

4-1

Resources and Choices

GOALS

- Describe needs and wants and explain how financial resources help fulfill needs and wants.
- Prepare a personal cash flow statement and a personal net worth statement.
- Apply a decision-making process to personal financial choices.

KEY TERMS

- needs, p. 118
- wants, p. 118
- financial resources, p. 118
- cash inflows, p. 119
- cash outflows, p. 119
- assets, p. 119
- liabilities, p. 119
- net worth, p. 119
- tradeoff, p. 121
- opportunity cost, p. 121

needs things needed for survival, such as food, clothing, shelter, and medical care

wants things people desire for reasons beyond survival and basic comfort

financial resources money or other items of value that are used to acquire goods and services

What Are Needs and Wants?

Needs are things you must have for survival, including food, clothing, shelter, and medical care. Beyond these basic needs, people may have *other needs* to fulfill in order to lead a comfortable lifestyle. Other needs could include things such as more than one pair of shoes, clothing for different purposes, an education, and furniture. **Wants** refer to things people desire for reasons beyond survival and basic comfort. These items allow people to enjoy life more. Examples of wants include new cars, vacations, a large wardrobe, dozens of pairs of shoes, and so on. *Luxury items*, which are very costly, often fill emotional wants rather than physical needs.

RESOURCES LIMIT CHOICES

Financial resources include money or other items of value that people can use to acquire goods and services. Although people's financial resources are limited, their wants and needs are unlimited and growing. Every day, new products and services are introduced on the market to tempt consumers. Because most people do not have enough resources to meet all their needs and wants, they must make choices.



©Tyler Olson, 2010/Used under license from Shutterstock.com

What needs are represented in this photo? Wants?

For a person who has few resources, the choices available will also be few. This person may need to spend all resources to cover basic and other needs. For a person with more resources, more choices will be available. The amount of money a person has to spend after needs are met is called *discretionary income*. People who have high discretionary income can consider buying luxury items they may want.

CHECKPOINT ▶▶▶

How are your wants and needs related to your financial resources?

How Are Income and Wealth Measured?

Your income can be measured using a cash flow statement. Your *wealth*, or items of value minus any debts owed against those items, can be measured using the *personal net worth statement*. By preparing these forms on a regular basis, such as once a month or year, you will be able to see how your wealth is growing (or shrinking) over time.

THE PERSONAL CASH FLOW STATEMENT

The *personal cash flow statement* lists your cash inflows and cash outflows for a period of time. **Cash inflows** include income you receive from your job, investments, and other sources. You can spend this amount of money without using savings.

Cash outflows are expenses, or items for which you must spend money. Most people have regular expenses to meet. Some expenses are easy to predict. Others happen unexpectedly, such as the cost of replacing a blown tire. It is wise to make saving a planned expense. In order to save, you will need to spend less than you receive in income. Saving increases your wealth.

If your cash inflows exceed your cash outflows, you have a positive cash flow, or *net income*, for the period. If your cash outflows exceed your cash inflows, you have a negative cash flow, or *net loss*, for the period. Comparing monthly cash flow statements over time can help you see whether you are meeting your financial goals. As an example, the personal cash flow statement for Andrea McCall is shown in Figure 4-1.1. She has a positive cash flow of \$22.

THE PERSONAL NET WORTH STATEMENT

A *personal net worth statement* shows a person's net worth based on his or her assets and liabilities. **Assets** are money and items of value that you own. For certain assets, such as a car, their value is the price you could get if you sold them. Debts that you owe are called **liabilities**. The amount owed on a car loan is a liability. The difference between your assets (what you own) and your liabilities (what you owe) is called **net worth**. As an example, the net worth statement for Jerry Perez is shown in Figure 4-1.2. It indicates that he has net worth of \$3,351.58 as of May 1, determined as follows: \$4,652.56 (total assets) – \$1,300.98 (total liabilities) = \$3,351.58 (net worth).

cash inflows income from your job, investments, and other sources

cash outflows expenses, or items for which you must spend money

assets money and items of value that you own

liabilities debts that you owe

net worth the difference between your assets and your liabilities

Figure 4-1.1 Personal Cash Flow Statement

ANDREA MCCALL PERSONAL CASH FLOW STATEMENT April 1–30, 20--		
Cash Inflows		
Work (part-time)	\$120.00	
Allowance for household chores	40.00	
Lunch money allowance	60.00	
Savings account interest	<u>2.00</u>	
Total cash inflows		\$222.00
Cash Outflows		
Gifts	\$ 20.00	
Clothes and shoes	60.00	
Loan payment to parents	20.00	
Lunches	60.00	
Entertainment/miscellaneous	<u>40.00</u>	
Total cash outflows		<u>200.00</u>
Net cash flow		<u>\$ 22.00</u>

Figure 4-1.2 Personal Net Worth Statement

JERRY PEREZ PERSONAL NET WORTH STATEMENT May 1, 20--			
Assets		Liabilities	
Cash and checking account	\$ 452.56	Car loan	\$1,100.00
Savings account	500.00	Credit card debt	<u>200.98</u>
Savings bonds	300.00	Total liabilities	\$1,300.98
Baseball card collection	100.00		
Computer, iPod, games	300.00	Net Worth	
Car, current value	<u>3,000.00</u>	Assets minus liabilities	<u>3,351.58</u>
Total assets	<u>\$4,652.56</u>	Total liabilities and net worth	<u>\$4,652.56</u>
			Net Worth

Assets that are growing in value are said to be *appreciating*. The value of savings bonds, for example, will grow over time. The value of land or a house may also increase over time. Other assets, such as cars and electronic items, may be *depreciating*, or decreasing in value. These items have temporary value that will be used up over time.

CHECKPOINT ▶▶▶

What is the purpose of a personal cash flow statement?



Building Communications Skills

READING VOCABULARY

Reading is a basic communications skill. Much of the information you need comes in written form. You read for many reasons, such as to learn new ideas related to school, work, or personal activities. You read directions for completing a task or following a particular route. You also read stories, novels, or poems for pleasure.

Your *vocabulary* is made up of the words you know and understand how to use. Whatever your purpose in reading, improving your vocabulary will help you better understand the material you read. For example, key terms are listed in each chapter of this textbook. Learning these words will help you understand the concepts presented. Use the following strategies to add new words to your vocabulary:

- Try to learn the meaning of a word from the way it is used in a sentence. Then check a dictionary to see if that meaning is correct.
- Divide a long word into parts. If you know the meaning of one part, you may be able to guess

the meaning of the entire word. Again, check a dictionary to see if that meaning is correct.

- When you are reading and see a word you do not know, find the meaning in a dictionary at that time, if possible. If you cannot check the dictionary right away, make a note of the word and find it in a dictionary later.
- If you find a word you do not know when reading a textbook, see if the word is defined in a glossary at the end of the book.
- Practice using new words in conversation or in writing to help you remember their meanings.

Try It Out

Read a newspaper or magazine article about money management. Highlight any words that are new to you. Did you learn their meaning from the article? If not, look up the definition for those words you still do not know. Then read the passage again. Describe what you learned from reading the article.

How Can You Make Good Financial Choices?

Buying decisions play an important part in managing your money. When you give up one option in exchange for another that you think is more desirable, you are making a **tradeoff**. For example, you may choose to use your money to buy an iPod® instead of a bicycle. The tradeoff results in an **opportunity cost**, which is the value of your next best option—what you are giving up. For example, in buying the iPod, the opportunity cost is the value of the bicycle. Value can be measured in many ways, such as in dollars, time, convenience, enjoyment, and so forth.

tradeoff giving up one option in exchange for another

opportunity cost the value of your next best option—what you are giving up

DECISION-MAKING PROCESS

To help you make good financial decisions, use a step-by-step decision-making process.

1. *Define the need.* Determine what need will be filled or problem resolved by buying the item or service. For example, you might need a computer to do online research and to complete homework. Think about all the ways in which the item or service could be used and the features it should have to meet your needs.
2. *List options for meeting the need.* You could buy a new computer or borrow use of a computer at the local library or school lab. List the cost of each option. Research the features of any items you consider buying.

3. *Compare the options you have identified.* List the advantages and disadvantages of each one. Also, think about the opportunity cost of each option. For example, using a computer at the library would be less costly than buying a computer. What are the opportunity costs of choosing this option? You would have to travel to the library each time you wanted to use the computer and could use it only during the hours the library is open. Thus, the opportunity cost, or the value of your next best option, would be the convenience of owning your own computer. You must decide which you value most—convenience or saving money.
4. *Make a decision.* Based on your research and evaluation of the information you have gathered, choose the option that is best for you.
5. *Take action based on your decision.* For example, buy a computer or plan times to use one at the library.
6. *Reevaluate your choice.* After some time has passed, think about your decision again. Did the option you chose resolve the problem or fill the need for which it was selected? If the answer is no, or if your needs have changed, follow the process again to make a new decision.

FINANCIAL STRATEGIES

Financial choices you make today will affect your finances tomorrow. If you plan ahead, you will be better prepared to use your resources to meet your needs and wants. Making good financial choices will help prevent worry over financial matters. Follow these strategies to make better financial choices:

- Financial choices should be forward-looking. Ask yourself how a choice will affect your future.
- Consider the opportunity cost (the value of what you give up) each time you make a purchase. Doing so will help you decide whether the item or service selected is the best choice for you.
- When in doubt about whether to buy a particular item or service, do not make the purchase. If you are not sure of a choice, keep asking questions or doing research until you know enough to make a good decision.
- Do not make snap decisions about financial matters. *Buyer's remorse occurs when you make a purchase and then later regret it.*
- Spend less than your income each month. Set aside money for unexpected expenses.
- Be realistic when deciding which wants you can fill. Learn to enjoy the items you have rather than always wanting more items.
- Take enough time to read all financial agreements. Ask questions to be sure you understand what you are agreeing to before signing a document.
- Learn from mistakes that others have made. Listening to the experiences of others can help you avoid the same financial problems.

CHECKPOINT ▶▶▶

Why is it important to compare options before buying?