# A FEW BASIC CONCEPTS

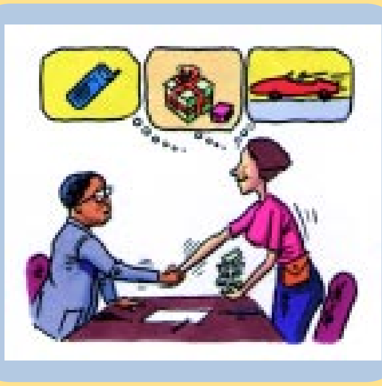
*This section introduces some basic concepts. We will look at all of them in greater detail further on.*

## Borrowing and lending

When we **borrow** something, we are given permission to use it for a period of time and we usually have to pay for this. For example, if we are **hiring** a **car**, we are, in fact, borrowing it and we **pay** to do so.

We can also borrow money. Borrowed money is called a **loan** or **credit**. The price we pay to borrow it is **interest**. The actual amount that we borrow is the **principal or capital amount**.

It's easy to understand why many people want to *borrow* money. Very few of us have enough money to pay cash for something as expensive as a house or a car, so we borrow money and agree to pay back the amount, plus interest, over time. If we can live without something, though, it is better to wait until we have the money to pay cash.



But why would someone *lend* us money? To make it worth their while to lend their money to a borrower, lenders must **earn** something for the service that they provide and for the risk that they take. The **interest** that they get from the borrower is their reward or "return". Interest is usually written as a percentage of the principal amount over a period of time, e.g. for a R10 000 loan you may have to pay **24% interest p.a.** That is **R200 a month** in addition to what you borrowed**.**

## Credit

**Credit** is **borrowed** money. When we buy something "on credit", whether it is a fridge or a car, we are using it before we have paid for it. When we **borrow** money, we are spending money before we have **earned** it.

## Interest rates

Interest is either money we earn when we deposit money at the bank, or it is the price we pay for credit.

The interest percentage that we earn or pay per year is called the **interest rate**. For example, we may borrow R50 000 at an interest rate of 20% per year to buy a car. In simple terms, the cost of borrowing that money for the first year of the loan is 20% of R50 000 which is R10 000 (R833 a month).

However, interest rates are sometimes a bit more complex, depending on whether all the interest is calculated at the **beginning** of the period of the loan, or whether you pay interest on the **balance** of the debt after every monthly repayment. Ask your bank to explain to you exactly how the interest on your loan will be calculated.

*Never borrow money if you are not sure that you can afford the repayments.*

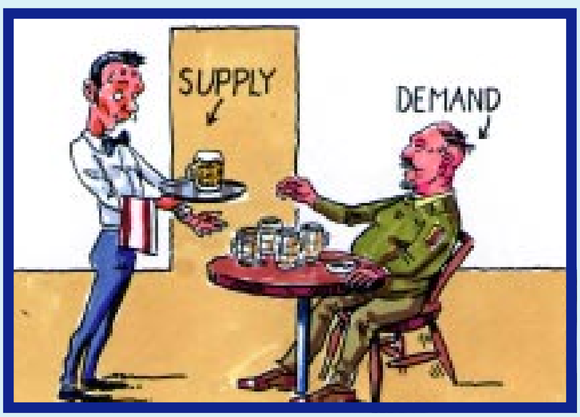
## Goods and services

The things we buy are either **goods** or **services**. For example, items such as food, furniture and clothes are goods, while medical care, banking and education are services.

## Supply and demand

**Producers supply** goods and services to meet **customers' demand**. For example, if a lot of people buy apples, producers will produce a lot of apples. If there is a **strong demand** for apples, but a **limited supply**, the **price will rise**. As producers supply more apples to meet demand, the price will fall again.

When people are buying all the apples they can afford, and producers are selling all the apples they can produce at a profit, we say that demand and supply are in **equilibrium** (or balance) and the price of apples is stable.




*Producers go to great lengths to ensure a balance between supply and demand.*

## Intermediary

In the financial world an intermediary is someone who facilitates business between the consumer (the client) and the supplier of the service (a bank or an insurance company or the JSE Securities Exchange, for example). Intermediaries include insurance brokers, bank officials and stockbrokers. Find out more about them on page 17.

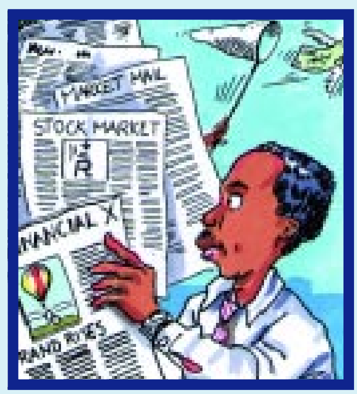
## Return

A **return** is basically income. Investors must make a return on their money or they may as well keep it under a mattress and not invest it. The money that investors invest in businesses is called **capital**, or **equity**. Investors expect a return on their equity. If a business cannot provide the expected **return on equity** (**ROE**) to the investors who have put money into it, the investors will take their money out of the business and the business will have to find new investors or close down. Banks, just like other businesses, must attract investors by ensuring an adequate return on their money.

## Risk and reward

The **more risk** an investor takes, the **bigger the reward** he or she expects. If there is a high risk that investors will lose part or all of their capital, they will expect a higher return on equity to compensate for that risk.

***Never* risk money you cannot afford to lose!**




## Inflation

Inflation is an **overall, ongoing rise in prices**. Prices are always rising and falling as supply and demand change, but a price increase on a single product is not inflation. Inflation is usually given as the percentage increase in overall prices over a year. This reflects the **reduction in the purchasing power** of your money. If you divide 72 by the inflation rate (say 10%), you get the number of years it will take before your money buys only half of what it buys today!