Let Lenders and Borrowers Be

Introduction

Buying a gallon of milk is a pretty straightforward exchange. You walk into a store, grab a plastic jug, pay the cashier, and you're on your way. Saving, borrowing—and even investing—are a bit like buying products at a grocery store.

A bank, credit union, or other financial institution can be thought of as a supermarket. It brings a number of products together in one place so that buyers don't have to shop all over town for what they want. At a financial institution, consumers can cash a check, deposit money, apply for a loan, purchase a certificate of deposit, or get investment advice.

One of the most important roles of a financial institution is to act as an intermediary. Intermediaries bring together those who are in need of funds and those who wish to invest. For example, when a new company is just getting off the ground, it needs funding—for materials, equipment and supplies, maybe even to hire more workers.

Somewhere out there, investors are looking for an opportunity to earn a return on their funds. Often it is through a financial institution that the start-up company (that has a business opportunity) and the investor are brought together. The company finds its funder, and the investor finds an opportunity.

In this lesson, you will learn how banks, credit unions, savings and loan associations, and other financial institutions act as intermediaries, bringing together savers, borrowers, and investors. This information will give you food for thought as you begin to make investment decisions on your own.

Vocabulary

Financial intermediary: Banks, credit unions, pension funds, insurance companies, mutual funds and other financial institutions acting to bring together savers and borrowers as well as buyers and sellers of stock.

Interest: The price paid for using someone else's money.

Opportunity cost: The next-best alternative that is given up when a choice is made.

Demand: The quantity of a good or service that customers are willing and able to buy at all possible prices during a period of time.

Profit: The money a business has left over after selling its goods and services and paying its costs of production.

Revenue: The money a business receives from customers who buy its goods and services.

Supply: The quantity of a good or service that producers are willing and able to offer for sale at all possible prices during a period of time.

NAME: ______________________ CLASS PERIOD: __________

Calamity in Cow Town

Directions: Read the story below and answer the questions that follow.

Every town has at least one grocery store. In Cow Town, there are three large supermarkets. For the most part, all three markets get their groceries from the same food wholesalers and pay similar prices for the items they sell. This includes the milk that each market sells.

In the summer of 2010, Mrs. Jones created a new drink to serve her bridge club. She mixed milk, bananas, and pineapple juice together and called it banana milk. The ladies in the club couldn't get enough of the banana milk; the eight of them went through five gallons of milk, six pounds of bananas, and two gallons of pineapple juice that day. They each asked for the recipe and, on the way home from Mrs. Jones's house, they each bought two gallons of milk, along with the other ingredients.

The next day each lady made up a batch of banana milk and served it to her children, grandchildren, the neighbors, and anyone else who happened by. Everyone loved the stuff and headed for the grocery stores to get milk. Day after day, more people came to know and love banana milk; day after day, people bought more milk than they ever had bought before.

The grocers in Cow Town would place the usual amount of milk on the shelves in the morning, and it would be gone by mid-afternoon. Then it was gone by noon. Then it was gone by mid-morning. Finally, the grocers were simply handing the milk to the awaiting hordes early in the morning. The grocers tried to get more milk, but there were only so many cows in Cow Town.

What could the grocers do to reduce the frenzy? There was only one answer. The grocers raised the price of milk. First, they raised their prices by ten cents a gallon. Then 20 cents. Then 30 cents. As they raised the price, they sold fewer and fewer gallons until, one day, the milk actually stayed on the shelf the whole day before the last gallon was grabbed.

Yes, in the summer of 2010, the people of Cow Town learned a lesson in supply and demand. What happened to the people of Cow Town who cut their milk consumption because of the higher price? They drank orange juice instead.

Questions

1. What happened to the demand for milk in the story? Why?

____

____

2. What happened to the supply of milk in the story? Why?

____

____

3. What happened to the price of milk in the story? Why?

____

____

4. What do you think happened to the prices of bananas and pineapple juice?

____

____

5. If you were one of the dairy farmers in Cow Town and the price of milk went up, what changes might you have made on your farm?

____

____

____

NAME: ______________________________ CLASS PERIOD: __________

Financial Terms

Match the terms (numbers) with their descriptions (letters).

1. The next-best alternative given up when a decision is made	A. saver
2. The difference between revenue and costs	B. profit
3. Banks are sometimes called this	C. opportunity cost
4. The supplier of funds for loans	D. interest
5. The demander of loans	E. borrower
6. The price of money	F. financial intermediary

