Lecture Notes on BAF 111 Introduction to Finance I.
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LECTURE 1

MONEY

DEFINITION

Money is anything generally accepted within a given community and printed by Central Bank of Nigeria for the purpose of making payments and discharging obligations.

BRIEF HISTORY OF MONEY

Early history of money was trade by barter, where goods were exchanged in the market place. It was a clumsy and tedious system for the following reasons:

i. Double coincidence of wants; a situation whereby one who had salt for example but wanted to exchange for smoked fish, was faced with two problems.
First, was to find one who had smoked fish and secondly, that discovered one would be in need of salt otherwise no deal.

ii. Determination of a rate to exchange goods. In our example above, what quantity of salt would exchange for a medium sized smoked fish? It was a problem that bedeviled the market.

iii. Lack of change. If my great grand ma went to my village market and had a well-developed fowl to sell to return with a list of soup items that included pepper, egusi, tomatoes, crayfish etc, she would expect that the first trader who took the fowl and had pepper to exchange would give her change. That was not possible in a barter system.

iv. Lack of a unit of account. There was no currency or measure to denominate accounting.

v. No standard for deferred payment. If I owed my neighbor a bag of rice for example and returned it at the end of the month as agreed, it might not excite my neighbor who had a deluge of harvested rice to dispose of. There was no standard by which debts could be paid.

Coinage and paper money started with goldsmiths. They had credible vaults for keeping valuables and issued receipts for all such valuables. With time, the goldsmiths observed that they could lend out part of such deposits safely. The depositors also observed that they could trade with the receipts given by the goldsmiths. That was the beginning of paper money.

Modern money started in Sweden around 1640 when the first unit of legal tender called Krona went into circulation. Today, every sovereign state has its own legal tender e.g. Nigeria uses naira, Ghana-cedis, Britain-pound sterling, U.S.A.-dollar. The world has even gone further to have monetary integration whereby several countries come together to have a single currency under a sole monetary authority e.g. most countries of Europe use Euro as their legal tender under a sole monetary authority called the European Central Bank.

Like the developed countries of the world, the new focus on currency management is the “Cashless Policy” designed in Nigeria by Central Bank of Nigeria to encourage payment by electronics means rather than cash for almost all purchases.

FUNCTIONS OF MONEY

It is not appropriate as undergraduates to just state that there are four functions of money.

We should be able to split the functions into primary functions, derived functions and dynamic functions.

1. Primary Functions
    a) Medium of Exchange
    It is the means by which buying and selling of goods and services in the modern world is facilitated.
    b) Unit of Account
    Money is a common denominator by which the values of goods and services are expressed.
2. Derived Functions (derived from the primary functions)
    a) Store of Value
    This enables wealth to be stored easily and conveniently. It is on this basis that savings are made and banks operate.
    b) Standard for deferred Payments
    Money facilitates future payments like salaries, insurance, pension and loan repayment. Money as a veil for savings and acquiring in the future, one's desires, is emphasized in this function.
3. The Dynamic Functions of Money
    This means that money is an economic lubricant. It does this in the following ways:
    a) It makes possible specialization and division of labour.
    b) It makes possible credit business as in bank lending and borrowing or buying things on credit.
    c) Through price formation, money determines what to produce, when to produce it and the quantity to produce. Money makes the market system to work.

CHARACTERISTICS OF MONEY

We are interested to know what features or characteristics anything selected and designed to serve as money must have. They are as follows:

1. General Acceptability
    In the length and breadth of the community, money should be respected and be generally acceptable for the payment of goods and services. The item must have been issued by the government's monetary authority to win general acceptance.
2. Stability in Value
    The value in economic terms must be stable for it to function as a standard for deferred payment. Otherwise, in a severe inflationary period, the holder will quickly get rid of whatever money that comes to hand before the value depreciates.
3. Relative Scarcity
    The naira for example, should not be pickable on the side walk. To have it, one must work for it or benefit from another person who worked hard to earn it. It should be scarce to have but not too scarce.
4. Portability
    It should be possible to pocket some quantity of the money item and walk freely without exposure. It should be portable for handling.
5. Divisibilty

The currency item should be in different denominations so that change can be given when necessary.

6. Homogeneity
   Different denominations should be same in colour and size for easy recognition.
7. Durability
   The item used as money should not fade easily by mere usage. The naira currency can be in circulation for many years without drastically fading except it is defaced.
8. Cognisability
   The money item should easily be recognized anywhere within the community using it. That is to say, the trader does not need any convincing that the item before him is money issued by the monetary authority.

   Thus, although money is paper and your note book is also paper, your note book can never serve as money because of the above characteristics which abide with money and money alone.

TYPES OF MONEY

1. Legal Tender or Pure Money
   It is the currency printed by the monetary authority of the country and backed up with appropriate monetary policies to retain and improve on its value. It is the legal tender that is used as naira for market transactions.
2. Bank Deposits
   They are in the form of current account, savings account and term deposit account e.g. fixed deposit account. While current account performs the primary function of money if funded, savings and term deposits accounts perform the derived functions of money.
3. Quasi or Near Money
   It is investment in treasury bills, treasury certificates, bonds, shares etc which cannot be spent in the market place in their present form. They have to be liquified or purified by converting them to cash before they can be spent.

THEORIES OF MONEY

1. The Classical Quantity Theory

The theory was a product of 17^{th} century led by a philosopher named Irving Fisher. The theory says there is a direct and proportionate relationship between the quantity of money in circulation and the general price level. The two sides of the equation were depicted thus:

$MV=PT$

where

M= the amount of money in circulation

V= the velocity of money or the number of times money changes hands.

P= the unit price of goods and services being bought and sold in the economy

T= the number of transactions that takes place.

Holding V and T constant, an increase in M leads to an increase in P.

2. The Keynesian Theory of Money

The Keynesian school of thought was led by J. M. Keynes, a world renowned economist. The theory says that there are three motives for holding money, namely:

i) Transactionary Motive

This is the proportion of one's income held for household needs and to keep one going until the next income comes to hand. It can be left in cash at home or in the current account withdrawable by cheque or automatic machine or used for purchases at point of sale machine.

ii) Precautionary Motive

People hold money under this point after satisfying their transactionary motive. Such money will be savings against the rainy day.

iii) Speculative Motive

Speculators hold money on the look-out for an opportunity to make phenomenal profits. It is a risky motive but much depends on how prone the speculator is to risk.

3. The Monetarist (Modern Theory)

This is another view of the theory of money championed by Milton Friedman of the University of Chicago. The monetarists argue that people hold money not only for Keynesian motives but for a combination of variables which include:

i) Interest rate
ii) Level of income
iii) Market conditions
iv) Opportunity cost.