GreatHearts®

Economics 10: Personal Financial Literacy

March 23-27

Time Allotment: 20 minutes per day

Student Name: ___________________________________

Teacher Name: ___________________________________

Packet Overview

Date	Objective(s)	Page Number
Monday, March 23	1. Explain the importance of a budget and describe its components 2. Define net worth and distinguish between assets and liabilities.	3
Tuesday, March 24	Analyze different types of bank accounts and the role of savings in the economy.	8
Wednesday, March 25	Identify, and explain the differences between, the main types of investments.	11
Thursday, March 26	Identify, and explain the differences between, the main types of business structures.	14
Friday, March 27	Explain the different ways to borrow money and the potential pitfalls of doing so. **Quiz over this week's material** (Closed book!)	21

Additional Notes:

Given our unique circumstances, we are going to take a quick detour from what we had just started studying—namely the rise of Capitalism—and will instead study personal financial literacy for the next two weeks which is typically the last unit of the course. It is the least reading intensive portion of the course, however, given its practical application it is nonetheless a very important one and should serve as a foundation for you learning about, and be prepared for, the many personal financial decisions you will need to make the rest of your life. We certainly cannot cover in great depth many of these important topics, so I encourage you to use these lessons as a springboard for your own research and that you use the extra time over these next weeks to do so. As we will cover, the time to start financial planning is now!

As you go through each lesson, the expectation for that lesson will be clearly stated at the beginning of the lesson. Sometimes it might be to answer the questions posed throughout the lesson, sometimes it might be to simply read and annotate, and other times it might be both. All lessons will also involve answering summary questions. This entire packet will need to be turned in for grading purposes, however, it will be returned before any assessment. Some exercises ask you to use the internet to perform some brief research. If you are unable to use the internet, simply sign the statement next to the exercise stating you were unable to access the internet and you will receive credit for completing that exercise.

Each day's lesson is designed to take no more than 20 minutes. If you have spent more than 20 minutes on a lesson, then have your parent sign the page next to the "student expectation" section under each lesson and you will receive full credit for the assignment.

While not a formal course requirement, I strongly encourage you to read about and even research the economic issues that we are confronting today. This is not a financial crisis per se, but rather a public health emergency that is having, and will continue to have, tremendous economic implications. After we complete the personal financial literacy portion of this course, we will be studying many economic concepts that are highly relevant today. Thus, as you read about the economic issues that we are confronting today, you should reflect upon the following questions as we will be considering them in the weeks ahead in this course:

- Is international trade good? Who benefits? When should nations restrict international trade? Who benefits from those restrictions?
- What kind of economic system was established by the US Constitution? What are some of the key provisions in the US Constitution that do this?
- What roll should the government play in operating and managing an economy? Can the government effectively plan for an entire economy? Can the government effectively plan for specific industry or segment of an economy? Why or why not?
- How does the government use tax and spending policies to influence the economy?
- How does the government use interest rates to influence the economy?
- How does the government use regulations to influence the economy?
- How can you measure how well the US economy is doing?
- How big is the national debt? Is there, or should there be, a limit to how much the US can borrow? What is the impact of such a large national debt?

Again, this is not a requirement. However, reflecting upon these questions will certainly enhance our learning over the remaining weeks of this course as we explore these concepts.

Though we cannot enjoy being together, we can nonetheless still share the joy of exploring economics together. This will obviously require a lot of independent work and study, but I am here to support and guide you in every way I can. As with class, you need to ask questions! Please e-mail me at any time: Patrick.Franzese@greatheartsnorthernoaks.org.

Academic Honesty

I certify that I completed this assignment independently in accordance with the GHNO Academy Honor Code.	I certify that my student completed this assignment independently in accordance with the GHNO Academy Honor Code.
Student signature:	*Parent signature:*
______________________________	______________________________

Unit Overview: Personal Financial Literacy
Personal Financial Literacy focuses on the ability to manage personal finance matters efficiently and, in doing so, create wealth for you and your family. Throughout this unit, we must always keep in mind the difference between seeking wealth as an end itself and seeking wealth as a means to an end. Recall the lesson of Socrates who demonstrated he was wealthier than Critobulus because he had sufficient material goods to enable his pursuit of the good life. Wealth, when properly oriented, should enable truth, beauty and goodness. In order to make sound financial decisions, one must have sufficient knowledge in a wide array of areas such as budgeting, retirement, investing, borrowing/debt, real estate, paying for college, retirement and estate/tax planning, insurance and charitable giving. This unit will cover these topics and others.

Monday, March 23 - Lesson 1: Creating a Financial Plan

Objective: Be able to do this by the end of this lesson.
1. Explain the importance of a budget and describe its components.
2. Define net worth and distinguish between assets and liabilities.

Lesson 1 Student Expectations: You should annotate the short reading segments, paying attention to the various definitions. Moreover, you should fully address/answer the various exercises/questions to include the summary questions.

Introduction to Lesson 1
The first lesson in the Personal Financial Literacy section starts with the most fundamental aspect of wealth creation. Namely knowing understanding what you want and then analyzing both your current financial situation and cash flow.

Goals
We all have goals in life, and it is important to establish financial goals. Write down a couple of reasons why you believe it would be important to establish financial goals.

When prioritizing financial goals, people typically group them into short-term financial goals (0-2 years); medium-term financial goals (2-5 years) and long-term financial goals (5+ years). (Note, these time horizons can vary). Considering your future and what you hope to achieve, please list a couple of financial goals that fall into each time horizon.

Short-Term Financial Goals:

Medium-Term Financial Goals:

Long-Term Financial Goals:

Net Worth
The first step in determining you current financial situation in determining your net worth. *Net worth* is defined as the difference between your assets and liabilities.

An *asset* is something you own that has value. There are two types:

- A *wealth-creating asset* is a possession that generally increases in value or provides a return. Examples include:
    - Savings account
    - Stocks and bonds
    - House
    - Antique Car

- Some possessions (like your car, household furnishings and clothes) are assets, but they *are not wealth-creating assets* because they don't earn money or rise in value. Examples includes:
    - A car
    - Personal Clothing
    - Computers/Electronics
    - Household Items

A *liability*, also called debt, is money you owe, such as:

- Home mortgage.
- Credit card balances.
- Car loan.
- Hospital and other medical bills.
- Student loans.

Which should be greater, your assets or your liabilities? Why?

Cash Flow
Once you have determined your net worth, the next step is determining what money you have coming into you and, more importantly, where your money is going. *Cash flow* is the difference between how much you have coming in (i.e., income) and how much you have going out (i.e., expenses).

Take a couple of minutes and think through both all the possible sources of income you may have as an adult and all the possible expenses/bills that you may have as an adult. To help you, consider all the sources of income your family currently has and all the expenses your family currently has. List as many items as you can think of below and you can use general categories (e.g., you do not need to write out socks, shoes, pants etc… simply write clothing).

Income	Expenses	Expenses (cont.)

Which should be greater, your income or your expenses? Why?

____

____

Budget
Now that you have thought through your financial goals, assessed your current net worth and collected in one list both your current income and expenses, you are ready to that the most important step towards financial security, creating a budget. A budget is vital for three important reasons. A budget allows you to:

- Understand where your money goes.
- Avoid overspending.
- Find money for saving and investing to build your wealth.

Without a budget, you will have no idea where you money is going and thus will likely overspend, preventing you from building wealth. In short, a *budget is the plan by which you will achieve your financial goals.* As the saying goes, "failing to plan is planning to fail."

Briefly think about what you occupation you would like to pursue and think about what you can expect your annual salary to be once you get a job. If you do not know, you can use the amount of $48,672 (which was the median income for a full-time wage or salary worker for the fourth fiscal quarter of 2019 as calculated by the U.S. Bureau of Labor Statistics). Using the salary you prefer, devise a monthly budget using the categories on the back. (Feel free to add categories as needed!)

TOTAL ANNUAL INCOME (Salary): _________________
TOTAL ANNUAL EXPENSES: _________________
DIFFERENCE: _________________

Categories	Monthly	Annual
Automobile:		
Car Payment/Savings for New(er) Car		
Gas		
Insurance_________________		
Maintenance		
Clothing:		
Food: _________________		
Dining-Out		
Groceries_________________		
Gifts: _________________		
Charitable:		
Family/Friends: _________________		
Housing: _________________		
Furniture-Appliances: ______________		
Maintenance:		
Mortgage/Rent: _________________		
Insurance:		
Supplies: _________________		
Utilities (i.e., phone, internet, electric):		
_________________		
Medical: _________________		
Doctor/Dentist: _________________		
Insurance:		

Medications:______		
Misc (i.e., gym/fitness, books, parks-museums, haircut, movies, additional educations):		
Retirement Investments:		
Short-Term Savings/Rainy Day Fund:		
Income Taxes:		
Vacation:		
TOTAL EXPENSES:		

Summary Questions:

1. Define the following:

a) Net Worth - ____

b) Asset - ____

c) Liability - ____

2. What is the difference between a wealth-generating asset and a non-wealth generating asset?

____

____

____

3. What is the purpose of creating a budget and why is it important?

____

____

____

<u>Tuesday, March 24 - Lesson 2: Banking</u>

Objective: Be able to do this by the end of this lesson.
Analyze different types of bank accounts and the role of savings in the economy.

Lesson 2 Student Expectations: Read/annotate the reading and answer the questions at the end.

Introduction to Lesson 2
The first lesson in the Personal Financial Literacy showed us the importance of creating a budget in creating wealth and meeting our financial goals. This lesson build upon that lesson by starting to address the question of what people should do with their savings.

Savings
The key to building wealth and capital formation in an economy is savings. In order for individuals to create savings, their income must exceed their expenses. Individuals do this by forgoing current consumption of consumer goods and service.

Banks
There was a time where many Americans did not use banks. Rather, they kept their money hidden at home and/or safely stored in their mattress as the story goes. While some might be tempted to store money at home still, there are three advantages that banks offer which are critical to understand.

1) *Security.* You might initially think security means having a guard at the door and a big bank vault. However, security means more than that. Bank runs—which occurred when many depositors demanded to get all of their money out of a bank at once for fear of a bank failure—were a common feature of American life for many decades. However, bank runs were essentially stopped once that US Government established the Federal Deposit Insurance Corporation (FDIC) which protects bank accounts <u>up to $250,000</u> at FDIC insured banks and savings associations. This means that even if a FDIC insured bank were to fail financially, every account holder is insured up to $250,000. Thus, if you had a $75,000 in a savings account at a bank and it were to go bankrupt you would get all $75,000 back.

2) *Convenience.* Traditionally, banks offered the convenience of not having to carry all of your money around to ensure you had it available when needed. The ability to write checks was the feature most people sought. However, over the last couple of decades, banking has become even more convenient with such innovations as ATMs, direct deposit, internet banking, electronic transfers between accounts, bill pay etc…

3) *Other people can benefit from the savings.* Banks are the intermediary between lenders (i.e. depositor/savers) and borrowers. Banks make money by lending out the money that

you deposit. They do so by charging higher interest rates on the loan they make compared to the interest rates they pay depositors.

Types of Bank Accounts

There are four main types of Bank Accounts and each have different characteristics. As you read thru them, keep in mind the fact that a depositor will earn more interest the longer the bank gets to keep his/her money!

1) *Checking accounts* offer safety and convenience.
   a) You keep your money in the account and write a check, use a debit card or access your account online when you want to pay a bill or transfer some of your money to someone else.
   b) If your checkbook or debit card is lost or stolen, you can cancel the debit card or close your account and open a new one so that nobody can use your old account information. (When cash is lost or stolen, you rarely see it again.)
   c) Banks sometimes charge a fee for checking accounts because processing transactions can be costly. Many banks also offer no-fee checking and checking accounts that earn interest if you agree to keep a certain amount of money—a minimum balance—in the account.

2) *Savings accounts* are for people who want to keep their money in a safe place and earn interest at the same time.
   a) You don't need a lot of money to open a savings account, and you can withdraw it easily.
   b) You can make deposits and withdrawals but usually can't write checks.
   c) The bank usually pays an interest rate that's higher than a checking account but lower than a money market account or CD.
   d) Many people use it as a place to keep emergency cash since access to cash is easily available.
   e) Some savings accounts charge a fee if your balance falls below a specified minimum.

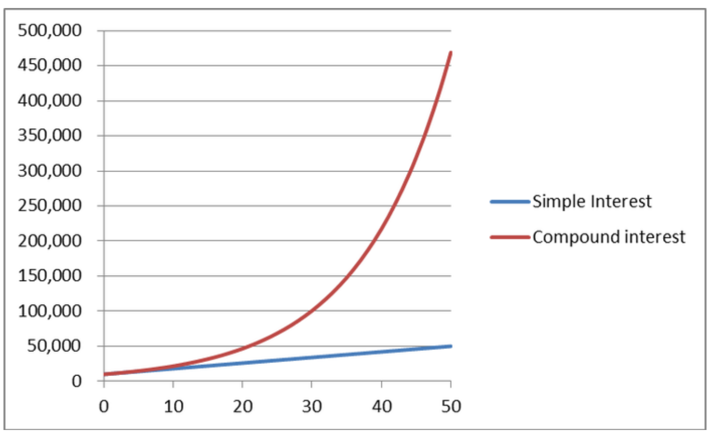
3) *Money market deposit accounts (MMDAs)* are similar to checking accounts that earn interest, except that they usually pay a higher rate of interest and require a higher minimum balance (often $2,500 or more). They also limit the number of checks you can write per month.

4) *Certificates of deposit (CDs)* are savings deposits that are sometimes called "time deposits" because you are required to keep a certain amount of money in the bank for a fixed period of time (for example: $1,000 for two years).
   a) Because your money will be inaccessible for the period of time you have agreed upon, you are rewarded with a higher interest rate.
   b) The longer you agree for the bank to hold your money, the higher the rate you will receive.
   c) There is usually a penalty if you withdraw your money early, so don't select this option if you think you might need the money before the maturity date (the time period you have agreed upon)

Interest Rates

When it comes to both investing money and borrowing money it is vital to understand the role interest rates play. There are two different types of interest: *Compound* and *Simple*.

1) Comparing Simply and Compound Interest
   a) Let's say you invest $10,000 at 8% simple interest. This means that after the first year, $800 is added to your account. In the second year, another $800 in interest is paid, and the same with the third year, fourth year, and so on.
   b) If your investment paid 8% *compound* interest on an annual basis, it wouldn't make a difference at first. After the first year, you'd receive the same $800 interest payment as you would with a simple interest calculation. However, this is where it starts to get very different.
   c) In the second year, your 8% interest is calculated on your *entire* new balance of $10,800, not just your original $10,000. This produces an interest payment of $864 for the second year, which is then tacked on to the principal when calculating your interest for the third year.
   d) You may be surprised at how quickly this can add up. At 8% simple interest, your $10,000 investment would be worth $34,000 after 30 years. However, using compound interest, the value would balloon to more than $100,000 after 30 years. Look at the graph to see how simple and compound interest compare over a 50-years!



2) **2)** Rule of 72 - For compound interest, as a rule of thumb you can calculate how long it will take your money to doubly by diving 72 by your interest rate. For example, if you invested $1,000 at 8% compounded it would take 9 years to double! (72/8 = 9)

Current Interest Rates

Briefly research the current interest rates that you can earn by putting your money in a bank account. Pick any bank of your choosing and then fill in the rates for the following:
Checking Account (assume $5,000 deposit):__________________
Savings Account (assume $15,000 deposit): __________________
Money Market Account (assume $10,000 deposit): __________________
1-year Certificate of Deposit (assume $5,000 deposit): __________________

What do you notice about the interest rates that you can earn?

If you are unable to access the internet, simply sign here: ______________________

Summary Questions:

1. What is the key to building wealth and capital formation?_____________________________

2. Of the four types of bank accounts, which typically offers the best interest rate and why?

3. Do want to earn simple interest or compound interest on your deposit/investment? Why?

4. What does FDIC stand for? Why is it important to insure you only use a FDIC-insured bank?

Wednesday, March 25 - Lesson 3: Investing

Objective: Be able to do this by the end of this lesson.
Identify, and explain the differences between, the main types of investments.

Lesson 3 Student Expectations: Read/annotate the reading and answer the questions at the end.

Introduction to Lesson 3
Yesterday's lesson focused on the initial step many people take in creating wealth; saving money and putting it in bank to earn interest. However, as the exercise in researching the interest rates of the various bank accounts, it will take you a LONG time to build wealth if you simply left all your money in a bank. Thus, many people look to invest their money. We explore those basic investment options.

Main Type of Investments.

1) Stocks
   a) When you buy *common stock*, you become a part owner of the company and are known as a *stockholder*, or *shareholder*.

b) Stockholders can make money in two ways—receiving dividend payments and selling stock that has appreciated.
c) A *dividend* is an income distribution by a corporation to its shareholders, usually made quarterly.
d) Stock *appreciation* is an increase in the value of stock in the company, generally based on its ability to make money and pay a dividend.

2) Mutual Funds—Investing in Many Companies
   a) *Mutual funds* are established to invest many people's money in many firms. When you buy mutual fund shares, you become a shareholder of a fund that has invested in many other companies. By diversifying, a mutual fund spreads risk across numerous companies rather than relying on just one to perform well. Mutual funds have varying degrees of risk. They also have costs associated with owning them, such as management fees, that will vary depending on the type of investments the fund makes.

3) Bonds
   a) Represent loans to corporations, municipalities, governments or their agencies.
   b) They are term loans. The length of time and interest rate are established before they are sold.
   c) Bonds and bank loans share some characteristics.
      (1) Interest rate
      (2) Term (length of the loan)
      (3) Regular and/or Scheduled payments by the borrower
   d) Bonds and bank loans have important differences.
      (1) A bank, rather than an individual depositor, bears the risk of default on a loan. A bond holder individually bears the risk of default on a bond.
      (2) Banks generally have more stringent lending guidelines, while individual investors are free to accept more risk when they purchase bonds.

Risk versus Reward.
While stocks, mutual funds and bond offer the potential for greater gain than leaving your money in a bank account, they also pose great risk. You can lose all of your money when investing in a stock, mutual fund or bond. However, as we learned in our first lesson, banks are insured up to $250,000. Note, that stocks are most volatile, mutual funds less volatile and bonds the least volatile. This means stocks offer the greatest potential for gain and pose the greatest risk of loss.

Current Status of Investments - A week before Spring Break, each of you were given a notional $10,000 dollars to invest. Needless to say, a lot has happened since then. Take some time to check on the current status of your investment. (If you forgot what you invested in, please email me and I can provide you that information.) In the space provided below: (a) write down how your investment(s) is/are currently worth; (b) If your total investment has gone up during this time, provide an explanation why you believe it has. If your total investment has gone down during this time, provide some thoughts as to whether you would hold on to it or sell it and why; and (c) state whether you believe this would be a good time buy specific stocks and why. Make sure take some time to research how the stock market has done overall and reflect on what you believe will happen in the near-term and long-term.

If you are unable to access the internet, simply sign here: ______________________

Summary Questions:

1. Why are mutual funds less volatile that a individual stock?

2. Should you invest money into the stock market which you intend to use to meet your short-term goals? (i.e., should you invest money in the stock market that you might need in the next year?) Why or why not?

Thursday, March 26 - Lesson 4: Starting a Business

Objective: Be able to do this by the end of this lesson.
Identify, and explain the differences between, the main types of business structures.

Lesson 4 Student Expectations: Read/annotate the reading. Note, the reading is long, so focus on the advantages and disadvantages of each type of business organization.

Introduction to Lesson 4
The previous lessons focused on how people create wealth through saving and investing. Another way people create wealth is through starting a business. Your choice of whether your business should be a proprietorship, a partnership or a corporation can be important for many reasons. Each has advantages and disadvantages depending on the type of activity you are engaged in.

Choosing Your Legal Structure
Part of keeping your home-based business legal involves choosing the legal structure for it: sole proprietorship, partnership, or corporation. Aside from being necessary for government reporting and tax purposes, this can enable your business to operate more efficiently. Since each legal form has its own unique characteristics, your goal is to choose the form that works best for you.
Once the entrepreneur has determined the goods or services the company will offer and whether there is a market for the product, a decision must be made on the type of business formation. Usually you will choose either a sole proprietorship, a partnership or a corporation. There's no right or wrong choice that fits everyone. Your job is to understand the advantages and disadvantages of each legal structure and pick the one that best meets your needs.

Sole Proprietorship. A business owned by one person, who is entitled to all of its profits and responsible for all of its debts, is considered a sole proprietorship. These firms are owned by one person, usually the individual who has day-to-day responsibility for running the business. Sole proprietors own all the assets of the business and the profits generated by it. They also assume complete responsibility for any of its liabilities or debts. This legal form is the simplest, providing maximum control and minimum government interference. Currently used by more than 75 percent of all businesses, it is often the suggested way for a new business that does not carry great personal liability threats. The owner simply needs to secure the necessary licenses, tax identification numbers, and certifications in his or her name, and you are now in business!

The main advantages that differentiate the sole proprietorship from the other legal forms are (1) the ease with which it can be started, (2) the owner's freedom to make decisions, and (3) the distribution of profits (owner takes all).

Still, the sole proprietorship is not without disadvantages, the most serious of which is its unlimited liability. As a sole proprietor, you are responsible for all business debts. Should these exceed the assets of your business, your creditors can claim your personal assets--home, automobile, savings account, and investments. In other words, the law basically treats the business and the owner as one and the same. This uniform treatment also has important tax implications. Partnerships and corporations may lessen their tax liability through a myriad of business expenses and other tax avoidance techniques. These tax deductions may not be applicable to a sole proprietorship. Also, the potential growth and reach of a sole proprietorship pale in comparison with that of a corporation. Sole proprietorships also tend to have more difficulty obtaining capital and holding on to key employees. This stems from the fact that sole proprietorships generally have fewer resources and offer less opportunity for job advancement. Thus, anyone who chooses the sole proprietorship should be prepared to be a generalist, performing a variety of functions, from accounting to advertising.

Advantages	Disadvantages
· You're the boss. · It's easy to get started. · You keep all profits. · Income from business is taxed as personal income. · You can discontinue your business at will.	· You assume unlimited liability. · The amount of investment capital you can raise is limited. · You need to be a generalist. Retaining high-caliber employees is difficult. · The life of the business is dependent on the owner's.

Partnership. A business owned by two or more people, who agree to share in its profits, is considered a partnership. Like sole proprietorships, the laws do not distinguish between the business and its owners. The Partners should have a legal agreement that sets forth how decisions will be made, profits will be shared, disputes will be resolved, how future partners will be admitted to the partnership, how partners can be bought out, or what steps will be taken to dissolve the partnership when needed. It is difficult to think about a "break-up" when the business is just getting started, but many partnerships split up at crisis times and unless there is a defined process, there will be problems. They also must decide up front how much time and capital each will contribute. Like the sole proprietorship, it is easy to start and the red tape involved is usually minimal. The tax structure is the same as proprietorship except in the profits and losses of the partnership are divided by an agreed percentage by the partners.

The main advantages of the partnership form are that the business can (1) draw on the skills and abilities of each partner, (2) offer employees the opportunity to become partners, and (3) utilize the partners' combined financial resources.

However, for your own protection, it is advisable to have a written partnership agreement that will spell out the specifics of the agreement. This should state (1) each partner's rights and responsibilities, (2) the amount of capital each partner is investing in the business, (3) the distribution of profits, (4) what happens if a partner joins or leaves the business, and (5) how the assets are to be divided if the business is discontinued. Things have a way of changing and people forgetting over time, so it is essential that there be a signed document that all abide by.

Partnerships also have their share of disadvantages. The unlimited liability that applies to sole proprietorships is even worse for partnerships. As a partner, you are responsible not only for your own business debts, but for those of your partners as well. Should they incur debts or legal judgments against the business, you could be held legally responsible for them. Disputes among partners can be a problem, too. Unless you and your partners see eye to eye on how the business should be run and what it should accomplish, you are in for trouble.

However, a partnership is generally the least advisable way to go. It requires filing a separate partnership tax return, does not carry liability protection for general partners, and can lead into legal and personal disputes. A corporate form of ownership is generally recognized as preferable over partnership, because it can serve the same purpose while offering a cleaner and better protected structure for the owners.

Advantages	Disadvantages
· Two heads are better than one. · It's easy to get started. · More investment capital is available. · Partners pay only personal income tax. · High-caliber employees can be made partners.	· Partners have unlimited liability. · Partners must share all profits. · The partners may disagree. · The life of the business is limited.

You can create a partnership based on an oral agreement, but it's much smarter to put it in writing. A partnership is a business form created automatically when two or more persons engage in a business enterprise for profit. Consider the following language from the Uniform Partnership Act: "The association of two or more persons to carry on as co-owners of a business for profit forms a partnership, whether or not the persons intend to form a partnership." A partnership – in its various forms – offers its multiple owners flexibility and relative simplicity of organization and operation. In limited partnerships and limited liability partnerships, a partnership can even offer a degree of liability protection.

Partnerships can be formed with a handshake – and often they are. In fact, partnerships are the only business entities that can be formed by oral agreement. Of course, as with any important legal relationship, oral agreements often lead to misunderstandings, which often lead to disputes. Thus, you should only form a partnership that is memorialized with a written partnership agreement. Preferably, you should prepare this document with the assistance of an attorney. The cost to have an attorney draft a partnership agreement can vary between $500 and $2,000 depending on the complexity of the partnership arrangement and the experience and location of the attorney.

How Partnerships Are Managed

Partnerships have very simple management structures. In the case of general partnerships, partnerships are managed by the partners themselves, with decisions ultimately resting with a majority of the percentage owners of the partnership. Partnership-style management is often called owner management. Corporations, on the other hand, are typically managed by appointed or elected officers, which is called representative management. Keep in mind that a majority of the percentage interest in a partnership can be very different from a majority of the partners. This is because one partner may own 60 percent of a partnership, with four other partners owning only 10 percent each. Partnerships (and corporations) universally vest ultimate voting power with a majority of the percentage ownership interest.

Of course, partners and shareholders don't call votes every time they need to make some small business decision such as signing a contract or ordering office supplies. Small tasks are managed informally, as they should be. Voting becomes important, however, when a dispute arises among the partners. If the dispute cannot be resolved informally, the partners call a meeting and take a vote on the matter. Those partners representing the minority in such a vote must go along with the decision of the partners representing the majority.

Partnerships do not require formal meetings like corporations do. Of course, some partnerships elect to have periodic meetings anyway. Overall, the management and administrative operation of a partnership is relatively simple, and this can be an important advantage. Like sole proprietorships, partnerships often grow and graduate to LLC or corporate status.

Varieties of Partnerships There are several varieties of partnerships. They range from the simple general partnership to the limited liability partnership.

The general partnership. By default, a standard partnership is referred to as a general partnership. General partnerships are the simplest of all partnerships. An oral partnership will almost always be a general partnership. In a general partnership, all partners share in the management of the entity and share in the entity's profits. Matters relating to the ordinary business operations of the partnership are decided by a majority of the partners. Of course, some partners can own a greater share of the entity than other partners, in which case their vote counts according to their percentage ownership--much like voting of shares in a corporation. All partners are responsible for the liabilities of a general partnership.

The limited partnership. The limited partnership is more complex than the general partnership. It is a partnership owned by two classes of partners: general partners manage the enterprise and are personally liable for its debts; limited partners contribute capital and share in the profits but normally do not participate in the management of the enterprise. Another notable distinction between the two classes of partners is that limited partners incur no liability for partnership debts beyond their capital contributions. Limited partners enjoy liability protection much like the shareholders of a corporation. The limited partnership is commonly used in the restaurant business, with the founders serving as general partners and the investors as limited partners.

A limited partnership usually requires a state filing establishing the limited partnership. Some states, most notably California, allow the oral creation of a limited partnership. Of course, establishing a limited partnership with nothing more than an oral agreement is unwise. Oral limited partnership agreements will very likely lead to disputes and may not offer liability protection to limited partners. Because of the complexity of limited partnerships, the formation of one is not something you should undertake on your own. The formation of a limited partnership is best left to a qualified attorney.

Partnership Agreements

Your partnership agreement should detail how business decisions are made, how disputes are resolved, and how to handle a buyout. You'll be glad you have this agreement if for some reason you run into difficulties with one of the partners or if someone wants out of the arrangement. 4 The agreement should address the purpose of the business and the authority and responsibility of each partner. It's a good idea to consult an attorney experienced with small businesses for help in drafting the agreement. Here are some other issues you'll want the agreement to address:

- 1. How will the ownership interest be shared? It's not necessary, for example, for two owners to equally share ownership and authority. However you decide to do it, make sure the proportion is stated clearly in the agreement.
- 2. How will decisions be made? It's a good idea to establish voting rights in case a major disagreement arises. When just two partners own the business 50-50, there's the possibility of a deadlock. To avoid a deadlock, some businesses provide in advance for a third partner, a trusted associate who may own only 1 percent of the business but whose vote can break a tie.
- 3. When one partner withdraws, how will the purchase price be determined? One possibility is to agree on a neutral third party, such as your banker or accountant, to find an appraiser to determine the price of the partnership interest.
- 4. If a partner withdraws from the partnership, when will money be paid? Depending on the partnership agreement, you can agree that the money be paid over three, five or ten years, with interest. You don't want to be hit with a cash flow crisis if the entire price has to be paid on the spot in one lump sum.

How Partnerships Are Governed

Partnerships are governed by the law of the state in which they are organized and by the rules set out by the partners themselves. Typically, partners set forth the governing rules in a partnership agreement.

Often the governance rules determined by the partners differ from the governance rules set by state law. In most cases, the rules of the partners override state law. For example, state law typically dictates that a partnership's profits are to be divided among partners in proportion to their ownership interests. However, the partners are free to divide profits by a formula separate from their ownership interests, and the decision of the partners will override state law. Thus, the governance rules in state law are default provisions that apply in the absence of any rules set by the partners in a partnership agreement.

This fact underscores the need for a partnership agreement. Otherwise, the partnership will by default be governed by state law. The laws set forth by state law may not be appropriate for every partnership. For the most part, however, the default state rules are fair and well-balanced.

Corporation. A corporation differs from the other legal forms of business in that the law regards it as an artificial being possessing the same rights and responsibilities as a person. This means that, unlike sole proprietorships or partnerships, it has an existence separate from its owners. It has all the legal rights of an individual in regards to conducting commercial activity -- it can sue, be sued, own property, sell property, and sell the rights of ownership in the form of exchanging stock for money. A corporation can be taxed; it can be sued; it can enter into contractual agreements. The owners of a corporation are its shareholders. The shareholders elect a board of directors to oversee the major policies and decisions. The corporation has a life of its own and does not dissolve when ownership changes.

A corporation is a juridical entity. It must be created by or composed of at least 2 natural persons, technically called “incorporators.” Juridical persons, like other corporations or partnerships, cannot be incorporators, although they may subsequently purchase shares and become corporate shareholders/stockholders. The liability of the shareholders of a corporation is limited to the amount of their capital contribution. In other words, personal assets of stockholders cannot generally be attached to satisfy the corporation’s liabilities, although the responsible members may be held personally liable in certain cases. For instance, the incorporators may be held liable when the doctrine of piercing the corporate veil is applied. The responsible officers may also be held solitarily liable with the corporation in certain labor cases, particularly in cases of illegal dismissal.

As a result, the corporation offers some unique advantages. These include (1) limited liability: owners are not personally responsible for the debts of the business, (2) the ability to raise capital by selling shares of stock, and (3) easy transfer of ownership from one individual to another. Plus, unlike the sole proprietorship and partnership, the corporation has "unlimited life" and thus the potential to outlive its original owners.

Advantages	Disadvantages
· Stockholders have limited liability. · Corporations can raise the most investment capital.	· Corporations are taxed twice. · Corporations must pay capital stock tax. · Starting a corporation is expensive.

· Corporations have unlimited life. · Ownership is easily transferable. · Corporations utilize specialists.	· Corporations are closely regulated by government agencies.

The main disadvantage of the corporate form can be summed up in two words: *taxation and complexity*. In what amounts to double taxation, you must pay taxes on both the income the corporation earns and the income you earn as an individual. Along with this, corporations are required to pay an annual tax on all outstanding shares of stock. Given its complexity, a corporation is both more difficult and more expensive to start than are the sole proprietorship and the partnership. In order to form a corporation, you must be granted a charter by the state in which your home-based business is located. For a small business the cost of incorporating usually ranges from $500 to $1,500. This includes the costs for legal assistance in drawing up your charter, state incorporation fees, and the purchase of record books and stock certificates. And, since corporations are subject to closer regulation by the government, the owners must bear the ongoing cost of preparing and filing state and federal reports.

The biggest businesses take the form of corporations, a testament to the effectiveness of this business organization. A corporation, however, is relatively more difficult to create, organize and manage. There are more reportorial requirements with the stock-exchange. Unless you own sufficient number of shares to control the corporation, you'll most likely be left with no participation in the management. The impact of these concerns, however, is minimized by the army of lawyers, accountants and consultants that assist the corporation's management.

Summary Questions:

1. Why are most small businesses either sole proprietorships or partnerships?

2. What are most large businesses corporations?

<u>Friday, March 27 - Lesson 5: Borrowing Money</u>

Objective: Be able to do this by the end of this lesson.
Explain the different ways to borrow money and the potential pitfalls of doing so.

Lesson 5 Student Expectations: Read/annotate the reading and complete the exercise and summary questions. <u>****After completing the lesson, take the quiz on the last page. Do not turn to the quiz until you are ready to begin it. Please do not use your study packet to complete the quiz. By signing the academic integrity statement on page 2 of this packet, you are saying that you completed the quiz on your own and without use of your packet or notes.****</u>

Introduction to Lesson 5
The previous lessons have focused on creating wealth. The lesson today covers the significant pitfall on the way to creating wealth…debt. Many individuals take loans out to buy a house, buy a car or pay for school. However, many individuals also take loans out to cover short-term consumer purchases of goods and services. Some will even take loans out to invest or start a business. Being able to understand the types of debt and how to both manage and limit debt is vital to ensuring you can meet your financial goals and build wealth.

Loans and Their Characteristics:
There are three key features of loans:

1) Open-End v. Closed-End
    a) Open-End/Revolving Credit
        i) typically used for daily expenses and can be used repeatedly
        ii) interest charged when balance not paid in full at the end of the month
        iii) ex. Credit card, home equity loans
    b) Closed-End/Term/Installment Loan
        i) typically used to finance for a specific purpose of a specific period of time
        ii) regular repayment schedules that includes interest
        iii) ex. Mortgages, car loans, appliance loans, payday loans, student loans
2) Secured v. Unsecured
    a) Secured – backed by collateral
    b) Unsecured – Not backed by collateral
3) Fixed-rate v. Variable Interest
    a) Fixed-rate: the rate never changes
    b) Variable-rate: the rate changes (and can go up A LOT!!!)

Using the chart on the next page, think of at least five different types of loans/sources of money that you can get if/when you need money (i.e., home loan from a bank, credit card, payday loan, etc…). Then, do some <u>***brief***</u> research (no more than 5-10 minutes) to determine the three characteristics of each of those loans as discussed above and determine the current interest rate or fee associated with each.

	Type of Loan/Source	Open-End or Closed-End	Secured or Non-Secured	Fixed or Variable Rate Interest	Interest Rate and/or Fee
1					
2					
3					
4					
5					
6					

If you are unable to access the internet, simply sign here: ______________________

Credit Cards

Credit cards are an easy way to obtain money for many Americans and, as a result, has trapped many Americans in debt. According to NerdWallet, in 2016 Americans had an average of $16,061 in credit card debt. While it does not seem like a lot of money, as you saw above credit cards are a type of revolving credit that typically has very high interest rates. Consider this example:

- Imagine you owe $3,000 on a credit card that charges 17% APR and decide to pay the minimum of 3% of your balance or $25, whichever is greater (* Your account agreement or monthly statement will contain language similar to "your minimum payment is 3% of your balance or $25, whichever is greater). How long will it take you to pay if off and how much interest will you pay?

- It will take you 126 months to pay off your debt, if you make minimum monthly payments on a balance of $3000.00 with a 17% APR. In that time, you will pay $2241.14 in interest charges.

In short, that $3,000 credit card balance could be with you for over 10 years and result in you paying back approximately 75% more than what you borrowed. Now imagine the same scenario when having a balance of $16,061 in credit card debt!

Credit card companies make money from both the interest that people pay as well as transaction fees every time their card is used. Needless to say, they want you to use their credit card and entice people to do so by offering such incentives as cash back, airline miles or "points" that can be used to purchase other items. They also entice you to sign-up for their card by offering free airline tickets, low introductory interest rates and increased points for the first six months of use.

Credit cards are a very convenient way to purchase goods and services. However, because of this convenience it is very easy to get trapped in debt. Studies have shown that people will spend more if using a credit card versus writing a check or paying in cash. Psychologically, it is far easier for someone to "swipe a card" for a $500 purchase than it is for them to take $500 in cash from their wallet and hand it over.

If you are going to use a credit card, be aware of how easy it is to spend money, so think twice about what you are purchasing. Moreover, most financial advisors recommend you pay off your credit card balance in full every month. Not only will you avoid paying interest, but you might even "make" money from the incentives credit card companies offer!

Conclusion
Always remember that whatever you borrow, you have to pay back and, more importantly, you have to pay it back with interest. Moreover, if wealth gives you the personal freedom to live the good life and pursue truth, beauty and goodness, then debt restricts it and/or takes it away!!

Summary Questions:

1. What factors should you consider when you are borrowing money?

2. Should you use credit cards? Why/why not? If you do use them, under what conditions?

Personal Financial Literacy Quiz
(Complete without looking at your notes or packet!)

1. Place an "A" if the item is an Asset or a "L" if the item is a liability

___ Credit Card Balance	___ Savings Account	___ House	___ Car Loan
___ Car	___ Mortgage/Home Loan	___ Medical Bill	___ Clothing

2. Stock and Bonds are:

A. Wealth Creating Assets
B. Non-Wealth Creating Asset

3. Match the Bank Account to its Characteristics by placing the letter next to the account:

___ Savings Accounts	A. Are savings deposits that are sometimes called "time deposits" because you are required to keep a certain amount of money in the bank for a fixed period of time (for example: $1,000 for two years). There is usually a penalty if you withdraw your money early
___ Certificate of Deposits	B. You keep your money in the account and write a check, use a debit card or access your account online when you want to pay a bill or transfer some of your money to someone else.
___ Checking Accounts	C Are similar to checking accounts that earn interest, except that they usually pay a higher rate of interest and require a higher minimum balance (often $2,500 or more). They also limit the number of checks you can write per month.
___ Money Market Deposit Accounts	D. You don't need a lot of money to open this account, and you can withdraw it easily. You can make deposits and withdrawals but usually can't write checks. Many people use it as a place to keep emergency cash since access to cash is easily available

4. Increasing your personal debt increases your personal freedom (circle one):

A. TRUE B. FALSE