Topic 1: Spending choices and personal financial budgets

After completing this topic, you will be able to:

- use calculations to make spending choices;
- understand the benefits of shopping around;
- understand value for money and how to work out the impact of depreciation; and
- understand the link between personal financial budgets and spending choices.

Shopping around

It does not matter what you are buying – whether it is socks, an ice cream sundae or life assurance – it is always important to shop around. Shopping around is about doing some research to make sure that you get the best deal possible for the money that you are prepared to spend. The more expensive a product, the more worthwhile it is to shop around, because the more money you may be able to save. If you are shopping around for a new TV, for example, you could save yourself perhaps £50 or £100 by looking around for the best deal; it is not so important if you are buying only a £2 pair of socks.

Shopping around is not only about price; it is also about quality, additional features and, more importantly, how a particular product suits your own personal preferences or requirements. If you do not bother to shop around, you could end up with a product or service that is not exactly what you want or need, and if it does not do what you want it to do, it is a waste of your money.

When you are shopping around for a particular item, you have to be prepared to go to numerous shops (or websites, if you are shopping online), and it will often be the case that they do not all stock the same brand, or that they offer a totally different alternative to the item for which you were originally looking. That alternative might do the same job – it might even be better than the item that you initially wanted – but unless you put in the time and effort, you cannot be sure that you are getting the best deal for *you*.

Shopping around can sometimes be a real bind – it is time-consuming and often boring – but the end result is that you get the product that you want, which does the things that you need it to do, and at the right price.

Activity 1a

Discuss how quickly you get tired or bored when shopping around.

- ***Who is the most determined shopper?***
- ***How many times have you bought something without shopping around and regretted it?***
- ***What method might you use to compare the products, other than memory?***

The problem with shopping around is that:

- no one can know every product that is available;
- it takes time to compare the choices;
- it takes organisation to make enough notes to remember the features and benefits of each option so that you can make a final choice; and
- you have to consider the costs of the shopping-around exercise – that is, fuel, bus fares, time spent on the Internet, etc.

Shopping around for financial products

It is just as important to shop around when it comes to buying financial products as it is when buying clothes and other items – probably even more so. The benefits offered or provided by financial products are not so easy to measure or compare with each other.

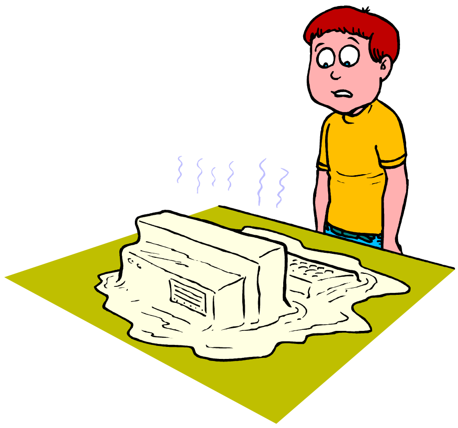
Think about insurance, for example: you have to consider the premium, the level of cover, the items that are covered and the 'events' that are being insured (that is, fire, theft, damage, etc).

Whether one insurance policy will perform better than another in the event of a disaster is very hard to predict. The only thing that you can do is to make sure that you have researched as much as you are able at the time that you buy the product to give yourself the best possible chance of being protected should the worst happen to you.

You might be thinking of using a price comparison website to help you to make your choice – but the problem with doing only this is that these sites look only at price. So it is up to you to find out what you are getting for your money.

Let us look at home contents insurance.

Activity 1b



Company A has the cheapest premium, but the insurance that it offers does not cover 'accidental damage' to things such as DVD players or computers.

Company B is slightly more expensive, but if you accidentally drop or cause some other damage to electrical items in your home, Company B will replace them.

Company C is the most expensive policy of all. It covers breakages, spillages and loss of items while away from the home.

a) Which policy is the best?

b) Will everyone make the same choice?

c) On what will their choices depend?

Comparing borrowing products (such as loans and overdrafts), however, is mostly about price. It is much easier these days to compare loan products than it is to compare insurance products because the annual percentage rate (APR) and the equivalent annual rate (EAR) are designed to make it easier to see compare one product with another.

Can you remember which type of borrowing products quote the APR and which type quote the EAR?

APR is quoted for personal loans and mortgages, and EAR is quoted for overdrafts.

If you are looking for a savings account, you look for the AER. Can you remember what 'AER' stands for?

The annual equivalent rate (AER) works in a similar way to the APR and EAR – that is, it helps you to find out which savings account offers the best interest rate.

Calculations about spending choices

We can shop around and make our choices. Every product has a price and we might need to do some calculations to work out if this is the best price. Some items are sold individually; others are sold in multipacks, such as crisps and cans. Some shops might even have an offer such as 'buy one get one free'.

Case study

You and three of your friends are in town and fancy some crisps. You could go to a newsagent and all buy your own packet of crisps for 40p each. Alternatively, you could go to the supermarket and buy a multipack. The multipack contains six packets for £1.80.

- Six packets for £1.80 means that each pack is much cheaper than the price in the newsagent:

$$£1.80 \div 6 = 30\text{p}$$

- There are four of you, however, so the price per bag will be calculated as follows:

$$£1.80 \div 4 = 45\text{p}$$

- There will be two packets left over.
- All of the packets in the multipack are the same flavour.

So, do you go to the newsagent and get the exact flavour that each of you wants for 40p a bag?

Or do you get six bags for £1.80 (that is, at 30p per bag) from the supermarket and all have the same flavour?

At first glance, 30p per bag seems like quite a bargain, but it means that you all have to agree on the same flavour. Also, by buying the multipack, it actually costs each of you 45p and you will have two bags of crisps left over that you did not need.

On this occasion, buying from the supermarket is not necessarily the best choice for you and your friends.

Activity 1c

So, you bought the 40p bags of crisps from the newsagent and now you are all thirsty. You each want to buy a bottle of water.

You find a supermarket and go to a shelf full of different bottles of water. Which do you choose?

You could work out the price for each bottle, but the bottles are different sizes, so we should work out the price for 100 ml as well.

Complete the table below, rounding amounts to the nearest penny.

Product	**Evian mineral water** 	**Highland Spring mineral water** 	**Belu water** 
Size of bottles	4 x 750 ml	1 x 500 ml	6 x 500 ml
Price	£2.83	£0.50	£1.99
Price per bottle			
Price per 100 ml			

Source: Sainsbury's online

The cheapest is Highland Spring and the Evian is the most expensive. But what other factors might you take into account when choosing your water?

Value for money

Value for money does not always mean getting something at the cheapest price. There are many cheap shops around selling their goods at rock-bottom prices – but the goods are not always good quality and do not always last a long time. You might then have to spend more money if the item breaks or wears out.

This type of purchase is sometimes called a 'false economy' – that is, you think that you are getting a bargain, but if you have to buy the item twice because it is badly made or does not do the job properly, you have not got value for money. You may even end up spending more in total than you would have done had you bought a more expensive item in the first instance.

Value for money is therefore about many things, as follows.

- **Quality** – How well is it made? Or how good does it taste?
- **Quantity** – How much are you getting for your money?
- **Convenience** – How easy is it to obtain?
- **Price** – Is it cheaper to buy in a larger quantity? Do you need the larger quantity?
- **Suitability** – Is it what you need? Does it do the job that you want it to do?
- **How long it lasts** – Is it a 'throwaway' item, or does it need to last longer?
- **What it looks like** – It is prettier, sturdier or a nicer colour than the cheaper option?
- **How it makes you feel** – After all, sometimes, you want to treat yourself!
- **Flexibility** – Can it be used in more than one way? Might it be able to do the job of two different products?

Value for money and financial products

Financial products are 'intangible' – that is, you cannot hold them or touch them. The value that they give to you is discussed in monetary terms. They either pay better interest, or cost you less, or provide better cover – all of which benefits are hard to measure.

Also, when we talk about financial products, we are usually talking about larger amounts of money:

- insurance premiums are usually hundreds of pounds and claims are often for thousands of pounds;
- savings can be as little as a few pounds or as much as thousands of pounds, and the interest earned can also be in the hundreds or thousands; and
- loan repayments are usually a big chunk of your wages or salary, so if you make the wrong choice, it will cost you more.

When you buy financial products, you are also usually committing yourself for a longer period of time.

- Insurance is usually bought annually.

- Choosing a savings account can take a long time, especially when you weigh up all of the benefits. If you make the wrong choice, it is inconvenient to start again and choose another one.

So it is really important that you make sure that you are getting value for money from the outset.

Activity 1d

Imagine that you have £500 to invest and that you want to get the best interest rate.

Think about how many providers you might look at in order to get the best price.

- ***Would you go to a comparison site such as www.moneysavingexpert.com or www.moneysupermarket.com and select from its top ten choices? Or would you do more research? Would you then think that you had value for money?***

- ***Would your answer be different if the amount to be invested were £15,000?***

For financial products, the following are the types of question that you might ask yourself to find out if you are getting value for money.

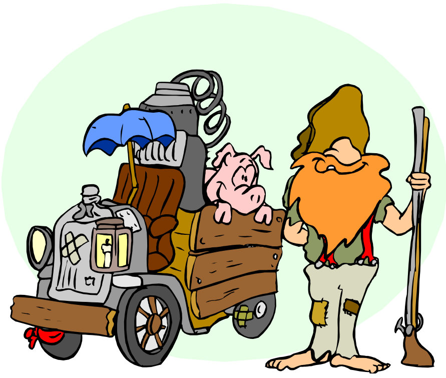
- **Insurance** – Does the insurance cover the things that I need covering? Will it pay out when I need it? Is the premium worth the cover I am getting? If it is more expensive than another, is the extra premium worth the extra cover?
- **Savings** – Am I getting the highest interest rate for the amount that I want to save? Can I access my money when I need it?
- **Loans and borrowing products** – Am I getting the lowest interest rate, over a term that suits me? Does this borrowing allow me to get the thing(s) that I most want?

Depreciation

Most products decline in value after they have been bought and used. If you buy a car new from a garage and then try to sell it a year later, for example, you will get less money for it than you paid. The same applies to computers, or computer games, or other electrical items. This decline in value is known as 'depreciation'.

How much an item depreciates in value over time depends on a number of things, including the following.

- How much has it been used? (For a car, this could include how many miles it has been driven.)
- What condition is it in? Has it been looked after well?
- Is it still fashionable?
- Has technology moved on? (Think about all of the different versions of the iPod that there have been.)



- Is it still useful? (For example, think about how little you would get for a video player these days, even if it were in good condition, when you cannot get new videos for it.)
- Has it been replaced by something better? (For a car, a new model may now be on the market.)
- Have there been better versions released into the market since you bought it? (Think about the first Xbox, or about a camera that is not digital.)

So depreciation is the loss of value of an item.

Can you think of any more items that will lose value? Can you think of the reasons why they will depreciate?

Activity 1e

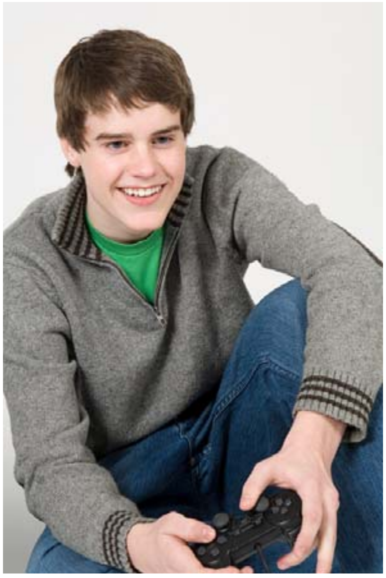
List five things that you own. You may have bought them, or you may know how much was paid for them. Things such as a phone, MP3 player, computer game, games console, DVD, item of clothing or handbag would be good examples.

Complete the following table for each of these items.

Item	Price paid £	Likely value in the marketplace now £	Where you might sell it	Why has it gone down in value?

You will probably see that all of the items on your list will have gone down in value. When giving the reasons, use the words at which we have just looked – that is:

- ***'it is out of date';***
- ***'it has been used';***
- ***'it is damaged';***
- ***'it is not the latest technology'; or***
- ***'it has been replaced by something better'.***



Case study

Mike bought a games console two years ago, for which he paid £400. He has now looked at the same item on eBay and sees that it is being auctioned for about £200. It is old now and a new version has come out.

We would say that the games console has 'depreciated' by:

$$£400 – £200 = £200$$

This is a yearly depreciation of:

$$£200 \div 2 = £100$$

Activity 1f

Look back at the list you made in Activity 1e.

For the same items, complete the table below to show the loss in value, for how long you have had the item and the depreciation each year.

Item	**Price paid £**	**Likely value in the marketplace now £**	**Loss in value (depreciation) £**	**For how long have you had it?**	**Yearly depreciation**

Depreciation is usually expressed as a percentage. This makes it easier to compare the loss of value between products.

Percentage depreciation can be calculated as:

$$\frac{\text{Yearly depreciation}}{\text{Cost of the item}} \times 100 = \%\text{ depreciation}$$

Case study

Mike's games console cost £400 and depreciated by £100 each year:

$$\frac{100}{400} \times 100 = 25\%$$

So the games console depreciated at a rate of 25 per cent per year.

Activity 1g

Look back at the tables that you completed in Activities 1e and 1f.

Complete the following table to show percentage depreciation. (The columns for Mike have been completed as an example.)

Item	Price paid £	Depreciation each year £	Depreciation %
Games console	400	100	25%

Appreciation

The opposite of 'depreciation' is 'appreciation'. This refers to the situation in which the item purchased increases in value over time. Items that are likely to appreciate in value are those that are rare or limited in supply – for example, limited editions of certain products, classic cars, works of art, antiques, etc.

Property is another example of something that appreciates. Although property values usually fall during periods of recession, their values tend to appreciate over the medium-to-long term.

Impact of spending choices on budgets

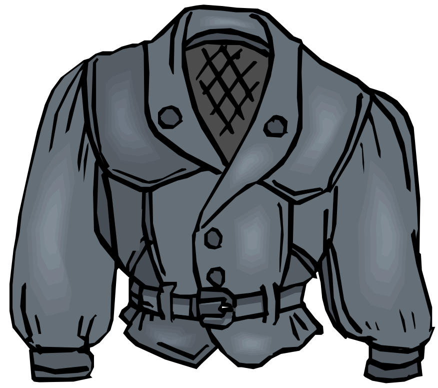
A budget is a financial plan and can be for any time period. Many people budget for one month – that is, looking at how they manage their money week by week – while others will look at budgeting for the medium term, such as six months.

When we make a budget, we sometimes have to adjust it if we make a purchase that was not included in our initial plans; this is what happens to most of us in real life. We cannot always predict what is going to happen in the future, and so we have to build some flexibility into our budgets so that we can cope with the unexpected, such as a car repair bill or medical bill for which we did not plan.

Also, it is only human to want to treat ourselves once in a while. Often, these kinds of purchase are spontaneous – that is, they happen on the 'spur of the moment'. If we make this type of purchase, however, we should revisit our budget to see how we need to adjust it for the next month, two months or longer, so that we stay on top of our finances and do not get into a financial mess.

Case study

Emma is out shopping with her friend Gemma. She needs a jacket and has seen two or three that she really likes – all of which cost around £35.



Suddenly, Emma sees a really gorgeous designer jacket that costs £200. She has not budgeted to spend this amount of money on a jacket, so she puts it back, remembering that her bicycle is in the repair shop and that she needs to pay for that this month. She needs her bike to get to college.

But Gemma tells Emma that the designer jacket really suits her and suggests that she ought to buy it; otherwise it will not be there next time they go shopping. Emma decides to buy the designer jacket and put it on her credit card.

Emma feels great in her new jacket – until her credit card bill arrives.

Emma has to decide whether to:

- repay the £200 off the credit card straight away so that she does not pay any interest to the credit card company – in which case, she will not be able to go out with her friends for a few weeks; or
- repay it in instalments.

Emma decides to repay it at a rate of £50 per month. This means that she has to adjust her monthly budget plan for the next four months, so that she can afford to repay the credit card company £50 per month.

Do you think that Emma's credit card debt will be completely cleared after repaying £50 each month for four months? What do you think might happen if Emma does not adjust her budget plan to take account of the extra £50 that she has to pay each month?

Activity 1h

Katie has to tax and insure her car.

Before she does so, she also has to get it through its MOT.

Overleaf is Katie's budget for the next few months.

	March £	April £	May £	June £
Income	1,250	1,250	1,250	1,250
Expenditure				
Rent	600	600	600	600
Bills	125	125	265	125
Food	220	220	220	220
Phone	35	35	35	35
Savings	75	75	75	75
MOT		200		
Tax		135		
Car insurance		552		
Total expenditure	1,055	1,942	1,195	1,055
Net cash	195	–692	55	195
Opening bank	50	245	–447	–392
Net cash	195	–692	55	195
Closing bank	245	–447	–392	–197

It is clear, then, that Katie has a budget problem.

Katie does not want to have a bank overdraft or use her credit card, because she is worried about borrowing for several months.

- ***From her research, she has found out that the car tax can be paid every six months at a cost of £74.25 (rounded down to £74).***
- ***Her car insurance can be paid monthly at £49.23 (rounded up to £50).***

a) ***Work out Katie's new budget, taking these revised payments into account. Does paying monthly solve her budget problem?***

b) ***Compare the monthly payment for the insurance with the annual fee. How much extra will it cost her to spread the cost over 12 months?***

c) ***Annual car tax is £135, but the six-month cost is £74.25. How much extra does paying biannually (that is, two times in the year) cost her?***

d) ***Work out the total increased costs of running her car if Katie takes these options.***

e) ***Is this worth it? Does she have any other choices?***

Review questions

1. Why is it important to shop around?

2. Why is it particularly important to shop around for financial products?

3. What factors might you consider when deciding whether something is value for money?

4. What is ‘depreciation’?

5. How much an item depreciates depends upon what factors?

6. Having created a budget, under what circumstances might we have to adjust it?

Learning activities

Internet

- Visit www.parkers.co.uk and look at the valuation prices for second-hand cars. Try to choose some models and work out the depreciation rates.
- Visit www.ebay.co.uk and look at the auction prices for some of the items that you listed in Activities 1e–1g. Which ones are showing the most depreciation?

Group

Visit www.tesco.com and check out the prices of multipacks; compare them to the cost of buying individual items. You might look at lemonade, crisps and tinned food. Also check out the prices of things such as toilet rolls.

- How much cheaper is it to buy 36 toilet rolls instead of two or four?
- Are there any special offers, such as ‘buy one, get one free’, or ‘buy two, get one free’?
- How much discount does this represent?

Individual

Visit www.moneysupermarket.com and practise getting a quote for car insurance – make up the car details, but try different quotes for different values of car.

- Is there a big difference between the most expensive and the cheapest?
- By looking at the features, can you see what additional benefits the more expensive insurance policies offer?

Key points for Topic 1

You should now understand:

- what 'shopping around' is, and its advantages and disadvantages;
- what 'value for money' is;
- what 'depreciation' is;
- the reasons for depreciation;
- how to calculate depreciation;
- calculations to work out the effect of personal financial decisions on budgets.