FINANCE 30- MODULE 7B FINANCIAL INSTITUTIONS NAME __________

A STRATEGY FOR MANAGING CASH

LO**1** Analyze factors that affect selection and use of financial services.

With 86 banks, 61 trust and loan companies, and over 623 credit unions and caisses populaires, an extensive Canadian financial services market exists. These organizations provide a variety of services for your daily payment and savings needs. Today, a trip to "the bank" may mean visiting a credit union or an automated teller machine (ATM), or checking an account balance on the Web or phone app. In recent years, financial services have expanded. A bank is not the only source of chequing accounts. Mortgages are available from several types of financial institutions.

While some financial decisions relate directly to goals, your daily activities require using financial services for various business transactions. **Exhibit 4–1** provides an overview of financial services for managing cash flows and moving toward financial goals. In simplest terms, you can increase current savings only by spending less than you take in.

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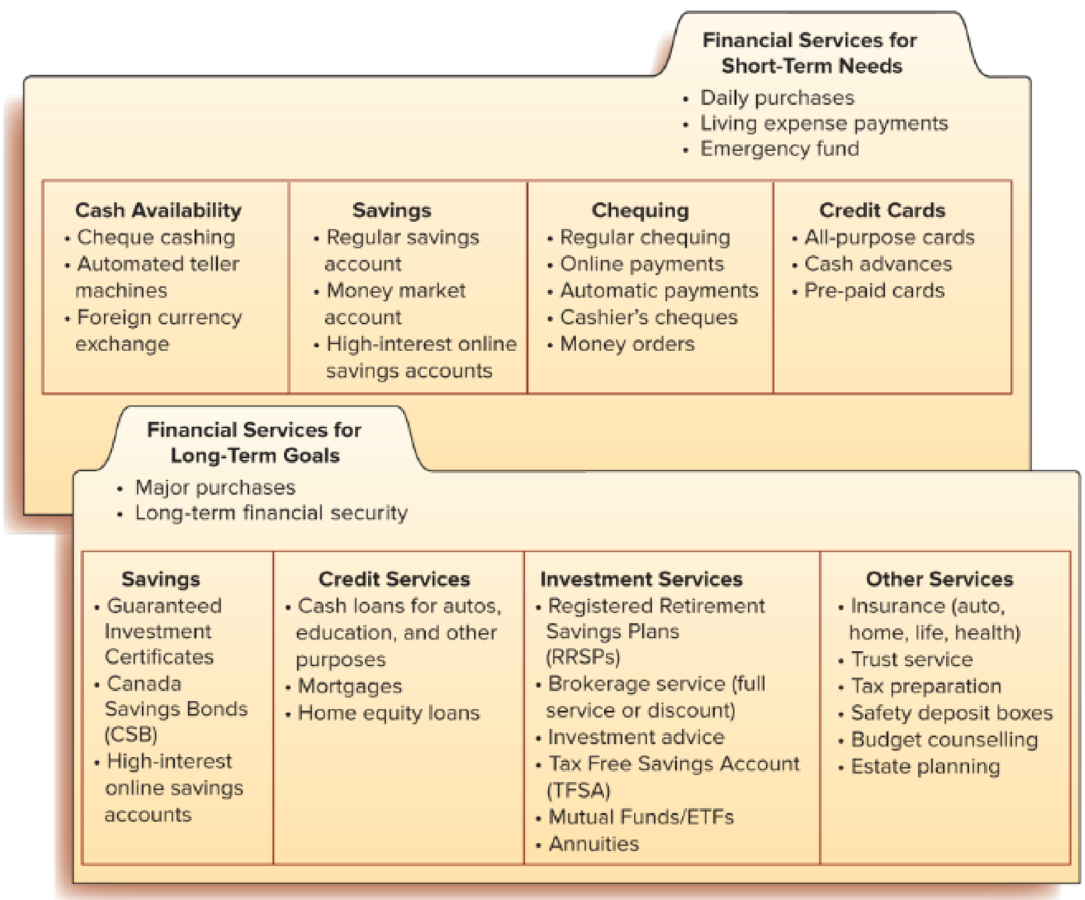
Exhibit 4–1 Financial Services for Managing Cash Flow



MEETING DAILY MONEY NEEDS

Buying groceries, paying the rent, and other routine spending activities require a cash management plan.

MANAGING CASH Cash, cheque, credit card, or automated teller machine (ATM) card (also known as *debit card*) are the common payment choices. While most people desire ease of payment, they must also consider fees and the potential for impulse buying and overspending. For example, in recent years ATM fees have risen from nothing to as high as $5 per transaction, depending upon the type of transaction, where it takes place, and whether or not ATM transactions are covered under the account's service package.

If you are charged two $1 transaction fees a week and could invest your money at 5 percent, this convenience will cost you more than $570 over a five-year period.

Common mistakes made when managing current cash needs include:

- Overspending as a result of impulse buying and using credit cards.
- Having insufficient liquid assets (cash, chequing account) to pay current bills.
- Using savings or borrowing to pay for current expenses.
- Failing to put unneeded funds in an interest-earning savings account or investment plan to achieve long-term goals.

SOURCES OF QUICK CASH No matter how carefully you manage your money, there may be times when you need more cash than you currently have available. To cope with that situation, you have two basic choices: liquidate savings or borrow. A savings account, cashable Guaranteed Investment Certificate, mutual fund, ETF, or other investment may be raided when you need funds. Alternatively, a bank overdraft or credit card cash advance may supply funds quickly, but at a high cost. The best and most efficient source of quick cash is an emergency fund you set up in a simple high-interest savings account that is accessible; however, if that isn't an option then use a personal line of credit, arranged before the need arises. Remember, however, that both using savings and increasing borrowing reduce your net worth and your potential to achieve long-term financial security.

TYPES OF FINANCIAL SERVICES

Banks and other financial institutions offer services to meet a variety of needs. These services fall into four main categories.

1. SAVINGS Safe storage of funds for future use is a basic need for everyone. These services, commonly referred to as *time deposits*, include money in savings accounts and investment certificates. Selection of a savings plan is commonly based on the interest rate earned, liquidity, safety, and convenience. These factors are discussed later in the chapter.

2. PAYMENT SERVICES The ability to transfer money to other parties is a necessary part of daily business activities. Chequing accounts and other payment methods, commonly called *demand deposits*, are also covered later in the chapter.

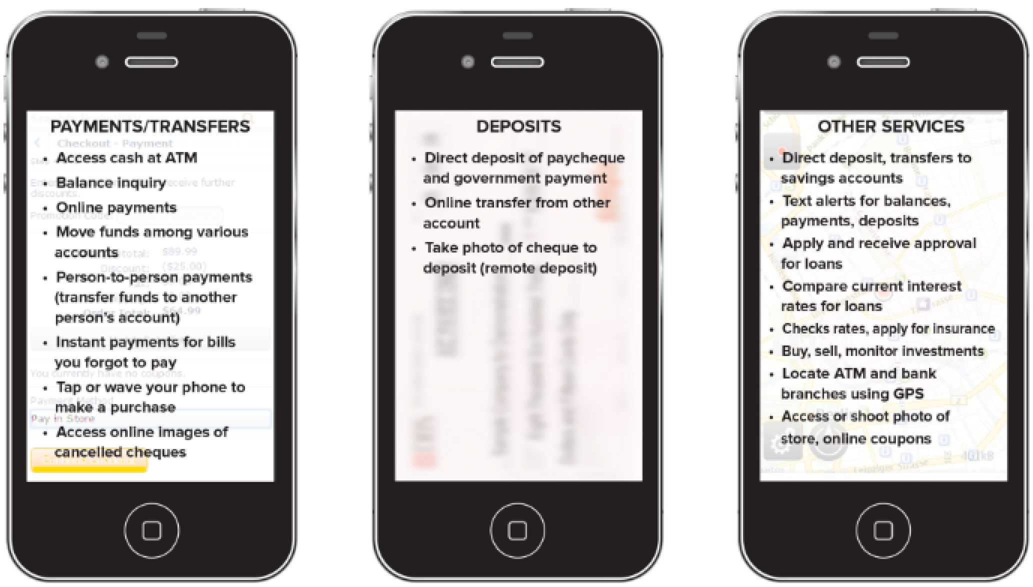
3. BORROWING Most people use credit at some time during their lives. Credit alternatives range from short-term accounts, such as credit cards and cash loans, to long-term borrowing, such as a home mortgage. **Chapters 5** and **6** discuss the types and costs of credit.

4. OTHER FINANCIAL SERVICES Insurance protection, investment for the future, real estate purchases, tax assistance, and financial planning are additional services you may need for successful financial management. With some financial plans, someone else manages your funds. A **trust** is a legal agreement that provides for the management and control of assets by one party for the benefit of another. This type of arrangement is most commonly created through a commercial bank or a lawyer. Parents who want to set aside certain funds for their children's education may use a trust or an Registered Education Savings Plan (RESP). The investments and money in the trust are managed by a bank, and the necessary amounts go to the children for their educational expenses. Trusts are covered in more detail in **Chapter 15**.

ELECTRONIC BANKING SERVICES

Years ago, people had to conduct banking activities only during set business hours, usually between 10 A.M. and 3 P.M. Today, things are different. Several million Canadians bank or pay bills online. Computerized financial services (see **Exhibit 4–2**) provide fast, convenient, and efficient systems for recording inflows and outflows of funds.

Exhibit 4–2 Mobile Banking Options



DIRECT DEPOSIT Each year, more and more workers are receiving only a pay stub on payday. Their earnings are automatically deposited into chequing or savings accounts. This process saves time, effort, and money. Government agencies are also increasing their use of direct deposits to reduce costs and fraud. Provincial and federal government cheques going to contractors and to Canada Pension Plan, Old Age Security, and welfare recipients are deposited electronically into the payees' bank accounts.

AUTOMATIC PAYMENTS Many utility companies, lenders, and other businesses allow customers to use an automatic payment system, with bills paid through direct withdrawal from a bank account. Experts recommend that you stagger your bill payments and savings plans to coincide to when your paycheques are deposited. This allows you to pay bills (or save) in an orderly fashion while stabilizing your cash flow and avoid unnecessary NSF (non-sufficient fund) charges. Be sure to check bank statements regularly to ensure that the correct amounts have been deducted from your account. A minor error can result in an overdrawn account and expensive fees.

AUTOMATED TELLER MACHINES **Automated teller machine (ATM)** convenience can be expensive. As the **opening case** points out, a person who uses an ATM several times a week can incur service charges of several hundred dollars a year.

To reduce ATM fees, experts suggest that you:

- Compare ATM fees at different financial institutions before opening an account. Get the fee schedule in writing.
- Use your own bank's ATM whenever possible to avoid surcharges imposed when using the ATM of another financial institution.
- Consider purchasing a monthly service package that includes ATM activity.
- Withdraw larger cash amounts, as needed, to avoid fees on several small transactions.
- Get cash back at the grocery store while paying with your debit card.
- Consider using personal cheques, traveller's cheques, credit cards, and prepaid cash cards when away from home if they are more cost effective.

METHODS OF PAYMENT

1. POINT-OF-SALE TRANSACTIONS Debit cards are routinely accepted in most retail stores and restaurants in major urban centres. Your personal identification number (PIN) might be required for abnormal or larger purchases. In cases of smaller or regular purchases you may simply tap a micro chip to a key pad and the amount is immediately debited from your bank account, reducing your available funds.

Credit cards are also used at the time of sale, but merchandise charges accumulate and appear on the following monthly statement. Credit card transactions used to require you to enter your PIN only for a cash advance but now most transactions require a PIN as a replacement of the old system of signing a credit card slip.

2. STORED-VALUE CARDS Prepaid cards for buying cell phone time, transit fares, laundry service, library fees, groceries and even a credit card are common. While some of these access cards, such as phone cards, are disposable (or become collector's items), others are reloadable "stored-value" cards such as Starbucks and can be registered online in case you lose them at which point you can recover the value stored on the card and get a new card issued.

Did you know?

Generic ATMs are everywhere, with surcharges that are added to the regular transaction fees. These additional fees usually start at $1.50 and can climb much higher. Since the machines warn you about the service charge before your transaction is complete, however, you can cancel your transaction if you think the fee is excessive.

3. SMART CARDS "Smart cards," sometimes called "electronic wallets," look like ATM cards; however, they also include a microchip. This minicomputer stores prepaid amounts for buying goods and services. In addition, the card stores data about your account balances, transaction records, insurance information, and medical history.

4. SOFTWARE-BASED PAYMENT SYSTEMS Software-(**https://en.wikipedia.org/wiki/Bitcoin**), are often referred to as digital currencies. In fact, Bitcoin in 2015 was accepted by 100,000 merchants as the fees charged were in the range of 0–2 percent compared to the 2–3 percent fee charged to merchants by most credit cards. These currencies are electronically created and stored, and, like traditional money, may be used to buy physical goods and services. Sometimes use of these currencies is restricted to certain communities, such as for use in certain online gaming communities or social networks.[1]

OPPORTUNITY COSTS OF FINANCIAL SERVICES

When making decisions about spending and saving, consider the trade-off between current satisfaction and long-term financial security. In a similar manner, you consider opportunity cost—what you give up—when you evaluate, select, and use financial services. The money you save by shopping around for a low-cost chequing account must be balanced against the value of the time you spend gathering information. Other common trade-offs related to financial services include the following:

- Higher returns of long-term savings and investment plans may be achieved at the cost of *low liquidity*, the inability to obtain your money quickly.
- The convenience of a 24-hour ATM or a bank branch office near your home or place of work must be weighed against service fees.
- The "no fee" chequing account that requires a non–interest-bearing $1,000 minimum balance means lost interest of nearly $220 at 2 percent compounded over 10 years. However, with interest rates being as low as they are today, in most cases maintaining a balance to avoid service fees outweighs the benefits of interest income.

CONCEPT CHECK 4–1

1. What is the relationship between financial services and overall financial planning?
2. What are the major categories of financial services?
3. What financial services are available through electronic banking systems?
4. Why shouldn't you select financial services on the basis of only monetary factors?