is highly valued by employers and developed through education.

Glossary

angel investors

individuals who will invest their own money in small, new companies at an early stage of development in exchange for ownership in the company

barter

trading one good or service for another

bond

a financial contract where a borrower agrees to repay the amount borrowed plus interest over a period of time in the future

bondholder

anyone who owns a bond and receives interest payments

capital gain

increase in the value of the stock (or of any asset) between when it is bought and when it is sold

central bank

the organization responsible for conducting monetary policy and ensuring that a nation's financial system operates smoothly

certificate of deposit

a savings medium where the depositor commits to leaving an amount of money in the bank for a specified period of time.

collateral

an asset such a property promised by a borrower to protect the interests of the lender in case the borrow cannot repay their loan

commodity money

objects that have their own value in addition to their use as money

corporate bond

a bond issued by a company

corporation

a business owned by shareholders who have limited liability for the corporation's debts

covenant

a rule included in a contract

critical thinking

obtaining, interpreting, and using information to analyze issues, make decisions, and overcome problems

cryptocurrency

a digital or virtual currency that is based on cryptography to ensure secure transactions

demand deposits

money held in accounts where the bank must give the account owner their money on demand when a check or debit card is used; also called checkable deposits

discount rate

the interest that the Fed charges banks that need to borrow money

dividend

a direct payment from a corporation to its shareholders

double coincidence of wants

two people each want some good or service that the other person can provide

equity

an ownership interest in a company

Federal Reserve

the central bank of the U.S.; also called the Fed

fiat money

money that derives value from the government that issued it

financial capital markets

a market where financial intermediaries bring together those who wish to invest money and those who wish to borrow money

financial intermediary

an institution such as a bank that operates between two parties to facilitate financial transactions

initial public offering

the first time a corporation sells stock to the public

liquidity

how quickly a financial asset can be used to buy a good or service

M1 money supply

includes the most liquid forms of money such as cash, demand deposits, and traveler's checks

M2 money supply

includes M1 money in addition to other monies that are less liquid such as time deposits, certificates of deposit, and money market funds

medium of exchange

money acts as an intermediary between buyer and seller

mobile payments

a way of accessing financial services and conducting transactions on a mobile device

money

anything that people use to pay for goods and services and to pay people for their work

money market funds

accounts where the deposits of many individual investors are pooled together and invested in a safe way, such as in short-term government bonds

municipal bond

a bond issued by a city

open market operations

when the Fed sells or buys U.S. Treasury bonds

private corporation

is a business whose shares are not traded on a public stock exchange

regionally-based currency

currencies developed by regions such as cities or groups of communities to support local economic development

reserve requirement

the rule that members of the Federal Reserve System must hold some of their deposits in cash in their vaults or in an account at a district Federal Reserve bank

savings deposits

accounts that do not include the ability to write checks but can be accessed via ATM or withdrawal from the bank

shareholder

a person who owns stock in a corporation

shares

a fractional piece of ownership of a corporation

state bond

a bond issued by a U.S. state government

stock

a type of investment that represents ownership in a corporation

stock exchange

marketplace where anyone may purchase stock

store of value

money holds its value from day to day

time deposit

deposits at a bank or other financial institution that pay interest but cannot be withdrawn on demand

unit of account

the standard by which other values are measured

venture capital

money gathered from a variety of individual or institutional investors by a business that invests in start-ups with substantial growth potential