Finance and Investment

© gary718/Shutterstock.com

In this part, we look at another business resource—money. First, we discuss the functions of money and the financial institutions that are part of our banking system. Then we examine the concept of financial management and investing for both firms and individuals.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

18 Understanding Money, Banking, and Credit

© Dmitriy Shironosov/Shutterstock.com

Learning Objectives

What you will be able to do once you complete this chapter:

1. Identify the functions and characteristics of money.
2. Summarize how the Federal Reserve System regulates the money supply to maintain a healthy economy.
3. Describe the organizations involved in the banking industry.
4. Identify the services provided by financial institutions.
5. Understand how financial institutions are changing to meet the needs of domestic and international customers.
6. Explain how deposit insurance protects customers.
7. Discuss the importance of credit and credit management.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

inside business

TD Bank Seeks to Wow Customers

Living up to its slogan, "America's most convenient bank," TD Bank works hard to wow its customers with convenient service from the northern tip of Maine to the southern coast of Florida. TD Bank is one of the 15 largest U.S. commercial banks, with 23,000 employees and 6.5 million customers in 13 states plus Washington, DC.

In all, TD Bank has more than 1,100 U.S. stores (its name for branches), while its Toronto parent, TD Bank Financial Group, has about 1,100 Canadian branches. With such a big network throughout North America, doing business with the bank is especially appealing for companies that reach across the border to sell to customers or buy from suppliers.

Like many other banks, TD Bank has been on both sides of the industry's merger and acquisitions activity. Until 2008, the bank was known as TD Banknorth, reflecting the names of its Canadian parent and the New England bank acquired by the parent for its U.S. expansion. Banknorth's history stretches back to 1852, when it was founded as Portland Savings Bank. Over the years, the Maine bank gobbled up smaller banks in a bid to widen its geographic scope and, in turn, was acquired by TD Bank Financial Group in 2007. Once TD Banknorth bought Commerce Bank in 2008 as part of its growth plans, it switched all stores to the TD Bank name.

As a commercial bank, TD Bank offers a full range of financial services for consumers and businesses of all sizes, including small-business loans backed by SBA guarantees and international banking services for large corporations. It did not get mixed up with the kinds of risky mortgage lending that have hurt so many banks in recent years, and it has kept its focus on service to build a solid customer base. TD Bank stores stay open much later than traditional bank branches and also offer convenient weekend hours for banking in person. In addition, the bank provides around-the-clock assistance by telephone, online, and via e-mail. TD Bank's personal touch is a competitive advantage. Not many banks post fan mail on their Web sites, but TD Bank does.[1]

FYI

Did You Know?

TD Bank is one of the 15 largest U.S. commercial banks, with 23,000 employees and 6.5 million customers in 13 states plus Washington, DC.

The Economic Crisis! These three words say a lot about the recent downturn in the nation's economy. These same three words do not tell the entire story, however, because the crisis caused a ripple effect through the entire economy—including the banking and financial industry. In reality, most Americans were frightened by a crisis that some experts described as the worst the nation had seen since the Great Depression. In fact, the economic crisis affected everyone in the United States in some way. For example,

- Many individuals lost their homes because they obtained loans they could not afford.
- Many individuals and business firms filed for bankruptcy because they could not repay money they had borrowed from financial institutions.
- Many individuals and businesses found that it was harder, or in some cases impossible, to borrow money from financial institutions.

Although some banks like TD Bank—the financial institution profiled in the Inside Business case for this chapter—continued to offer a full range of financial services for both consumers and businesses of all sizes, not all financial institutions were as well managed as TD Bank. Many of the nation's banks became known as

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

"troubled" banks with too many nonperforming loans. Especially hard hit were large mortgage lenders that had financed home loans for customers who could no longer make their loan payments.

To help solve the problems, the Federal Reserve Bank became heavily involved in an effort to inject cash into the nation's banking system. The government also protected bank customers by merging troubled banks with financially stable banks. Finally, Congress passed two different rescue plans designed to restore confidence in the banking and financial industry. After all was said and done, two facts became obvious. First, it will take time for the U.S. economy to recover from what some experts describe as a financial meltdown. Second, healthy banks and financial institutions are necessary for both individuals and businesses to function in today's economic world.

Most people regard a bank, savings and loan association, credit union, or similar financial institution as a place to deposit or borrow money. When you deposit money, you *receive* interest. When you borrow money, you must *pay* interest. You may borrow to buy a home, a car, or some other high-cost item. In this case, the resource that will be transformed into money to repay the loan is the salary you receive for your labor.

Businesses also transform resources into money. A business firm (even a new one) may have a valuable asset in the form of an idea for a product or service. If the firm (or its founder) has a good credit history and the idea is a good one, a bank or other lender may lend it the money to develop, produce, and market the product or service. The loan—with interest—will be repaid out of future sales revenue. In this way, both the firm and the lender will earn a reasonable profit.

In each of these situations, the borrower needs the money now and will have the ability to repay it later. Although the decision to borrow money from a bank or other financial institution should always be made after careful deliberation, the fact is that responsible borrowing enables both individuals and business firms to meet specific needs.

In this chapter, we begin by outlining the functions and characteristics of money that make it an acceptable means of payment for products, services, and resources. Then we consider the role of the Federal Reserve System in maintaining a healthy economy. Next, we describe the banking industry—commercial banks, savings and loan associations, credit unions, and other institutions that offer banking services. Then we turn our attention to how banking practices meet the needs of customers. We also describe the safeguards established by the federal government to protect depositors against losses. In closing, we examine credit transactions, sources of credit information, and effective collection procedures.

1

Identify the functions and characteristics of money.

What Is Money?

The members of some societies still exchange goods and services through barter, without using money. A **barter system** is a system of exchange in which goods or services are traded directly for other goods or services. One family may raise vegetables and herbs, and another may weave cloth. To obtain food, the family of weavers trades cloth for vegetables, provided that the farming family is in need of cloth.

The trouble with the barter system is that the two parties in an exchange must need each other's products at the same time, and the two products must be roughly equal in value. Thus, even very isolated societies soon develop some sort of money to eliminate the inconvenience of trading by barter.

barter system a system of exchange in which goods or services are traded directly for other goods or services

money anything a society uses to purchase products, services, or resources

Money is anything a society uses to purchase products, services, or resources. Historically, different groups of people have used all sorts of objects as money—whales' teeth, stones, beads, copper crosses, clamshells, and gold and silver, for example. Today, the most commonly used objects are metal coins and paper bills, which together are called *currency*.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

The Functions of Money

Money aids in the exchange of goods, services, and resources. However, this is a rather general (and somewhat theoretical) way of stating money's function. Let's look instead at three *specific* functions money serves in any society.

Money as a Medium of Exchange A **medium of exchange** is anything accepted as payment for products, services, and resources. This definition looks very much like the definition of money. It is meant to because the primary function of money is to serve as a medium of exchange. The key word here is *accepted*. As long as the owners of products, services, and resources *accept* money in an exchange, it is performing this function. For example, if you want to purchase a Hewlett-Packard Photosmart printer that is priced at $149 in a Best Buy store, you must give the store the correct amount of money. In return, the store gives you the product.

© Xie Zhengyi/ChinaFotoPress/Newscom

Two kinds of money. It's easy for U.S. citizens to think that their currency is the only currency in the world, but in reality there are many other currencies used throughout the world. In this photo, U.S. currency is on the left; the Chinese currency—the yuan—is on the right. Both currencies serve as a medium of exchange, a measure of value, and a store of value.

Money as a Measure of Value A **measure of value** is a single standard or "yardstick" used to assign values to, and compare the values of, products, services, and resources. Money serves as a measure of value because the prices of all products, services, and resources are stated in terms of money. It is thus the "common denominator" we use to compare products and decide which we will buy.

Money as a Store of Value Money received by an individual or firm need not be used immediately. It may be held and spent later. Hence, money serves as a **store of value**, or a means of retaining and accumulating wealth. This function of money comes into play whenever we hold onto money—in a pocket, a cookie jar, a savings account, or whatever.

Value that is stored as money is affected by *inflation*. Remember from Chapter 1 that *inflation* is a general rise in the level of prices. As prices go up in an inflationary period, money loses purchasing power. Suppose that you can buy a Bose home theater system for $1,000. Your $1,000 has a value equal to the value of that home theater system. However, suppose that you wait and do not buy the home theater system immediately. If the price goes up to $1,025 in the meantime because of inflation, you can no longer buy the home theater system with your $1,000. Your money has *lost* purchasing power because it is now worth less than the home theater system. To determine the effect of inflation on the purchasing power of a dollar, economists often refer to a consumer price index such as the one illustrated in Figure 18.1. The consumer price index measures the changes in prices of a fixed basket of goods purchased by a typical consumer, including food, transportation, housing, clothing, medical care, recreation, education, communication, and other goods and services. The base amount for the consumer price index is 100 and was established by averaging the cost of the items included in the consumer price index over a 36-month period from 1982 to 1984. In April 2010, it took approximately $218 to purchase the same goods that could have been purchased for $100 in the base period 1982 to 1984.

medium of exchange anything accepted as payment for products, services, and resources

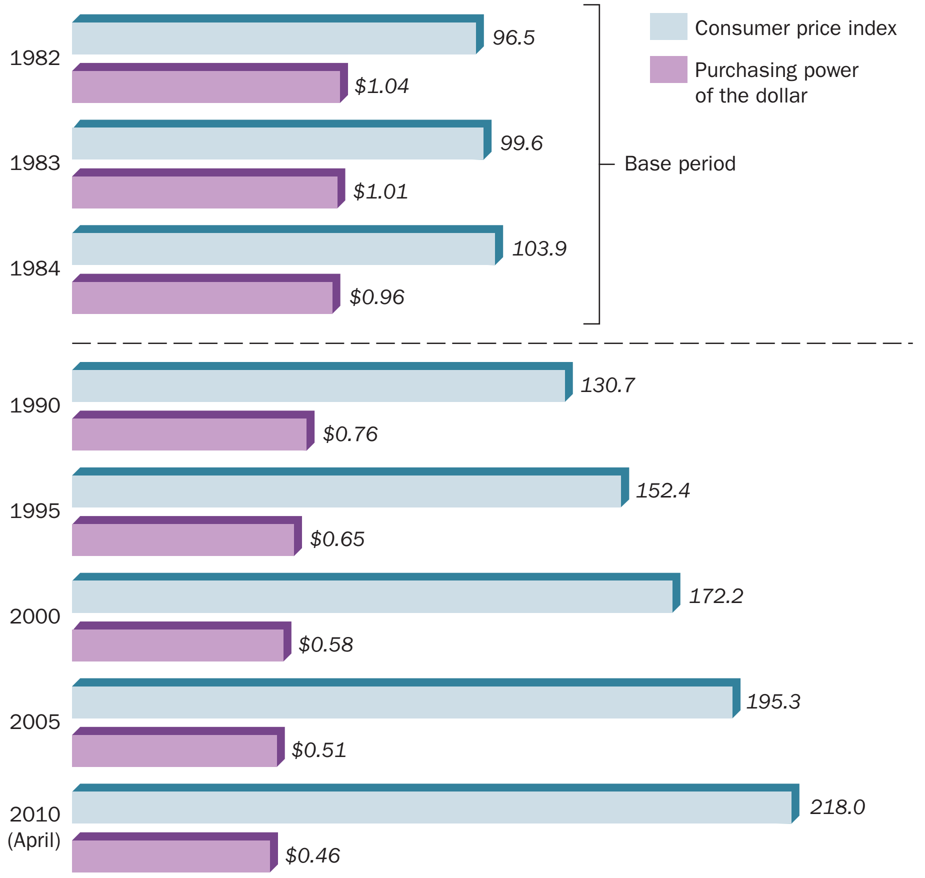
measure of value a single standard or "yardstick" used to assign values to, and compare the values of, products, services, and resources

store of value a means of retaining and accumulating wealth

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 18.1 The Consumer Price Index and the Purchasing Power of the Consumer Dollar (Base Period 1982–1984 = 100)

Inflation causes a loss of money's stored value. As the consumer price index goes up, the purchasing power of the consumer's dollar goes down.



Source: The U.S. Bureau of Labor Statistics Web site, http://www.bls.gov (accessed June 16, 2010).

Important Characteristics of Money

Money must be easy to use, trusted, and capable of performing the three functions just mentioned. To meet these requirements, money must possess the following five characteristics.

Divisibility The standard unit of money must be divisible into smaller units to accommodate small purchases and large ones. In the United States, our standard is the dollar, and it is divided into pennies, nickels, dimes, quarters, and half-dollars.

Portability Money must be small enough and light enough to be carried easily. For this reason, paper currency is issued in larger denominations—5-, 10-, 20-, 50-, and 100-dollar bills.

Stability Money should retain its value over time. When it does not, people tend to lose faith in their money. When money becomes extremely unstable, people may turn to other means of storing value, such as gold and jewels, works of art, and real estate.

Durability The objects that serve as money should be strong enough to last through reasonable use. To increase the life expectancy of paper currency, most nations use special paper with a high fiber content.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Difficulty of Counterfeiting If a nation's currency were easy to counterfeit—that is, to imitate or fake—its citizens would be uneasy about accepting it as payment. In an attempt to make paper currency more difficult to counterfeit, the U.S. government periodically redesigns its paper currency and uses watermarks and intricate designs to discourage counterfeiting.

The Supply of Money: M_1 and M_2

How much money is there in the United States? Before we can answer this question, we need to define a couple of concepts. A **demand deposit** is an amount on deposit in a checking account. It is called a *demand* deposit because it can be claimed immediately—that is, on-demand—by presenting a properly made out check, withdrawing cash from an automated teller machine (ATM), or transferring money between accounts.

A **time deposit** is an amount on deposit in an interest-bearing savings account or certificate of deposit. Financial institutions generally permit immediate withdrawal of money from savings accounts. However, they can require advance written notice before withdrawal of certificates of deposit, and the customer may need to pay an early withdrawal penalty. The time between notice and withdrawal is what leads to the name *time* deposit. For this reason, they are called *near-monies*. Other near-monies include short-term government securities and money-market mutual fund accounts.

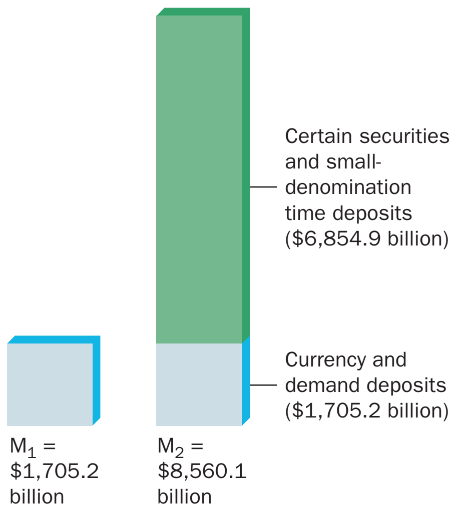
Now we can discuss the question of how much money there is in the United States. There are two main measures of the supply of money: M_1 and M_2.

The *M_1 supply of money* is a narrow definition and consists only of currency, demand and other checkable deposits, and traveler's checks. By law, currency must be accepted as payment for products, services, and resources. Checks (demand deposits) are accepted as payment because they are convenient, convertible to cash, and generally safe.

The *M_2 supply of money* consists of M_1 (currency and demand deposits) plus savings accounts, certain money-market securities, and small-denomination time deposits or certificates of deposit (CDs) of less than $100,000. The M_2 definition of money is based on the assumption that time deposits can be converted to cash for spending. Figure 18.2 shows the elements of the M_1 and M_2 supply of money.

Figure 18.2 The Supply of Money

Two measures of the money supply are M_1, which includes currency and demand deposits, and M_2, which includes M_1 plus certain securities and small-denomination time deposits.



Source: The Federal Reserve Web site, http://www.federalreserve.gov (accessed June 15, 2010).

demand deposit an amount on deposit in a checking account

time deposit an amount on deposit in an interest-bearing savings account or certificate of deposit

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

We have, then, at least two measures of the supply of money. (Actually, there are other measures as well, which may be broader or narrower than M_1 and M_2.) Therefore, the answer to our original question is that the amount of money in the United States depends very much on how we measure it. Generally, economists, politicians, and bankers tend to focus on M_1 or some variation of M_1.

2

Summarize how the Federal Reserve System regulates the money supply to maintain a healthy economy.

The Federal Reserve System

How do Federal Reserve actions affect me? What is the Federal Reserve System? These are both good questions. The Federal Reserve Board, often referred to as the Fed, is responsible for not only regulating the nation's banking system, but also maintaining a healthy economy. Although many people became aware of the Federal Reserve's actions during the recent economic crisis, the Fed's lending programs have been used since the early 1900s to maintain a healthy economy. Here's how it works. The Fed lowers the interest rates that banks pay to borrow money from the Fed in an effort to shore up a sagging economy. When the Fed lowers rates, banks pay less to borrow money from the Fed. In turn, they often lower the interest rates they charge for business loans, home mortgages, car loans, and even credit cards. Lower rates often provide an incentive for both business firms and individuals to buy goods and services, which, in turn, helps to restore the economic health of the nation. On the other hand, rate increases are designed to sustain economic growth while controlling inflation. When the Fed raises rates, banks must pay more to borrow money from the Fed. And the banks, in turn, charge higher rates for both consumer and business loans.

Now let's answer the second question. The **Federal Reserve System** is the central bank of the United States and is responsible for regulating the banking industry. Created by Congress on December 23, 1913, its mission is to maintain an economically healthy and financially sound business environment in which banks can operate.

The Federal Reserve System is controlled by its seven-member board of governors, who meet in Washington, DC. Each governor is appointed by the president and confirmed by the Senate for a 14-year term. The president also selects the chairman and vice chairman of the board from among the board members for four-year terms.

Federal Reserve System the central bank of the United States responsible for regulating the banking industry

The Federal Reserve System consists of 12 district banks located in major cities throughout the United States, as well as 24 branch banks (see Figure 18.3). All national (federally chartered) banks must be members of the Fed. State banks may join if they choose to and if they meet membership requirements. For more information about the Federal Reserve System, visit its Web site at http://www.federalreserve.gov.

© Chip Somodevilla/Getty Images

Two money men! U.S. Treasury Secretary Timothy Geithner (left) talks with Federal Reserve Chairman Ben Bernanke (right) while testifying before the U.S. House Financial Services Committee about the government's efforts to reduce the effects of the recent economic crisis.

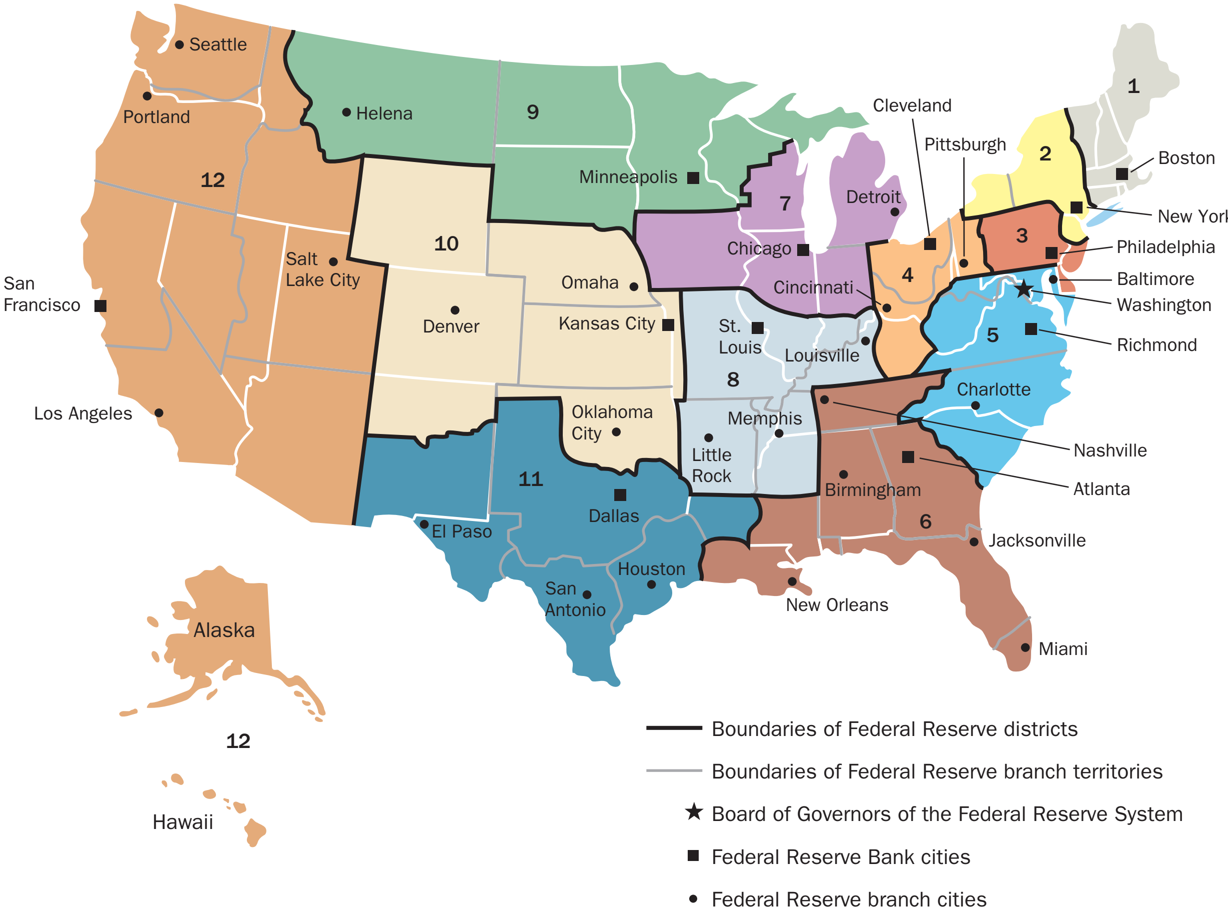
Economic Crisis and the Fed's Response

Lately, it seems like the Federal Reserve Board has been in the news more than usual. The reason for all the news coverage is quite simple: The Fed was responsible for maintaining the health of the U.S. economy during the recent economic crisis. Although three of the obvious problems associated with the recent crisis were described in the first part of this chapter, there were many more problems that affected the entire economy. To maintain a healthy economy, the Federal Reserve Board took a number of specific steps to minimize the effects of the crisis for both business and individuals. Specifically, the Fed[2]

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 18.3 Federal Reserve System

The Federal Reserve System consists of 12 district banks and 24 branch banks.



Source: "91st Annual Report, 2004," The Federal Reserve Board Web site, http://www.federalreserve.gov (accessed June 18, 2010).

- **Provided liquidity.** The Fed allowed banks in need of cash to borrow money from the Federal Reserve System. Without the ability to borrow needed funds from the Fed, some banks were in danger of failing. The Fed's lending activities also helped encourage other banks to continue loaning money to their customers. If they could not have borrowed money from the Fed, banks would have tightened lending requirements or stopped funding loans to both businesses and individuals.
- **Supported troubled financial markets.** For many businesses, short-term borrowing is essential to operate on a day-to-day basis. Often this much-needed financing is provided by individuals who buy shares in money-market mutual funds. The money-market funds, in turn, often purchase **commercial paper** issued by business firms that need short-term financing.

  During the first part of the crisis, investors feared that many commercial paper issues would become worthless and they stopped investing in money-market funds that held commercial paper. At the same time, many investors were withdrawing money from money-market funds. As a result, interest rates on commercial paper increased. In order to restore the commercial paper market and lower the cost of this type of short-term financing, the Federal Reserve provided secured loans to the financial institutions that sell this type of investment; as a result, the commercial paper market is now functioning well.

commercial paper a short-term promissory note issued by a large corporation

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- **Supported important financial institutions.** The failure of investment bank Lehman Brothers and the commercial bank Washington Mutual fueled fears that other large financial institutions could fail. The resulting panic threatened to lead to a full-scale "run" on banks and lenders that could have caused the entire financial system to break down. To restore faith in the system, the Fed agreed to provide non-recourse loans to large banks. The ability to borrow money from the Fed and other government agencies helped to calm investors and avoid an even larger financial meltdown.
- **Conducted stress tests of major banks.** In the spring of 2009, the Federal Reserve, along with other federal agencies, conducted an unprecedented review of the financial condition of the 19 largest U.S. banks. This "stress" test measured how well these banks could weather the economic crisis. Banks that failed the test were required to obtain new capital by selling stock or bonds or accept federal government funds.

The Fed's actions did help to restore confidence in the financial system, to encourage continued lending, to stabilize an unstable economy, and to provide additional time to create a financial rescue plan to restore the nation's economy. At the time of publication, although the health of the banking and financial industry has improved, there are still concerns about the long-term effects of the Federal Reserve's actions, what future actions may be needed to ensure continued economic growth, and the cost of the financial rescue plan. According to Federal Reserve Chairman Ben Bernanke, "The federal budget appears to be on an unsustainable path," but that the "exceptional increase" in the deficit has been necessary to pull the country out of recession.[3]

The most important function of the Fed is to use monetary policy to regulate the nation's supply of money in such a way as to maintain a healthy economy. In Chapter 1, monetary policy was defined as the Federal Reserve's decisions that determine the size of the supply of money in the nation and the level of interest rates. The goals of monetary policy are continued economic growth, full employment, and stable prices. Three methods—controlling bank reserve requirements, regulating the discount rate, and running open-market operations—are used to implement the Fed's monetary policy.

Regulation of Reserve Requirements

When money is deposited in a bank, the bank must retain a portion of it to satisfy customers who may want to withdraw money from their accounts. The remainder is available to fund loans. By law, the Federal Reserve sets the reserve requirement for financial institutions, whether or not they are members of the Federal Reserve System. The **reserve requirement** is the percentage of its deposits a bank *must* retain, either in its own vault or on deposit with its Federal Reserve district bank. For example, if a bank has new deposits of $20 million and the reserve requirement is 10 percent, the bank must retain $2 million. The present reserve requirements range from 0 to 10 percent depending on such factors as the total amount individual banks have on deposit and the location of the particular member bank.[4]

Once reserve requirements are met, banks can use the remaining funds to create more money and make more loans through a process called *deposit expansion*. In the preceding example, the bank must retain $2 million in a reserve account. It can use the remaining $18 million to fund consumer and business loans. Assume that the bank lends all $18 million to different borrowers and also assume that before using any of the borrowed funds, all borrowers deposit the $18 million in their bank accounts at the lending institution. Now the bank's deposits have increased by an additional $18 million. Because these deposits are subject to the same reserve requirement described earlier, the bank must maintain $1.8 million in a reserve account, and the bank can lend the additional $16.2 million to other bank customers. Of course, the bank's lending potential becomes steadily smaller and smaller as it makes more loans. Moreover, we should point out that as bankers are usually

reserve requirement the percentage of its deposits a bank *must* retain, either in its own vault or on deposit with its Federal Reserve district bank

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

very conservative by nature, they will not use deposit expansion to maximize their lending activities; they will take a more middle-of-the-road approach.

The Fed's board of governors sets the reserve requirement. *When it increases the requirement, banks have less money available for lending.* Fewer loans are made, and the economy tends to slow. *On the other hand, by decreasing the reserve requirement, the Fed can make additional money available for lending to stimulate a slow economy.*

Because this means of controlling the money supply is so very potent and has such far-reaching effects on both consumers and financial institutions, the Fed seldom changes the reserve requirement.

Regulation of the Discount Rate

Member banks may borrow money from the Fed to satisfy the reserve requirement. The interest rate the Federal Reserve charges for loans to member banks, called the **discount rate**, is set by the board of directors of each Federal Reserve District bank. For the period from January 2003 to December 2007, the discount rate has been as low as 2 percent and as high as 6.25 percent.[5] In January 2008, in an attempt to stabilize the economy and encourage lending, the Federal Reserve began lowering the discount rate. By February 2010, the discount rate was 0.75 percent and remained low throughout the remainder of the year.[6]

When the Fed *lowers* the discount rate, it is easier and cheaper for banks to obtain money. Member banks feel free to make more loans and to charge lower interest rates. This action generally stimulates the nation's economy. When the Fed *raises* the discount rate, banks begin to restrict loans. They increase the interest rates they charge and tighten their own loan requirements. The overall effect is to slow the economy. Although the discount rate has decreased to 0.75 percent, you should remember that the Fed can increase rates in an effort to maintain a healthy economy.

discount rate the interest rate the Federal Reserve System charges for loans to member banks

open-market operations the buying and selling of U.S. government securities by the Federal Reserve System for the purpose of controlling the supply of money

Open-Market Operations

The federal government finances its activities partly by buying and selling government securities issued by the U.S. Treasury (Treasury bills, notes, and bonds) and federal agency securities. These securities, which pay interest, may be purchased by any individual, firm, or organization—including the Fed. **Open-market operations** are the buying and selling of U.S. government securities by the Federal Reserve System for the purpose of controlling the supply of money.

The Federal Open Market Committee (FOMC) is charged with carrying out the Federal Reserve's open-market operations by buying and selling U.S. Treasury securities through the trading desk of the Federal Reserve Bank of New York. To reduce the nation's money supply, the FOMC simply *sells* government securities. The money it receives from purchasers is taken out of circulation. Thus, less money is available for investment, purchases, or lending. To increase the money supply, the FOMC *buys* government securities. The money the FOMC pays for securities goes back into circulation, making more money available to individuals and firms.

Because the major purchasers of government securities are banking and financial institutions, open-market operations tend to have an immediate effect on lending and investment.

Of the three tools used to influence monetary policy, the use of open-market operations is the most important. When the Federal Reserve buys and sells securities, the goal is to change the federal funds rate. The

How are banking and the stock market related? As many Americans found out during the recent economic crisis, it takes a strong banking system and a healthy stock market for a nation to experience economic prosperity. In this photo, traders on the floor of the New York Stock Exchange (NYSE) are buying and selling stocks for their clients. Without a healthy economy, consumers don't usually borrow money from banks and investors don't buy stocks.

© AP Images/Richard Drew

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Table 18.1 Methods Used by the Federal Reserve System to Control the Money Supply and the Economy

Method Used	Immediate Result	End Result
Regulating Reserve Requirement		
1. Fed *increases* reserve requirement	Less money for banks to lend to customers—reduction in overall money supply	Economic slowdown
2. Fed *decreases* reserve requirement	More money for banks to lend to customers—increase in overall money supply	Increased economic activity
Regulating the Discount Rate		
1. Fed *increases* the discount rate	Less money for banks to lend to customers—reduction in overall money supply	Economic slowdown
2. Fed *decreases* the discount rate	More money for banks to lend to customers—increase in overall money supply	Increased economic activity
Open-Market Operations		
1. Fed *sells* government securities	Reduction in overall money supply	Economic slowdown
2. Fed *buys* government securities	Increase in overall money supply	Increased economic activity

federal funds rate is the interest rate at which a bank lends immediately available funds on deposit at the Fed to another bank overnight to meet the borrowing bank's reserve requirements. Because the Fed funds rate is what banks pay when they borrow, it affects the rates they charge when they lend. Although the FOMC sets a target for the federal funds rate, it does not actually set the rate because it is determined by the open market.[7] (*Note:* There is a difference between the federal funds rate and the discount rate discussed earlier in this section. The *federal funds rate* is the interest rate paid by a bank to borrow funds from other banks. The *discount rate* is the interest rate paid by a bank to borrow funds from the Federal Reserve.) Table 18.1 summarizes the effects of open-market operations and the other tools used by the Fed to regulate the money supply and control the economy.

Other Fed Responsibilities

In addition to its regulation of the money supply, the Fed is also responsible for serving as the government's bank, clearing checks and electronic transfers, inspecting currency, and applying selective credit controls.

Serving as Government Bank The Federal Reserve is the bank for the U.S. government. As the government's bank, it processes a variety of financial transactions involving trillions of dollars each year. For example, the Federal Reserve provides financial services for the U.S. Treasury, including accounts through which incoming tax deposits and outgoing government payments are handled.

Clearing Checks and Electronic Transfers Today, many people use checks to pay for nearly everything they buy. A check written by a customer of one bank and presented for payment to another bank in the same town may be processed through a local clearing-house. The procedure becomes more complicated, however, when the banks are not in the same town. This is where the Federal Reserve System comes in. The Fed is responsible for the prompt and accurate collection of 15 to 17 billion checks each year.[8] Banks that use the Fed to clear checks are charged a fee for this service. Through the use of electronic equipment, most checks can be cleared within two or three days.

Inspection of Currency As paper currency is handled, it becomes worn or dirty. The typical $1 bill has a life expectancy of less than two years. Most $50 and $100 bills usually last longer because they are handled less. When member banks deposit their surplus cash in a Federal Reserve Bank, the currency is inspected. Bills unfit for further use are separated and destroyed.

federal funds rate the interest rate at which a bank lends immediately available funds on deposit at the Fed to another bank overnight to meet the borrowing bank's reserve requirements

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Selective Credit Controls The Federal Reserve System has the responsibility for enforcing the Truth-in-Lending Act, which Congress passed in 1968. This act requires lenders to state clearly the annual percentage rate and total finance charge for a consumer loan. The Federal Reserve System is also responsible for setting the margin requirements for securities transactions. The *margin* is the minimum amount (expressed as a percentage) of the purchase price that must be paid in cash or eligible securities. (The investor may borrow the remainder.) The current initial margin requirement is 50 percent. Thus, if an investor purchases $4,000 worth of stock, he or she must pay at least $2,000 in cash or its equivalent in securities. The remaining $2,000 may be borrowed from the brokerage firm. Although the minimum margin requirements are regulated by the Federal Reserve, margin requirements and the interest charged on the loans used to fund margin transactions may vary among brokerage firms and different security exchanges. For example, although an initial investment of at least $2,000 is required to open a margin account, some brokerage firms require more than $2,000.

3

Describe the organizations involved in the banking industry.

The American Banking Industry

Most bankers will tell you that the last few years have been frustrating for the American banking industry, to say the least. Furthermore, it's not just bankers who were affected. Almost everyone has been affected in one way or another by the nation's economic crisis.

Banks, savings and loan associations, credit unions, and other financial institutions were at the center of the nation's economic problems. Aggressive lending practices that led to record numbers of home foreclosures and nonperforming loans caused a financial meltdown. As the economic problems within the banking and financial industry became larger, the ability to borrow money became more difficult for both individuals and business firms—a very serious problem for both borrowers and lenders. In fact, the nation's economic problems (and the world's) became so severe that the government needed to take action. Both the Bush and the Obama administrations developed financial plans to rescue the economy. In addition, both the Federal Reserve Board and the U.S. Treasury took action. Eventually, the rescue plans did help relieve at least some of the financial problems associated with the economic crisis. Still, there was need for more changes in the way that banks and financial institutions operate.

Banking and Financial Reform: New Regulations

During the first part of 2010, the U.S. Congress tackled the issue of banking and financial reform. At the time of publication of this text, it is unclear what actions will be taken and how new regulations will affect individuals and businesses, banks and financial institutions, and Wall Street. Although there are many critics of increased regulation, it is apparent that something needs to be done to prevent the type of economic problems the nation has experienced over the past three years from happening again.

According to President Barack Obama, the goals of new government banking and financial regulations are more than justified in the wake of the crisis and include the following:[9]

- Protect American families from unfair and abusive financial and banking practices.
- Close the gaps in our financial system that allowed large banks and financial firms to avoid strong, comprehensive federal oversight.
- Curb the high-risk investment strategies that led to the financial problems at some major financial institutions and the nation's economic crisis.
- Require banks and financial firms to pay back bailout funds they received during the economic crisis.
- Provide a foundation for stable economic growth.

To accomplish these goals, a number of actions are currently being discussed by both the U.S. House of Representatives and the U.S. Senate. From an individual's

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

standpoint, the most important action that may be included in new government regulations is the creation of a new consumer financial protection agency. Although there are currently seven federal agencies that divide responsibility for enforcing financial regulations, this new "super" agency will be responsible for setting clear rules for the entire industry and regulating the big financial service providers.[10] For individuals, specific areas of concern include home mortgages, credit card accounts, auto loans, overdraft fees, financial literacy, and alternative financial services.[11]

To provide this type of comprehensive consumer protection, it will be necessary to make sure banks and financial institutions are complying with the new regulations. In addition to increasing consumer protection, future regulations will subject banks and financial institutions to more in-depth evaluations to determine their financial health and provide an early warning system to spot signs of trouble before they affect individuals, the American economy, and the world economy.

For more information about existing regulations and proposed new regulations, go to the Federal Reserve Board's Web site at http://www.federalreserve.gov, the U.S. Treasury Web site at http://www.ustreas.gov., or use a search engine like Google or Yahoo! and enter "banking reform" or "financial reform."

In addition to the nation's economic problems, competition among banks, savings and loan associations, credit unions, and other business firms that want to perform banking activities has never been greater. Let's begin this section with some information about one of the major players in the banking industry—the commercial bank.

Commercial Banks

A **commercial bank** is a profit-making organization that accepts deposits, makes loans, and provides related services to its customers. Like other businesses, the bank's primary goal—its mission—is to meet its cutomers' needs while earning a profit.

Because they deal with money belonging to individuals and other business firms, banks must meet certain requirements before they receive a charter, or permission to operate, from either federal or state banking authorities. A **national bank** is a commercial bank chartered by the U.S. Comptroller of the Currency. There are approximately 1,700 national banks.[12] These banks must conform to federal banking regulations and are subject to unannounced inspections by federal auditors.

A **state bank** is a commercial bank chartered by the banking authorities in the state in which it operates. State banks outnumber national banks by about four to one, but they tend to be smaller than national banks. They are subject to unannounced inspections by both state and federal auditors.

Table 18.2 lists the seven largest banks in the United States. All are classified as national banks.

commercial bank a profit-making organization that accepts deposits, makes loans, and provides related services to its customers

national bank a commercial bank chartered by the U.S. Comptroller of the Currency

state bank a commercial bank chartered by the banking authorities in the state in which it operates

Table 18.2 The Seven Largest U.S. Banks, Ranked by Total Revenues

Rank	Company	Revenues ($ millions)	Profits ($ millions)	Employees
1	Bank of America Corp.	150,450.0	6,276.0	283,717
2	J.P. Morgan Chase & Co.	115,632.0	11,728.0	222,316
3	Citigroup	108,785.0	−1,606.0	267,150
4	Wells Fargo	98,636.0	12,275.0	267,300
5	Goldman Sachs Group	51,673.0	13,385.0	36,200
6	Morgan Stanley	31,515.0	1,346.0	61,388
7	American Express	26,730.0	2,130.0	58,300

Source: The Fortune Web site, http://www.fortune.com (accessed June 20, 2010).

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Other Financial Institutions

In addition to commercial banks, at least eight other types of financial institutions perform either full or limited banking services for their customers.

Savings and Loan Associations A **savings and loan association (S&L)** is a financial institution that offers checking and savings accounts and CDs and that invests most of its assets in home mortgage loans and other consumer loans. Originally, S&Ls were permitted to offer their depositors *only* savings accounts. However, since Congress passed legislation regarding S&Ls in the 1980s, they have been able to offer other services to attract depositors.

Today, there are approximately 1,150 S&Ls in the United States insured by the Federal Deposit Insurance Corporation.[13] Federal associations are supervised by the Office of Thrift Supervision, a branch of the U.S. Treasury. State-chartered S&Ls are subjected to unannounced audits by state authorities.

Convenient banking! For both customers and employees, banking is different than it used to be. Bank customers, like the people in this photo, expect banks to provide ATM machines where customers can withdraw money and complete many banking activities. For employees, the name of the game is customer service whether the customer is standing at a bank teller's window or banking online.

© Richard B. Levine/Newscom

Credit Unions The United States currently has an estimated 7,800 credit unions.[14] A **credit union** is a financial institution that accepts deposits from, and lends money to, only those people who are its members. Usually, the membership consists of employees of a particular firm, people in a particular profession, or those who live in a community served by a local credit union. Credit unions may pay higher interest on deposits than commercial banks and S&Ls, and they may provide loans at lower cost. The National Credit Union Administration regulates federally chartered credit unions and many state credit unions. State authorities also may regulate credit unions with state charters.

Organizations that Perform Banking Functions Six other types of financial institutions are involved in banking activities. Although not actually full-service banks, they offer customers some banking services.

- *Mutual savings banks* are financial institutions that are owned by their depositors and offer many of the same services offered by banks, S&Ls, and credit unions, including checking accounts, savings accounts, and CDs. Like other financial institutions, they also fund home mortgages, commercial loans, and consumer loans. Unlike other types of financial institutions, mutual savings banks are owned by their depositors. The profits of a mutual savings bank go to the depositors, usually in the form of dividends or slightly higher interest rates on savings. Today, most mutual savings banks are located in the Northeast.
- *Insurance companies* provide long-term financing for office buildings, shopping centers, and other commercial real estate projects throughout the United States. The funds used for this type of financing are obtained from policyholders' insurance premiums.
- *Pension funds* are established by employers to guarantee their employees a regular monthly income on retirement. Contributions to the fund may come from the employer, the employee, or both. Pension funds earn additional income through generally conservative investments in corporate stocks, corporate bonds, and government securities, as well as through financing real estate developments.
- *Brokerage firms* offer combination savings and checking accounts that pay higher-than-usual interest rates (so-called money-market rates). Many people have switched to these accounts because they are convenient and to get slightly higher rates.

savings and loan association (S&L) a financial institution that offers checking and savings accounts and CDs and that invests most of its assets in home mortgage loans and other consumer loans

credit union a financial institution that accepts deposits from, and lends money to, only the people who are its members

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- *Finance companies* provide financing to individuals and business firms that may not be able to get financing from banks, S&Ls, or credit unions. Firms such as Ford Motor Credit, GE Capital, and General Motors Acceptance Corporation (now known as Ally Bank) provide loans to both individuals and business firms. Lenders such as Household Finance Corporation (HFC) and Ace Cash Express, Inc., provide short-term loans to individuals. The interest rates charged by these lenders may be higher than the interest rates charged by other financial institutions.
- *Investment banking firms* are organizations that assist corporations in raising funds, usually by helping sell new issues of stocks, bonds, or other financial securities. Although these firms do not accept deposits or make loans like traditional banking firms, they do help companies raise millions of dollars. More information about investment banking firms and the role they play in American business is provided in Chapters 19 and 20.

Careers in the Banking Industry

Take a second look at Table 18.2. The seven largest banks in the United States employ approximately 1,200,000 people. If you add to this amount the people employed by smaller banks not listed in Table 18.2 and those employed by S&Ls, credit unions, and other financial institutions, the number of employees grows dramatically. However, be warned: According to the *Career Guide to Industries,* published by the U.S. Department of Labor, banking employment is projected to grow more slowly than other jobs in the economy between now and the year 2018. Even though employment within the industry is expected to increase more slowly when compared with other industries, there will be job growth for office and administrative support workers because workers often leave these positions for other jobs that offer higher pay or greater responsibilities.[15]

To be successful in the banking industry, you need a number of different skills. For starters, employees for a bank, S&L, credit union, or other financial institution must possess the following traits:

1. *You must be honest.* Because you are handling other people's money, many financial institutions go to great lengths to discover dishonest employees.
2. *You must be able to interact with people.* A number of positions in the banking industry require that you possess the interpersonal skills needed to interact not only with other employees but also with customers.
3. *You need a strong background in accounting.* Many of the routine tasks performed by employees in the banking industry are basic accounting functions. For example, a teller must post deposits or withdrawals to a customer's account and then balance out at the end of the day to ensure accuracy.
4. *You need to appreciate the relationship between banking and finance.* Bank officers must interview loan applicants and determine if their request for money is based on sound financial principles. Above all, loan officers must be able to evaluate applicants and their loan requests to determine if the borrower will be able to repay a loan.
5. *You should possess basic computer skills.* Almost all employees in the banking industry use a computer for some aspect of their work on a daily basis.

Depending on qualifications, work experience, and education, starting salaries generally are between $18,000 and $30,000 a year, but it is not uncommon for college graduates to earn $35,000 a year or more.

If banking seems like an area you might be interested in, why not do more career exploration? You could take

How do you get a job in banking? To attract new employees, many banks send recruiters to college job fairs. In this photo, Wendy Weber of Charter One Bank interviews two potential employees. For banks and other financial institutions, honesty, the ability to interact with people, a strong background in accounting and finance, and basic computer skills are prerequisites for a career in banking.

© ANTHONY ROBERT LA PENNA/CHICAGO TRIBUNE /Newscom

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

a banking course if your college or university offers one, or you could obtain a part-time job during the school year or a summer job in a bank, S&L, or credit union.

Traditional Services Provided by Financial Institutions

4

Identify the services provided by financial institutions.

To determine how important banking services are to you, ask yourself the following questions:

- How many checks did you write last month?
- Do you have a credit or debit card? If so, how often do you use it?
- Do you have a savings account or a CD?
- Have you ever financed the purchase of a new or used automobile?
- How many times did you visit an ATM last month?

If you are like most people and business firms, you would find it hard to live a normal life without the services provided by banks and other financial institutions. Typical services provided by a bank or other financial institution are illustrated in Figure 18.4.

The most important traditional banking services for both individuals and businesses are described in this section. Online banking, electronic transfer of funds, and other significant and future developments are discussed in the next section.

Checking Accounts

Imagine what it would be like living in today's world without a checking account. Firms and individuals deposit money in checking accounts (demand deposits) so that they can write checks to pay for purchases. A **check** is a written order for a bank or other financial institution to pay a stated dollar amount to the business or person indicated on the face of the check. To attract new customers, many financial institutions offer free checking; others charge activity fees (or service charges) for checking accounts. Fees and charges generally range between $5 to $20 per month for individuals. For businesses, monthly charges are based on the average daily balance in the checking account, the number of checks written, or both. Charges for business checking accounts are often higher than those for individual accounts.

Most financial institutions offer interest-paying checking accounts, often called *NOW (negotiable order of withdrawal) accounts*. A **NOW account** is an interest-bearing checking account. For these accounts, the usual interest rate is between 0.05 percent and 0.25 percent. Typically, online Internet banks pay slightly higher

Figure 18.4 Typical Services Provided by Banks and Other Financial Institutions

Banking services can be divided into three broad categories: traditional services, electronic services, and international services.

TRADITIONAL	ELECTRONIC	INTERNATIONAL
• Checking • Savings • Loans • Credit and debit cards • Financial advice • Payroll service • Certified checks • Trust services • Safe-deposit boxes	• Automatic teller machines • Electronic transfer of funds • Automated clearing-houses • Point-of-sale terminals • Electronic check conversion	• Letter of credit • Banker's acceptance • Currency exchange

check a written order for a bank or other financial institution to pay a stated dollar amount to the business or person indicated on the face of the check

NOW account an interest-bearing checking account; *NOW* stands for *negotiable order of withdrawal*

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Sustaining the Planet

UN Capital Development Fund

The UN Capital Development Fund has made $200 million in small loans available to entrepreneurs in dozens of the world's least-developed countries, from Afghanistan to Zambia, to help strengthen local economies without compromising sustainability. Take a look: http://www.uncdf.org/english/index.php.

© United Nations Capital Development Fund (UNCDF)

interest rates. However, individual banks may impose certain restrictions on their NOW accounts.

Although banks and other financial institutions may pay low interest rates on checking accounts, even small earnings are better than no earnings. In addition to interest rates, be sure to compare monthly fees before opening a checking account.

Savings Accounts

Savings accounts (time deposits) provide a safe place to store money and a very conservative means of investing. The usual *passbook savings account* earns between 0.25 percent and 0.80 percent in commercial banks and S&Ls and slightly more in credit unions or online Internet banks.

A depositor who is willing to leave money on deposit with a bank for a set period of time can earn a higher rate of interest. To do so, the depositor buys a certificate of deposit. A **certificate of deposit (CD)** is a document stating that the bank will pay the depositor a guaranteed interest rate on money left on deposit for a specified period of time. The interest rates paid on CDs change weekly; they once briefly exceeded 11 percent in 1980. Recently, interest rates have ranged from 0.50 to 3 percent. The rate always depends on how much is invested and for how long. Generally, the rule is: The longer the period of time until maturity, the higher is the rate. Depositors are penalized for early withdrawal of funds invested in CDs.

Short- and Long-Term Loans

Banks, S&Ls, credit unions, and other financial institutions provide short- and long-term loans to both individuals and businesses. *Short-term business loans* must be repaid within one year or less. Typical uses for the money obtained through short-term loans include solving cash-flow problems, purchasing inventory, financing promotional needs, and meeting unexpected emergencies.

To help ensure that short-term money will be available when needed, many firms establish a line of credit. A **line of credit** is a loan that is approved before the money is actually needed. Because all the necessary paperwork is already completed and the loan is pre-approved, the business can obtain the money later without delay, as soon as it is required. Even with a line of credit, a firm may not be able to borrow money if the bank does not have sufficient funds available. For this reason, some firms prefer a **revolving credit agreement**, which is a guaranteed line of credit.

Long-term business loans are repaid over a period of years. The average length of a long-term business loan is generally three to seven years but sometimes as long as 15 years. Long-term loans are used most often to finance the expansion of buildings and retail facilities, mergers and acquisitions, replacement of equipment, or product development.

Most lenders require some type of collateral for long-term loans. **Collateral** is real estate or property (stocks, bonds, equipment, or any other asset of value) pledged as security for a loan. For example, when an individual obtains a loan to pay for a new Chevrolet Malibu, the automobile is the collateral for the loan. If the borrower fails to repay the loan according to the terms specified in the loan agreement, the lender can repossess the car.

certificate of deposit (CD) a document stating that the bank will pay the depositor a guaranteed interest rate on money left on deposit for a specified period of time

line of credit a loan that is approved before the money is actually needed

revolving credit agreement a guaranteed line of credit

collateral real estate or property pledged as security for a loan

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Repayment terms and interest rates for both short- and long-term loans are arranged between the lender and the borrower. For businesses, repayment terms may include monthly, quarterly, semiannual, or annual payments. Repayment terms (and interest rates) for personal loans vary depending on how the money will be used and what type of collateral, if any, is pledged. However, individuals typically make monthly payments to repay personal loans. Borrowers always should "shop" for a loan, comparing the repayment terms and interest rates offered by competing financial institutions.

How do you pay for everyday items like clothing? More and more people are using credit or debit cards to pay for purchases like clothing. For the customer, credit and debit cards are easy and convenient. For merchants, credit and debit card transactions can be quickly processed to improve a firm's cash flow.

© Andresr/Shutterstock.com

Credit-Card and Debit-Card Transactions

By 2010, 181 million Americans will use credit cards to pay for everything from tickets on American Airlines to Zebco fishing gear.[16] Why have credit cards become so popular?

For a merchant, the answer is obvious. By depositing charge slips in a bank or other financial institution, the merchant can convert credit-card sales into cash. In return for processing the merchant's credit-card transactions, the financial institution charges a fee that generally ranges between 1.5 and 4 percent. Typically, small, independent businesses pay more than larger stores or chain stores. Let's assume that you use a Visa credit card to purchase a microwave oven for $300 from Gold Star Appliance, a retailer in Richardson, Texas. At the end of the day, the retailer deposits your charge slip, along with other charge slips, checks, and currency collected during the day, at its bank. If the bank charges Gold Star Appliance 4 percent to process each credit-card transaction, the bank deducts a processing fee of $12 ($\$300 \times 0.04 = \$12$) for your credit-card transaction and immediately deposits the remainder ($288) in Gold Star Appliance's account. The number of credit-card transactions, the total dollar amount of credit sales, and how well the merchant can negotiate the fees the bank charges determine actual fees.

Do not confuse debit cards with credit cards. Although they may look alike, there are important differences. A **debit card** electronically subtracts the amount of your purchase from your bank account at the moment the purchase is made. (By contrast, when you use your credit card, the credit-card company extends short-term financing, and you do not make payment until you receive your next statement.) Debit cards are used most commonly to obtain cash at ATMs and to purchase products and services from retailers.

Innovative Banking Services

5

Understand how financial institutions are changing to meet the needs of domestic and international customers.

Today, many individuals, financial managers, and business owners are finding it convenient to do their banking electronically. Let's begin by looking at how banking will change in the future.

Changes in the Banking Industry

While the experts may not be able to predict with 100 percent accuracy the changes that will affect banking, they all agree that banking *will* change. The most obvious changes the experts do agree on are as follows:

- More emphasis on evaluating the credit-worthiness of loan applicants as a result of the recent economic crisis
- An increase in government regulation of the banking industry
- A reduction in the number of banks, S&Ls, credit unions, and financial institutions because of consolidation and mergers
- Globalization of the banking industry as the economies of individual nations become more interrelated

debit card a card that electronically subtracts the amount of your purchase from your bank account at the moment the purchase is made

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Going for SUCCESS

Mobile Banking Lets Customers Make the Call

Banking on-the-go? Let your cell phone make the call. Many banks now offer mobile banking via text message or apps (software applications) downloaded to cell phones. The goal is to let customers use their cell phones to check account balances, transfer money, and track deposits at any time, from anywhere. This is especially convenient for busy businesspeople who don't live or work next door to a bank branch and can't always get to a computer to use online banking.

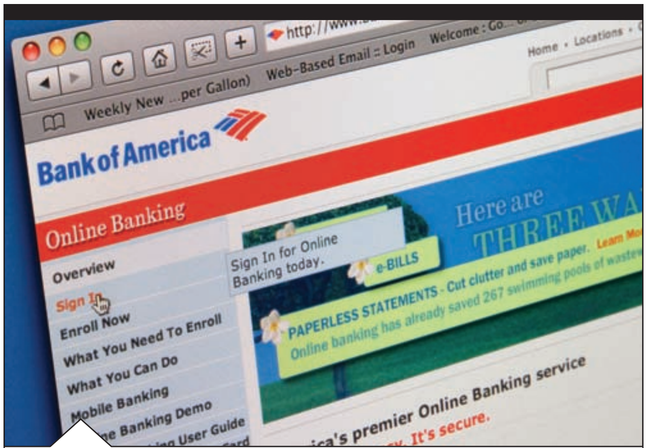
Wells Fargo has found that its average mobile-banking customer sends 19 text messages per month to handle banking transactions. "There's a whole group of customers for whom text banking is very attractive, and there are customers whose lives don't revolve around a PC," says an official. And because no account numbers appear in these messages, personal details remain secure.

© AP Images/Wells Fargo by Court Mast

USAA Federal Savings Bank offers a slightly different twist on mobile banking. After registering their cell phone numbers, customers choose a four-digit code and download the bank's app. When they click on the app and enter the code to get into their accounts, the software automatically verifies their information before allowing access. The whole process is fast and easy, offering "much more secure access and definitely a better experience for the customer," notes a USAA executive. For extra convenience, customers can use cell phone cameras to photograph checks and make electronic deposits without visiting an ATM or a branch.

Sources: Daniel Wolfe, "For USAA, Less Is More with Security," *American Banker*, March 2, 2010, 1; Kathy Brister, "Making the Most of Mobile," *US Banker*, March 1, 2010, 17; Daniel Wolfe, "Channel Surfing," *Bank Technology News*, March 1, 2010, 1; Daniel Wolfe, "Banks' Eureka Moment on Mobile Services," *American Banker*, February 9, 2010, 1.

- The importance of customer service as a way to keep customers from switching to competitors
- Increased use of credit and debit cards and a decrease in the number of written checks
- Increased competition from nonbank competitors that provide many of the same services as banks, S&Ls, credit unions, and other financial institutions
- Continued growth in online banking



© Eric Carr/Alamy

More and more people are banking online. Because online banking is convenient, the number of people using their computers to bank online increases every year. In fact, almost any banking activity—checking your balance, reconciling your checking account, or applying for a loan—can be accomplished with the click of your computer's mouse.

Online Banking and International Banking

Online banking allows you to access your bank's computer system from home, the office, or even while you are traveling. For the customer, online banking offers a number of advantages, including the following:

- The ability to obtain current account balances
- The convenience of transferring funds from one account to another
- The ability to pay bills
- The convenience of seeing which checks have cleared
- Easy access to current interest rates
- Simplified loan application procedures

For people who bank online, the largest disadvantage is not being able to discuss financial matters with their "personal banker." To overcome this problem, many larger

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

banks are investing huge amounts on electronic customer relationship management systems that will provide the type of service and financial advice that customers used to get when they walked through the doors of their financial institution.

Online banking provides a number of advantages for the financial institution. Probably the most important advantage is the lower cost of processing large numbers of transactions. As you learned in Chapter 17, lower costs often lead to larger profits. In addition to lower costs and increased profits, financial institutions believe that online banking offers increased security because fewer people handle fewer paper documents.

Electronic Funds Transfer (EFT) Although electronic funds transfer systems have been used for years, their use will increase dramatically as we continue through the 21st century. An **electronic funds transfer (EFT) system** is a means of performing financial transactions through a computer terminal or telephone hookup. The following four EFT applications are changing how banks do business:

1. *Automatic teller machines (ATMs)*. An ATM is an electronic bank teller—a machine that provides almost any service a human teller can provide. Once the customer is properly identified, the machine dispenses cash from the customer's checking or savings account or makes a cash advance charged to a credit card. ATMs are located in bank parking lots, supermarkets, drugstores, and even gas stations. Customers have access to them at all times of the day or night. There may be a fee for each transaction.
2. *Automated clearing-houses (ACHs)*. Designed to reduce the number of paper checks, automated clearing-houses process checks, recurring bill payments, Social Security benefits, and employee salaries. For example, large companies use ACHs to transfer wages and salaries directly into their employees' bank accounts, thus eliminating the need to make out individual paychecks.
3. *Point-of-sale (POS) terminals*. A POS terminal is a computerized cash register located in a retail store and connected to a bank's computer. At the cash register, you pull your credit or debit card through a magnetic card reader. A central processing center notifies a computer at your bank that you want to make a purchase. The bank's computer immediately adds the amount to your account for a credit-card transaction. In a similar process, the bank's computer deducts the amount of the purchase from your bank account if you use a debit card. Finally, the amount of your purchase is added to the store's account. The store then is notified that the transaction is complete, and the cash register prints out your receipt.
4. *Electronic check conversion (ECC)*. Electronic check conversion is a process used to convert information from a paper check into an electronic payment for merchandise, services, or bills. When you give your completed check to a store cashier, the check is processed through an electronic system that captures your banking information and the dollar amount of the check. Once the check is processed, you are asked to sign a receipt, and you get a voided (canceled) check back for your records. Finally, the funds to pay for your transaction are transferred into the business firm's account. ECC also can be used for checks you mail to pay for a purchase or to pay on an account.

electronic funds transfer (EFT) system a means of performing financial transactions through a computer terminal or telephone hookup

Looks like a typical Citibank branch. Take another look. This branch is located in Chongqing, China. This branch—along with other Citibank locations in China—offers full-service banking for both individuals and businesses. Experts predict that Citibank, along with its major competitors, will continue to open branches in China and other countries around the globe.

© Imaginechina via AP Images

Bankers and business owners generally are pleased with online banking and EFT systems. Both online banking and EFT are fast, and they eliminate the costly processing of checks. However, many customers are reluctant to use online banking or EFT systems. Some simply do not like "the technology," whereas others fear that the computer will garble their accounts. Early on, in 1978,

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Congress responded to such fears by passing the Electronic Funds Transfer Act, which protects the customer in case the bank makes an error or the customer's account information is stolen.

International Banking Services For international businesses, banking services are extremely important. Depending on the needs of an international firm, a bank can help by providing a letter of credit or a banker's acceptance.

A **letter of credit** is a legal document issued by a bank or other financial institution guaranteeing to pay a seller a stated amount for a specified period of time—usually 30 to 60 days. (With a letter of credit, certain conditions, such as delivery of the merchandise, may be specified before payment is made.)

A **banker's acceptance** is a written order for a bank to pay a third party a stated amount of money on a specific date. (With a banker's acceptance, no conditions are specified. It is simply an order to pay guaranteed by a bank without any strings attached.)

Both a letter of credit and a banker's acceptance are popular methods of paying for import and export transactions. For example, imagine that you are a business owner in the United States who wants to purchase some leather products from a small business in Florence, Italy. You offer to pay for the merchandise with your company's check drawn on an American bank, but the Italian business owner is worried about payment. To solve the problem, your bank can issue either a letter of credit or a banker's acceptance to guarantee that payment will be made. In addition to a letter of credit and a banker's acceptance, banks also can use EFT technology to speed international banking transactions.

One other international banking service should be noted. Banks and other financial institutions provide for currency exchange. If you place an order for merchandise valued at $50,000 from a company in Japan, how do you pay for the order? Do you use U.S. dollars or Japanese yen? To solve this problem, you can use a bank's currency-exchange service. To make payment, you can use either currency. If necessary, the bank will exchange one currency for the other to complete your transaction.

letter of credit a legal document issued by a bank or other financial institution guaranteeing to pay a seller a stated amount for a specified period of time

banker's acceptance a written order for a bank to pay a third party a stated amount of money on a specific date

6

Explain how deposit insurance protects customers.

The FDIC and NCUA

During the Great Depression, which began in 1929, a number of banks failed, and their depositors lost all their savings. To make sure that such a disaster did not happen again and to restore public confidence in the banking industry, Congress enacted legislation that created the *Federal Deposit Insurance Corporation (FDIC)* in 1933. The primary purpose of the FDIC is to insure deposits against bank failures.

Today, the FDIC provides basic deposit insurance of $250,000 per depositor. Because of a recent change in government policy, the $250,000 limit is now permanent.[17] Deposits maintained in different categories of legal ownership are insured separately. Thus, you can have increased coverage for different categories of ownership in a single institution. The most common categories of ownership are single (or individual) ownership and joint ownership. A depositor also may obtain additional coverage by opening separate accounts in different financial institutions. To determine if your deposits are insured or if your bank or financial institution is insured, visit the FDIC Web site at http://www.fdic.gov.

To obtain coverage, banks and S&Ls must pay insurance premiums to the FDIC. In a similar manner,

Ever wonder how safe your money is when you make deposits at a bank? It's easy to find out if your bank has FDIC insurance coverage. Just go to the FDIC Web site (http://www.fdic.gov) and take a look. While you're there, explore the Web site. There are many topics that explain more about insured deposits and what the FDIC is doing to regulate and improve banking in the United States.

Courtesy of the Federal Deposit Insurance Corporation (www.fdic.gov)

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

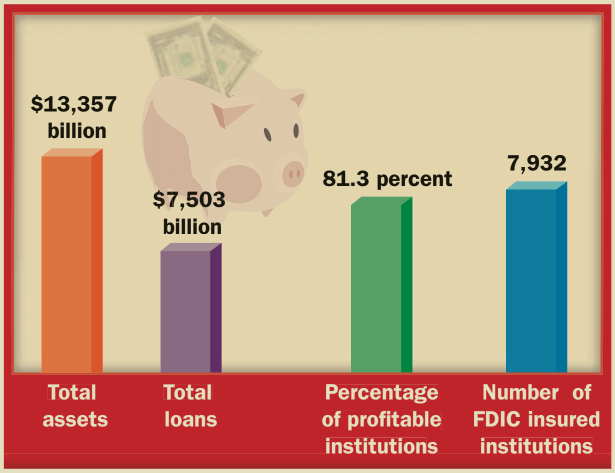
the National Credit Union Association (NCUA) insures deposits in member credit unions for up to $250,000 per depositor. Like FDIC coverage, increased coverage is provided for accounts with different categories of ownership.

The FDIC and NCUA have improved banking in the United States. When either of these organizations insures a financial institution's deposits, they reserve the right to examine that institution's operations periodically. If a bank, S&L, savings bank, or credit union is found to be poorly managed, it is reported to the proper banking authority.

Lending to individuals and firms is a vital function of banks. Making wise decisions regarding to whom it will extend credit is one of the most important activities of any financial institution or business. The material in the next section explains the different factors used to evaluate credit applicants.

SPOTLIGHT

Because of deposit insurance, you do not have to worry about losing money—you are protected up to $250,000 in an FDIC-insured bank or savings institution. Statistics are for insured institutions as of March 31, 2010.



Source: The Federal Deposit Insurance Corporation Web site at http://www.fdic.gov (accessed June 21, 2010).

Effective Credit Management

7

Discuss the importance of credit and credit management.

credit immediate purchasing power that is exchanged for a promise to repay borrowed money, with or without interest, at a later date

Credit is immediate purchasing power that is exchanged for a promise to repay borrowed money, with or without interest, at a later date. A credit transaction is a two-sided business activity that involves both a borrower and a lender. The borrower is most often a person or business that wishes to make a purchase. The lender may be a bank, some other lending institution, or a business firm selling merchandise or services on credit.

For example, suppose that you obtain a bank loan to buy a $150,000 home. You, as the borrower, obtain immediate purchasing power. In return, you agree to certain terms imposed by the bank, S&L, or home mortgage company. The lender requires that you make a down payment, make monthly payments, pay interest, and purchase insurance to protect your home until the loan is paid in full.

Banks and other financial institutions lend money because they are in business for that purpose. The interest they charge is what provides their profit. Other businesses extend credit to their customers for at least three reasons. First, some customers simply cannot afford to pay the entire amount of their purchase immediately, but they *can* repay credit in a number of smaller payments stretched out over some period of time. Second, some firms are forced to sell goods or services on credit to compete effectively when other firms offer credit to their customers. Finally, firms can realize a profit from interest charges that a borrower pays on some credit arrangements.

Too much of a good thing! Personal finance experts recommend that you have one or two credit cards and that you use them only for emergencies. Unfortunately, many Americans spend more than they make on a regular basis by paying with "plastics."

© iStockphoto.com/zentilia

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Ethical Challenges & SUCCESSFUL SOLUTIONS

Banks as Eco-Cops?

Should banks consider environmental and societal issues as well as credit-worthiness when loaning money to customers? If they adopt the Equator Principles, they do. The Equator Principles are voluntary standards that require banks to determine whether borrowers comply with environmentally and socially responsible policies and procedures. The idea is to avoid funding projects that carry significant ecological- or social-responsibility risk.

For example, London-based Standard Chartered Bank applies the Equator Principles to its commercial lending decisions. "Our financing decisions—who and what we finance—enable us to make our strongest contribution to sustainable development," says an executive. The bank will not approve loans for logging in ecologically sensitive forests, for example. Instead, it works with borrowers to ensure that projects meet independent environmental criteria before extending credit. In Argentina, Banco Galicia was guided by the Equator Principles when it made a $10 million loan to build an eco-resort in a nature preserve. The bank required the borrower to follow strict, internationally recognized standards for protecting both land and wildlife before providing funding.

In the United States, the multinational banking giants Citigroup, Bank of America, and JP Morgan Chase are three of many financial institutions that abide by the Equator Principles. Citigroup alone has loaned more than $100 billion for projects that meet with these standards. But should banks serve as eco-cops for projects they might finance anywhere in the world?

Sources: Yap Leng Kuen, "Banks' Role in Fostering Sustainable Practices," *The Star Online* (Malaysia), March 10, 2010, http://biz.thestar.com.my/news/story.asp?file=/2010/3/10/business/5826682&sec=business; Keren Fallwell, "Banking on the Environment," *TTJ The Timber Industry Magazine,* December 26, 2009, 26; Jane Monahan, "LatAm Banks Take CSR Plunge," *The Banker,* July 1, 2009, n.p.; http://www.equator-principles.com.

Getting Money from a Bank or Lender After a Credit Crisis

Many individuals and business owners are nervous when applying for a loan. They are not sure what information they need. They are also concerned about what happens if they are turned down. Let's begin with the basics. While lenders need interest from loans to help pay their business expenses and earn a profit, they also want to make sure that the loans they make will be repaid. Your job is to convince the lender that you are able and willing to repay the loan. That job is more difficult than it has ever been because of the recent economic crisis in the banking and financial industry. Today, bankers, lenders and suppliers, and credit-card companies are much more careful when evaluating credit applications. The reasons are simple: Many lenders already have a large number of "bad" or nonperforming loans and they want to make sure all borrowers are qualified and will be able to repay borrowed money.

For individuals, the following suggestions may be helpful when applying for a loan:

- Obtain a loan application and complete it at home. At home, you have the information needed to answer *all* the questions on the loan application.
- Be prepared to describe how you will use the money and how the loan will be repaid.
- For most loans, an interview with a loan officer is required. Here again, preparation is the key. Think about how you would respond to questions a loan officer might ask.
- If your loan request is rejected, try to analyze what went wrong. Ask the loan officer why you were rejected. If the rejection is based on incorrect information, supply the correct information and reapply.

Business owners in need of financing may find the following additional tips helpful:

- It is usually best to develop a relationship with your banker before you need financing. Help the banker understand what your business is and how you

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

may need future financing for expansion, cash-flow problems, or unexpected emergencies.
- Apply for a pre-approved line of credit or revolving credit agreement even if you do not need the money. View the application as another way to showcase your company and its products or services.
- In addition to the application, supply certified public accountant (CPA)-prepared financial statements and business tax returns for the last three years. If your business is small, you may want to supply your own personal financial statements and tax returns for the same period.
- Update your business plan in case the lender wants to review your plan. Be sure the sales estimates and other projections are realistic.
- Write a cover letter describing how much experience you have, whether you are operating in an expanding market, or any other information that would help convince the banker to provide financing.

From the lender's viewpoint, the major pitfall in granting credit is the possibility of nonpayment. However, if a lender follows the five C's of credit management, it can minimize this possibility.

The Five C's of Credit Management

When a business extends credit to its customers, it must face the fact that some customers will be unable or unwilling to pay for their credit purchases. With this in mind, lenders must establish policies for determining who will receive credit and who will not. Most lenders build their credit policies around the five C's of credit.

Character *Character* means the borrower's attitude toward credit obligations. Experienced lenders often see this as the most important factor in predicting whether a borrower will make regular payments and ultimately repay a credit obligation. Typical questions to consider in judging a borrower's character include the following:

1. Is the borrower prompt in paying bills?
2. Have other lenders had to send the borrower overdue notices before receiving payment?
3. Have lenders been forced to take the borrower to court to obtain payment?
4. Has the customer ever filed for bankruptcy? If so, did the customer make an attempt to repay debts voluntarily?

Although it is illegal to discriminate, personal factors such as drinking or gambling habits or other information may affect a lender's decision to loan money or extend credit to an individual or a business owner.

Capacity *Capacity* means the borrower's financial ability to meet credit obligations—that is, to make regular loan payments as scheduled in the credit or loan agreement. If the customer is a business, the lender looks at the firm's income statement. For individuals, the lender checks salary statements and other sources of income, such as dividends and interest. The borrower's other financial obligations and monthly expenses are also taken into consideration before credit is approved.

Capital The term *capital* as used here refers to the borrower's assets or net worth. In general, the greater the capital, the greater is the borrower's ability to repay a loan. The capital position of a business can be determined by examining its balance sheet. For individuals, information on net worth can be obtained by requiring that the borrower complete a credit application such as the one illustrated in Figure 18.5. The borrower also must authorize employers and financial institutions to release information to confirm the claims made in the credit application.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 18.5 Credit Application Form

Lenders use the information on credit application forms to help determine which customers should be granted credit.

Apply today! Just complete this application or call 1-800-438-9222.

Citizens Bank Customer Credit Card Application

Branch # ___________

This offer is for existing Citizens Bank Customers applying for a new credit card account

Existing Citizens Bank cardholders should call 1-800-438-9222 for special cardholder rate information.

Citizens Bank VISA® (Code: BVCFNU)

Please tell us about yourself

First Name | Middle Initial | Last Name

Address (street)

(City, state, zip)

Date of Birth | Social Security Number

Years/Months at Present Address | ❑ Own ❑ Rent ❑ Live with Parents

$ Monthly Housing Payment | ( ) Home Telephone

Previous Address *(if less than 2 years at present address)* | Years/Months There

Mother's Maiden Name

Citizens Bank Account Information

❑ Checking ❑ Savings ❑ Loan ❑ Citizens Circle℠ Checking

account # ______________________________

Please tell us about your employment

Present Employer | Position

Years/Months Employed There | ( ) Business Telephone

Previous Employer *(if less than 2 years at present employer)* | Years/Months There

$ Gross Monthly Household Income | $ Other Monthly Income*

*Alimony, child support, or separate maintenance income need not be revealed if you do not wish it to be considered as a basis for repaying this obligation.

24-hour banking convenience

Your card(s) can be encoded with a four-digit personal identification number (PIN) to obtain cash advances at automated teller machines. This four-digit PIN will be known only to you. So that we may properly encode your card(s), please select the four digits of your choice and enter them in the spaces below:

___ ___ ___ ___

Please send a second card at no cost for

First Name | Middle Initial | Last Name

Please read and sign

Your Signature | Date

All information on this application is true and complete, and Citizens Bank of Rhode Island, the card issuer, is authorized to obtain further credit and employment information from any source. I understand that you will retain this application whether or not it is approved. You may share with others, only for valid business reasons, any information relating to me, this application, and any of my banking relationships with you. I request issuance of a Citizens credit card and agree to be bound by the terms and conditions of the Agreement received with the card(s). I understand that Citizens Bank of Rhode Island will assign a credit line based on information provided and information obtained from any other source; and the issuance of a Gold card is subject to a minimum annual income of $35,000 and qualification for a minimum $5,000 credit line.

Transfer balances and save

Citizens will transfer your high interest rate balances to your new Citizens Bank VISA Card at no extra charge. Use the form below to indicate the amount(s) to be transferred in order of priority. (Citizens Bank will not transfer balances from existing Citizens Bank accounts.) (see reverse side for balance transfer disclosure)

Creditor Name	Account Number	$ Amount
Creditor Name	Account Number	$ Amount
Creditor Name	Account Number	$ Amount

Bank Use Only Bank Code: ❑ CBMA ❑ CBRI ❑ CBCT Sales ID# ______________ Application code: 1122

Source: Courtesy of Citizens Financial Group, Inc., Providence, Rhode Island.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Collateral For large amounts of credit—and especially for long-term loans—the lender may require some type of collateral. As mentioned earlier, collateral is real estate or property (stocks, bonds, equipment, or any other asset of value) pledged as security for a loan. If the borrower fails to live up to the terms of the credit agreement, the lender can repossess the collateral and then sell it to satisfy the debt.

Conditions *Conditions* refers to the general economic conditions that can affect a borrower's ability to repay a loan or other credit obligation. How well a business firm can withstand an economic storm may depend on the particular industry the firm is in, its relative strength within that industry, the type of product or service it sells, its earnings history, and its earnings potential. For individuals, the basic question focuses on security—of both the applicant's job and the firm for which he or she works. For example, if the economy takes a downturn, some employees may lose their jobs. Even though these former employees lost their jobs, they still have mortgage payments, car payments, and credit-card payments that must be paid.

Checking Credit Information

The five C's of credit are concerned mainly with information supplied by the applicant. But how can a lender determine whether this information is accurate? This depends on whether the potential borrower is a business or an individual consumer.

Credit information concerning businesses can be obtained from the following four sources:

- *Global credit-reporting agencies*. D&B (formerly Dun & Bradstreet) is the most widely used credit-reporting agency in the world. Their reports present detailed credit information about specific companies. For more information on D&B services, visit the company's Web site at http://www.dnb.com.
- *Local credit-reporting agencies*. These agencies may require a monthly or yearly fee for providing information on a continual basis.
- *Industry associations*. These associations may charge a service fee.
- *Other firms*. This refers to other firms that have given the applicant credit.

Various credit bureaus provide credit information concerning individuals. The following are the three major consumer credit bureaus:

- Experian—at http://www.experian.com or toll-free at 888-397-3742
- TransUnion—at http://www.transunion.com or toll-free at 800-888-4213
- Equifax Credit Information Services—at http://www.equifax.com or toll-free at 800-685-1111

*Note:*With the recent rise in identity theft, experts recommend that you check your credit report at least once a year or more often if you suspect suspicious activity. For more information about protecting your identity, complete the Journaling for Success exercise on page 563.

Consumer credit bureaus are subject to the provisions of the Fair Credit Reporting Act. This act safeguards consumers' rights in two ways. First, every consumer has the right to know what information is contained in his or her credit bureau file. In addition to the provisions contained in the federal Fair Credit Reporting Act, the Fair and Accurate Credit Transaction Act requires each of the nationwide credit reporting companies—Equifax, Experian, and TransUnion—to provide you with a free copy of your credit report, at your request, once every 12 months. To obtain your free credit report, go to http://www.annualcreditreport.com. (*Note*: Beware of other sites that may look and sound similar to this site but may charge for information or require that you spend money on credit monitoring.[18]) In other situations, the consumer may obtain the information for a fee that is usually about $8 to $15 per request. It is also possible to obtain credit reports on a monthly or quarterly basis by subscribing to a credit-reporting service, which usually charges higher fees.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Second, a consumer who feels that some information in the file is inaccurate, misleading, or vague has the right to request that the credit bureau verify it. If the disputed information is found to be correct, the consumer can provide a brief explanation, giving his or her side of the dispute. This explanation must become part of the consumer's credit file. If the disputed information is found to be inaccurate, it must be deleted or corrected. Furthermore, you may request that any lender or prospective employer that has been supplied an inaccurate credit report in the last six months be sent a corrected credit report.

New Protection for Consumers: The Credit Card Act of 2009

The Credit Card Act of 2009, which was enacted on February 22, 2010, also provides additional protection for credit card customers. This new federal law is designed to level the playing field between credit card customers and financial institutions that issue credit cards. This act[19]

- Encourages disclosures written in plain language that include more information about due dates, late fees, and the amount of time required to pay off card balances if only minimum monthly payments are made
- Provides new protections against arbitrary rate increases and requires a 45-day notice before existing rates are changed
- Increases protections for students and young people under the age of 21
- Standardizes billing dates and eliminates some common deceptive practices including due dates that change each month, weekend due dates, and payment deadlines that fall in the middle of the day
- Requires that all fees be necessary, reasonable, and proportional in relation to a violation of the cardholder's credit agreement
- Provides new measures for accountability including posting credit card contract information on the Internet and review of contract agreements by the Federal Reserve Board
- Increases existing penalties for companies that violate the Truth-in-Lending Act for credit card customers

If you want more information about provisions in the Credit Card Act of 2009, contact the financial institution that issued your credit card, the Federal Reserve Board (http://www.federalreserve.gov), or use the Internet.

Sound Collection Procedures

The vast majority of borrowers follow the lender's repayment terms exactly. However, some accounts inevitably become overdue for a variety of reasons. Experience shows that such accounts should receive immediate attention.

Some firms handle their own delinquent accounts; others prefer to use a professional collection agency. (Charges for a collection agency's services are usually high—up to half the amount collected.) Both tend to use the following techniques, generally in the order in which they are listed:

1. Subtle reminders, such as duplicate statements marked "Past Due"
2. Telephone calls to urge prompt payment
3. Personal visits to business customers to stress the necessity of paying overdue amounts immediately
4. Legal action, although the time, expense, and uncertain outcome of a lawsuit make this action a last resort

Good collection procedures should be firm, but they also should allow for compromise. Harassment is both illegal and bad business. Ideally, the customer will be convinced to make up missed payments, and the firm will retain the customer's goodwill.

In the next chapter, you will see why firms need financing, how they obtain the money they need, and how they ensure that funds are used efficiently, in keeping with their organizational objectives.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

return to inside business

TD Bank

Although the banking industry has been hard hit by problems with risky loans, TD Bank has grown and prospered through careful credit management, innovative services, and close attention to its customers' needs. At least five times a month, every store is visited by mystery shoppers who report back to headquarters about their customer service experiences. The bank also surveys more than 140,000 customers every year to find out what they think of its services.

TD Bank aims to be not only "America's most convenient bank" but also an outstanding corporate citizen. Its philanthropic contributions support financial literacy efforts, affordable housing initiatives, and non-profit groups that provide shelter and meals to people in need. And it's going green by investing in renewable energy, reducing its carbon footprint, stepping up recycling, and building new stores with solar panels and fixtures made of wood from sustainable sources. Investing in its communities is another way that TD Bank shows customers it cares about what they care about.

Questions

1. Why would TD Bank's customers care whether the bank was involved in risky lending practices?
2. Would you like to work for a commercial bank like TD Bank, which serves consumers, small businesses, and major corporations? Explain your answer.

SUMMARY

Summary

CHAPTER REVIEW

1 Identify the functions and characteristics of money.

Money is anything a society uses to purchase products, services, or resources. Money must serve as a medium of exchange, a measure of value, and a store of value. To perform its functions effectively, money must be divisible into units of convenient size, light and sturdy enough to be carried and used on a daily basis, stable in value, and difficult to counterfeit. The M_1 supply of money is made up of coins and bills (currency) and deposits in checking accounts (demand deposits). The M_2 supply includes M_1 plus savings accounts, certain money-market securities, and small-denomination time deposits.

2 Summarize how the Federal Reserve System regulates the money supply to maintain a healthy economy.

The Federal Reserve System is responsible for regulating the U.S. banking industry and maintaining a sound economic environment. Banks with federal charters (national banks) must be members of the Fed. State banks may join if they choose to and if they can meet the requirements for membership. Twelve district banks and 24 branch banks compose the Federal Reserve System, whose seven-member board of governors is headquartered in Washington, DC. During the recent economic crisis, it was necessary for the Federal Reserve to take specific actions to avoid the worst economic problems since the Great Depression. Specifically, the Fed provided liquidity to the banking and financial industry, supported troubled financial markets, supported troubled financial institutions, and conducted stress tests of major banks. These actions did help to restore confidence in the financial system.

To control the supply of money, the Federal Reserve System regulates the reserve requirement, or the percentage of deposits a bank must keep on hand. It also regulates the discount rate, or the interest rate the Fed charges member banks for loans from the Federal Reserve. It also engages in open-market operations, in which it buys and sells government securities. Of the three tools used to influence monetary policy, the use of open-market operations is the most important. When the Federal Reserve buys and sells securities, the goal is to increase or decrease the federal funds rate. The federal funds rate is the interest rate at which a bank lends immediately available funds on deposit at the Fed to another bank overnight in order to meet the borrowing bank's reserve requirements. The Fed serves as the government's bank and is also responsible for clearing checks and electronic transfers, inspecting currency, enforcing the Truth-in-Lending Act, and setting margin requirements for securities transactions.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3 Describe the organizations involved in the banking industry.

Most everyone has been affected in one way or another by the nation's economic problems. Now that the nation's economy shows signs of improvement, there is a movement in Washington to reform the banking and financial industry and increase government regulation. A commercial bank is a profit-making organization that accepts deposits, makes loans, and provides related services to customers. Commercial banks are chartered by the federal government or state governments. Savings and loan associations and credit unions offer the same basic services that commercial banks provide. Mutual savings banks, insurance companies, pension funds, brokerage firms, finance companies, and investment banking firms provide some limited banking services. A large number of people work in the banking industry because of the number of banks and other financial institutions. To be successful in the banking industry, you must be honest, be able to interact with people, have a strong background in accounting, appreciate the relationship between banking and finance, and possess basic computer skills.

4 Identify the services provided by financial institutions.

Banks and other financial institutions offer today's customers a tempting array of services. Among the most important and attractive banking services for both individuals and businesses are checking accounts, savings accounts, short- and long-term loans, and credit-card and debit-card transactions. Other traditional services include financial advice, payroll services, certified checks, trust services, and safe-deposit boxes.

5 Understand how financial institutions are changing to meet the needs of domestic and international customers.

Competition among banks, brokerage firms, insurance companies, and other financial institutions has increased. As we enter the 21st century, an increasing use of technology and the need for bankers to help American businesses compete in the global marketplace will change the way banks and other financial institutions do business. The use of technology will increase as financial institutions continue to offer online banking. Increased use of electronic funds transfer systems (automated teller machines, automated clearing-houses, point-of-sale terminals, and electronic check conversion) also will change the way people bank. For firms in the global marketplace, a bank can provide letters of credit and banker's acceptances that will reduce the risk of nonpayment for sellers. Banks and financial institutions also can provide currency exchange to reduce payment problems for import or export transactions.

6 Explain how deposit insurance protects customers.

The Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Association (NCUA) insure accounts in member financial institutions for up $250,000. The $250,000 limit is now a permanent change in the amount of deposit insurance. Deposits maintained in different categories of legal ownership are insured separately. The most common ownership categories are single ownership and joint ownership. It is also possible to obtain additional coverage by opening separate accounts in different banks, S&Ls, or credit unions. The FDIC and NCUA have improved banking in the United States. When either of these organizations insures a financial institution's deposits, they reserve the right to examine that institution's operations periodically. If a bank, S&L, or credit union is found to be poorly managed, it is reported to the proper banking authority.

7 Discuss the importance of credit and credit management.

Credit is immediate purchasing power that is exchanged for a promise to repay borrowed money, with or without interest, at a later date. Banks lend money because they are in business for that purpose. Businesses sell goods and services on credit because some customers cannot afford to pay cash and because they must keep pace with competitors who offer credit. Businesses also may realize a profit from interest charges.

Decisions on whether to grant credit to businesses and individuals usually are based on the five C's of credit: character, capacity, capital, collateral, and conditions. Credit information can be obtained from various credit-reporting agencies, credit bureaus, industry associations, and other firms. The techniques used to collect past-due accounts should be firm enough to prompt payment but flexible enough to maintain the borrower's goodwill. A number of federal regulations protect consumers from harassment and illegal collection procedures.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

barter system (534)
money (534)
medium of exchange (535)
measure of value (535)
store of value (535)
demand deposit (537)
time deposit (537)
Federal Reserve System (538)
commercial paper (539)
reserve requirement (540)
discount rate (541)
open-market operations (541)
federal funds rate (542)
commercial bank (544)
national bank (544)
state bank (544)
savings and loan association (S&L) (545)
credit union (545)
check (547)
NOW account (547)
certificate of deposit (CD) (548)
line of credit (548)
revolving credit agreement (548)
collateral (548)
debit card (549)
electronic funds transfer (EFT) system (551)
letter of credit (552)
banker's acceptance (552)
credit (553)

Review Questions

1. How does the use of money solve the problems associated with a barter system of exchange?
2. What are three functions money must perform in a sound monetary system?
3. Explain why money must have each of the following characteristics:
   a. Divisibility
   b. Portability
   c. Stability
   d. Durability
   e. Difficulty of counterfeiting
4. What is included in the definition of the M_1 supply of money? Of the M_2 supply?
5. What is the Federal Reserve System? How is it organized?
6. Describe the actions the Federal Reserve took to maintain a healthy economy during the recent economic crisis. In your opinion, were the actions necessary? Were the Fed's actions effective?
7. Explain how the Federal Reserve System uses each of the following to control the money supply:
   a. Reserve requirements
   b. The discount rate
   c. Open-market operations
8. The Federal Reserve is responsible for enforcing the Truth-in-Lending Act. How does this act affect you?
9. What is the difference between a national bank and a state bank? What other financial institutions compete with national and state banks?
10. Describe the major banking services provided by financial institutions today.
11. For consumers, what are the major advantages of online banking? What is its major disadvantage?
12. How do automated teller machines, automated clearinghouses, point-of-sale terminals, and electronic check conversion affect how you bank?
13. How can a bank or other financial institution help American businesses to compete in the global marketplace?
14. What is the basic function of the FDIC and NCUA? How do they perform this function?
15. List and explain the five C's of credit management.
16. How would you check the information provided by an applicant for credit at a department store? By a business applicant at a heavy-equipment manufacturer's sales office?

Discussion Questions

1. Based on what you know at the time you are answering this question, how would you describe the financial health of the U.S. economy? Of the global economy?
2. It is said that financial institutions use a process called deposit expansion to "create" money when they make loans to firms and individuals. Explain what this means.
3. Why does the Fed use indirect means of controlling the money supply instead of simply printing more money or removing money from circulation when necessary?
4. Why would banks pay higher interest on money left on deposit for longer periods of time (e.g., on CDs)?
5. How could an individual get in financial trouble by using a credit card? If you were in trouble because of credit-card debt, what steps could you take to reduce your debts?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

6. Lenders generally are reluctant to extend credit to individuals with no previous credit history (and no outstanding debts). Yet they willingly extend credit to individuals who are in the process of repaying debts. Is this reasonable? Is it fair? Explain your answer.
7. Assume that you want to borrow $10,000. What can you do to convince the loan officer that you are a good credit risk?

Video Case 18.1

Chase Bank Helps Small Business Owners

J.P. Morgan Chase & Co. is a global financial holding company formed in 2000 by a merger of the financial institutions that today are its two major brands: Chase (formerly Chase Manhattan Corp.) and J.P. Morgan. In 2004, the company also acquired Bank One Corp.; later, in 2008, it added both Bear Stearns Companies, Inc., and Washington Mutual, in the process creating the second-largest branch network in the United States and bringing its banking services within the reach of 42 percent of the U.S. population. The bank, which operates in more than 60 countries and employs more than 200,000 people worldwide, holds assets estimated to be worth about $2 trillion and is included in the widely watched stock index, the Dow Jones Industrial Average (DJIA). Despite an economic downturn, the bank recently posted better than anticipated profits for two quarters in a row.

Most people are probably more familiar with the functions performed on the Chase side of the operation. These operations include conducting everyday banking via branch offices, ATMs, telephone, and online; issuing consumer credit cards; serving small businesses with financing and banking services; offering home mortgages and home equity loans; helping customers with personal retirement and investment planning; and making auto and educational loans.

In its small-business banking operations, Chase exemplifies the words of J.P. Morgan, who told a Senate subcommittee in 1933 that "Another very important use of the banker is to serve as a channel whereby industry may be provided with capital to meet its needs for expansion and development." Providing capital to small businesses is one of the most important functions the bank fulfills for these business clients. Whether small companies need short-term loans to expand their operations or to bridge the time gap between manufacturing a product and collecting money for the sale, a line of credit to ease their cash flow during a tough period, or a commercial mortgage loan to buy a new factory or warehouse, Chase is ready to lend the necessary funds. The bank also offers several kinds of business credit cards, which small-business owners can use for everyday needs when cash is tight. These cards offer different incentives such as no annual fee, cash back for purchases, bonus points, or no interest on balances paid in full each month. Business debit cards are another option, backed by fraud monitoring and account alerts.

Chase is also there to help firms hang on to their money—not only by providing all those branch offices for making deposits but also by handling the safe collection of payments through its lock-box service (through which consumers send bill payments to a post-office box for collection). Chase makes it easier for its small-business customers to deposit checks, too. Now firms can scan paper checks right in their own offices, transforming them into electronic payments so they can take advantage of online banking's convenience, safety, and speed. Business checking accounts are available as well, with a wide range of specially tailored features and overdraft protection. Business savings accounts and CDs are offered, and business customers can link their accounts to Chase Business Packages to earn additional benefits, such as waived fees and reduced interest rates on borrowing. The bank even offers payroll processing.

Retail firms that accept credit cards like Visa, American Express, MasterCard, and Discover can rely on Chase for payment processing, and they can use the processed funds the very next day. Free technical support is available 24/7, and monthly statements and online reports help firms manage their credit card operations. Business owners can even pay bills, transfer funds, view account balances and transaction history, and send wire transfers by texting the bank from their mobile phones. Additionally, Chase makes it possible for small businesses to conduct transactions globally, whether that means buying goods abroad or accepting orders from international customers.[20]

Questions

1. If you were a small-business owner, would you take advantage of any of Chase's or another bank's small-business banking services? Why or why not?
2. Can you think of any additional financial or banking services that banks could offer small-business owners?
3. Chase prides itself on its ability to know many of its business customers personally and to keep up-to-date on the industries in which they operate. Why would this familiarity be an advantage for the bank?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Case 18.2

Are You Credit Savvy?

Never mind the national budget deficit: U.S. consumers are $2.5 trillion deep in consumer debt. Students are increasingly part of this credit tsunami. A little credit can be a good thing, but too much credit can be hazardous to your long-term financial health, especially when you're just starting on your career.

Studies show that more than 80 percent of all undergraduates carry a credit card; half of all undergrads have four or more credit cards. In addition the average credit-card debt of a new graduate is $4,100. "Students are using credit cards as a last resort to pick up the slack when they have difficulty getting loans or jobs to cover their expenses," explains a consumer finance analyst. "With fewer loans and jobs available, you have the makings of an increase in college student credit card debt on top of existing student loan debt." No wonder so many students feel overwhelmed as they try to keep up with credit repayments.

Of course, credit can come in handy when you need or want to make a large purchase but haven't got the cash. Payday may be a week away but that super-sale ends today or your gas tank is empty—so you plunk down your plastic. When the credit-card statement arrives, however, you have to pay in full or the interest-rate meter starts ticking. Suppose you only pay the minimum amount, planning to pay more next time. But if you don't pay more than the minimum month after month, the interest charges can mount up quickly. What happens if you have other debts or you suddenly lose your job?

That's what happened to Diane McLeod. She worked two jobs to pay two mortgages with escalating interest rates, a car loan, and high-interest credit cards. After the twin disasters of medical emergencies and lost employment, her home is being foreclosed and her credit rating is destroyed. McLeod admits creating some of her own problems by overspending and failing to read the fine print in credit agreements. But interest payments on her debts equal almost half her pretax income, and she owes thousands of dollars in fees alone.

How can you protect yourself from getting too deeply in debt? First, don't apply for or carry cards you don't need. Next, check your attitude about money. According to the National Association of Retail Collection Attorneys, more than 25 percent of students think it's okay to use cards to raise cash and are overoptimistic about paying back debt. Don't be fooled. With fees and interest rates, your outstanding balance can rise even if you stop using your card. A good rule of thumb is not to charge purchases unless you already have cash on hand to pay for them. Know what you can afford by creating a personal balance sheet and personal income statement—both topics covered in Chapter 17. Finally, use cash. It carries no interest charges or hidden fees, and any "rewards" you might earn with credit card purchases will be far from free when the bills come due.

If you want to apply for credit, shop around and know your rights. For example, under the Credit Card Act of 2009, interest rates can't be raised on a new credit account until after the first year. Be sure to check your credit report before you apply, so you'll know how credit-worthy you'll look to a lender.

If you must use a card, always pay on time, pay as much as you can, and certainly pay more than the minimum to avoid letting your balance climb. Consider substituting a debit card for a credit card to avoid debt. Don't take cash advances on your card (why pay 19 percent or even higher interest for money?), and avoid making impulse purchases. In the end, your credit health is up to you.[21]

Questions

1. If you have one or more credit cards, check your credit history for free at http://www.annualcreditreport.com. What does your history tell you about your spending and borrowing habits? What, if anything, do you need to change? Why should you check your credit reports on a regular basis?
2. What do you think is the real cost of "free" rewards offered on many credit cards? Who pays it? Do you think these rewards are worth the cost? Why or why not?
3. Imagine you've applied to a bank for a home mortgage, car loan, or tuition loan (or perhaps you already have such a loan or loans). Now put yourself in the bank's place. How do *you* rate on the five C's of credit management? Which of these criteria is most affected by your credit-card history?

Building Skills for Career Success

1 JOURNALING FOR SUCCESS

You could be one in a million—the 1 million Americans who fall victim to the crime of identity theft every year. Crooks who steal your name, birth date, credit-card numbers, bank account numbers, and Social Security number can withdraw money from your bank accounts, charge merchandise in your name, or contract for cell-phone service.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Assignment

1. Use the Internet to obtain information about how to prevent identity theft. Then, according to the professionals, describe the steps someone should take to protect his or her identity.
2. Complete a "security audit" of your personal information and financial records. Based on your audit and the recommendations from professionals, what should you do now to protect your identity?
3. It always helps to have a plan in case your identity is stolen. Based on the information you obtained from your Internet research, what immediate steps should you take if your identity is stolen?

2 EXPLORING THE INTERNET

Internet-based banking is no longer a new concept. For many Americans, technology has changed the way they conduct their banking transactions. For example, most people no longer carry their paychecks to the bank to be deposited; instead, the money is deposited directly into their accounts. In addition, an increasing number of individuals and businesses are using computers and the Internet to handle their finances, apply for loans, and pay their bills. Banking with the help of a home computer is continually being made easier, giving bank customers access to their accounts 24 hours a day and seven days a week. As a result, you have more control over your money.

Assignment

1. Examine the Web sites of several major banks with which you are familiar. Describe their online banking services. Are they worthwhile in your opinion?
2. In the past three years, how has technology changed the way you handle your money and conduct your banking transactions, such as depositing your paychecks, paying your monthly bills, obtaining cash, paying for purchases, and applying for loans?
3. In the next five to ten years, what will the banking industry be like? How will these changes affect you and the way you do your banking? The Internet and the library can help you to learn what is in the forefront of banking technology.
4. Prepare a report explaining your answers to these questions.

3 DEVELOPING CRITICAL-THINKING SKILLS

Assumption: There are banks, savings and loan associations, credit unions, and other financial institutions that want your business. Therefore, it pays to shop around for the lowest interest rates for loans needed to purchase a home mortgage or an automobile. It's also easy to compare interest rates when investing in certificates of deposit (CDs) or savings accounts. A logical place to start is with the financial institution where you do your banking. You can also compare interest rates at other local banks and financial institutions located close to where you live or work. Finally, you can use the Internet and Web sites like http://www.bankrate.com or http://www.interest.com to determine interest rates for loans and CD investments.

Assignment

To answer each question below, contact at least three different financial institutions in your city or town or three different Internet Web sites. *Hint*: If you use the Internet, use a search engine like Google or Yahoo! and enter "interest rates" in the search window.

1. What is the lowest rate you found for a 30-year $150,000 home mortgage?
2. Based on your research, what is the difference between the lowest interest rate and the highest interest rate for a home mortgage? Assuming you pay back the loan in 30 years, how could the difference in interest rates affect the total amount you will pay for your home?
3. What is the highest interest rate you found for a one-year certificate of deposit?
4. Based on your research, what is the difference between the highest rate and the lowest rate for a one-year CD? How could this affect the amount of money you would earn for the 12-month period?
5. In a one- to two-page report, summarize what you have learned from this critical-thinking exercise.

4 BUILDING TEAM SKILLS

Three years ago, Ron and Ginger were happy to learn that, upon graduation, Ron would be teaching history in a large high school, making $35,000 a year, and Ginger would be working in a public accounting firm, starting at $38,000. They married immediately after graduation and bought a new home for $110,000. Since Ron had no personal savings, Ginger used her savings for the down payment. They soon began furnishing their home, charging their purchases to three separate credit cards, and that is when their debt began to mount. When the three credit cards reached their $10,000 limits, Ron and Ginger signed up for one additional credit card with a $10,000 limit. Soon their monthly payments were more than their combined take-home pay. To make their monthly payments, Ron and Ginger began to obtain cash advances on their credit cards. When they reached the credit ceilings on their four credit cards, they could no longer get the cash advances they needed to cover their monthly bills. Stress began to mount as creditors called and demanded payment. Ron and Ginger began to argue over money and just about everything else. Finally, things got so bad they considered filing for personal bankruptcy; ironically, they could not afford the legal fees. What options are available to this couple?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Assignment

1. Working in teams of three or four, use your local library, the Internet, and personal interviews to investigate the following:
   a. Filing for personal bankruptcy.
      - What is involved in filing for personal bankruptcy?
      - How much does it cost?
      - How does bankruptcy affect individuals?
   b. Review Money Management International at http://www.cccsintl.org or How to Get Out of Debt at http://www.getoutofdebt.org
      - What services do these organizations provide?
      - How could they help Ron and Ginger?
      - What will it cost?
2. Prepare a specific plan for repaying Ron and Ginger's debt.
3. Outline the advantages and disadvantages of credit cards, and make the appropriate recommendations for Ron and Ginger concerning their future use of credit cards.
4. Summarize what you have learned about credit-card misuse.

5 RESEARCHING DIFFERENT CAREERS

It has long been known that maintaining a good credit record is essential to obtaining loans from financial institutions, but did you know that employers often check credit records before offering an applicant a position? This is especially true of firms that handle financial accounts for others. Information contained in your credit report can tell an employer a lot about how responsible you are with money and how well you manage it. Individuals have the right to know what is in their credit bureau files and to have the credit bureau verify any inaccurate, misleading, or vague information. Before you apply for a job or a loan, you should check with a credit bureau to learn what is in your file.

Assignment

1. Using information in this chapter, use the Internet or call a credit bureau and ask for a copy of your credit report. A small fee may be required depending on the bureau and circumstances.
2. Review the information.
3. Have the bureau verify any information that you feel is inaccurate, misleading, or vague.
4. If the verification shows that the information is correct, prepare a brief statement explaining your side of the dispute, and send it to the bureau.
5. Prepare a statement summarizing what the credit report says about you. Based on your credit report, would a firm hire you as its financial manager?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.