ROUTLEDGE

THE NEW PSYCHOLOGY OF MONEY

ADRIAN FURNHAM

THE NEW PSYCHOLOGY OF MONEY

Adrian Furnham

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CONTENTS

List of illustrations *ix*
List of tables *xi*
Preface *xiii*

1 The psychology of money 1

2 Money today 15

3 Different approaches to the topic of money 33

4 Money and happiness 55

5 Money attitudes, beliefs and behaviours 81

6 Understanding the economic world 115

7 Economic socialisation and good parenting 139

8 Sex differences, money and the family 165

9 Money madness: money and mental health 183

10 Money and motivation in the workplace 211

11 Behavioural economics 237

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12 Persuasion, pricing and money 259

Appendix 1 *281*
Appendix 2 *285*
References *289*
Index *308*

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LIST OF ILLUSTRATIONS

4.1 The evidence for the Easterlin hypothesis 65
5.1 Materialism and work–family conflict 107
9.1 A strategy to understand typologies 198
9.2 Questions to determine type 199
10.1 Money and performance 215
10.2 Key variables in performance-related pay 225
11.1 The pain and pleasure of loss and gain 239

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LIST OF TABLES

1.1	Unusual items which have been used as money	7
2.1	Today's equivalent to £1m in the past	19
2.2	Reasons for millionaires' wealth accumulation	20
4.1	Income as a predictor of happiness and well-being	71
4.2	Impacts on the money/happiness relationship	75
5.1	Factor loadings for the Money Ethic Scale	83
5.2	The money contented and the money troubled	87
5.3	Money associations and gender	88
5.4	Four-factor measure of attitudes to money	93
5.5	Four dimensions of money	96
5.6	Empirical studies: methodological characteristics and demographic and personality factors that do and do not influence money attitudes	99
5.7	The items for the Money Attitudes scale	102
5.8	The Economic Beliefs Scale: instructions, items, format and scoring	104
6.1	Dates, samples and stages found in studies of the development of economic understanding	117
6.2	Percentage of participants nominating the 11 'issues' on which government spends taxation money	129
6.3	Percentage of participants specifying taxes (other than income tax) that (British) people have to pay	129
7.1	Children have a large disposable income: consider the British data from the Walls' annual survey, in the last century	144
7.2	The proportion of respondents who believe schools should teach 11 finance-related topics at secondary school, and levels of significance for the logistic regression analyses with the seven background variables	146
7.3	British parents' beliefs	150

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8.1 Money grams 176
9.1 Money pathology of the British people 185
9.2 A test of the anal character 188
10.1 Reactions to inequity 218
10.2 Effectiveness of merit-pay and bonus incentive systems in achieving various desired effects 228
10.3 Advice for managers 230
12.1 Increasing donations 266
12.2 Common pricing techniques 276

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PREFACE

The Psychology of Money was published in 1998. It has been reprinted half a dozen times and translated into various languages including Chinese and Portuguese. It has been quoted over 350 times in the academic literature and was well reviewed. It has been bought in bulk by banks as well as conference organisers, and I once recall signing 300 copies in one session for those attending a conference.

It was written by myself and Michael Argyle, my PhD (DPhil) supervisor at Oxford. The reason we collaborated on the book was really a chance remark made 15 years after I graduated. Michael used to tell people that he kept a "secret list" of topics that, for some reason, psychology had neglected and about which he intended to write books. One was happiness and he was among the first to write a book on that topic, foreshadowing Positive Psychology. Another was *money*. We had both noticed that even work/organisational psychology seemed to really neglect the issue, and it was rare to find any psychology textbook that had money in the index. It was as if psychology had left the topic completely to the economists, who, as we shall see, treated the topic very differently. They believed it was the measure of all things but that it cannot itself be measured. They believed we were all rational beings bent on money accumulation.

I had been working on the topic for some time and had published various papers on it. In 1984 I developed a measure to assess attitudes to money which is now one of my most quoted papers. I had been particularly interested in children and money; more particularly how they think about, and use, money. I had in fact started writing the book, called *The Psychology of Money*, when Michael mentioned the topic and his plan. I told him my story and we jointly agreed to write the book together. It was not our first and we knew each other well. We had somewhat different interests and rather different styles but that was relatively easily sorted out. I wrote many of my chapters while working in New Zealand.

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Michael wrote four of the chapters: those on possessions, money and the family, giving money away and the very rich. All have been radically changed. In this book I have completely revised all the chapters on donating/giving money away and enormously expand the chapter on the very rich to include biographies of those with odd money habits. I have added new sections and the references have almost doubled. There is a whole new chapter on perhaps the most important new development in the area, namely *behavioural economics*. There is also a whole chapter on pricing and persuasion, and the way commercial organisations exploit our thinking about money. The chapter on children and money has been radically revised. The chapter on attitudes towards, and beliefs about, money has been greatly expanded. This is as much a new book as a second edition.

It is, of course, quite right that the book is dedicated to Michael. He was the kindest and most generous of men and I miss him still. He gave me confidence in my abilities at an early age and encouraged me to write and research topics I found of interest. I was one of his 50 doctoral students and his legacy is immense. I am not sure that he would have approved of all the contents of the second edition but know he would be forgiving of my misjudgements and peculiar enthusiasms.

I have tried to make this book both academically sound and well referenced but also approachable for those simply interested in the topic. I have found when giving both academic and popular talks about money that almost everyone is interested in some aspect of the topic. They recognise their (and others') foibles and fantasies, hopes and fears, rational and arational beliefs.

The topic of this book has attracted a lot of attention because money remains of great interest to many people. The BBC and other networks, I am sure, must have a file and next to the word *money* is my name. I am asked to appear on radio or television at least half a dozen times a year very specifically to talk about money-related issues. I did a dozen programmes on lottery winners as well as famous misers, tax dodgers and spendthrifts. I am also asked to talk about children's pocket money and how to make them more economically responsible and literate.

The media are particularly beguiled by the *Easterlin hypothesis* and how little money you need to achieve maximal/optimal happiness. The issue is the very contentious relationship between money and happiness and how much of the former you need to maximise the latter. The media, and I think people in general, have an insatiable desire to know more about money and why people seem so obsessed and irrational about it. All the recent work on "obscene banker bonuses" and the feeding frenzy of people in the money world still attracts attention. There are endless articles on the problems, particularly the unintended consequences, of performance-related pay.

But I certainly know that writing this book will not make me rich! Indeed, it is not intended to do so. My own money beliefs, behaviours and indeed pathology are to be found in the appendices, should anyone be interested. Further, I should confess that most of our family money affairs and issues are dealt with by my wife. We academics are strangely incompetent at practical issues.

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I have been helped and assisted by many people in the writing of this book. I need to thank particularly various groups of individuals. First, there are my colleagues at *Mountainview Learning*, especially Gorkan Ahmetoglu and Evengiya Petrova. They have helped me enormously in some areas, such as the psychology of pricing and behavioural economics as well as policies of donating: two chapters that are as much their work as mine. Indeed much of Chapters 10 and 11 are reliant on our joint work and reports that we presented to different organisations, such as the Office of Fair Trading.

Next there have been my research assistants from Bath university over the years, particularly Rebecca Milner, Kate Telford, Sharon Boo and Will Ritchie, who have located and summarised articles and set me straight on various topics. Will, in particular, has spent hours checking references as well as doing proofreading, which I am famously bad at, as well as helping me to get the last revision into shape.

Third, there have been my academic colleagues, particularly Sophie von Stumm and Tomas Chamorro-Premuzic, who have helped on numerous papers and projects. To be surrounded by talented, positive, attractive people while working on something that interests one is surely a very great privilege. Others, like Richard Wolman, Thomas Bayne and John Taylor have always been a good sounding board and source of new ideas for me to work on.

Of course, I have to take full responsibility for all errors and misjudgements in the text.

Adrian Furnham
Bloomsbury 2013

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1

THE PSYCHOLOGY OF MONEY

Money is like promises – easier made than kept.

Josh Billings

If you wonder why something is the way it is, find out who's making money from it being that way.

Anon

I do everything for a reason, most of the time the reason is money.

Suzy Parker

Always remember, money isn't everything – but also remember to make a lot of it before talking such fool nonsense.

Earl Wilson

Introduction

The *New Oxford (Colour) Thesaurus* defines money thus:

> **Money n:** affluence, arrears, assets, bank-notes, inf bread, capital, cash, change, cheque, coin, copper, credit card, credit transfer, currency, damages, debt, dividend, inf dough, dowry, earnings, endowment, estate, expenditure, finance, fortune, fund, grant, income, interest, investment, legal tender, loan, inf lolly, old use lucre, mortgage, inf nest-egg, notes, outgoings, patrimony, pay, penny, pension, pocket-money, proceeds, profit, inf the ready, remittance, resources, revenue, riches, salary, savings, silver, sterling, takings, tax, traveller's cheque, wage, wealth, inf the wherewithal, winnings.

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The above definition gives some idea of all the money-related issues that will be discussed later in the book. Money not only has many different definitions – it has multiple meanings and many uses. The sheer number of terms attests to the importance of money in society.

Money is, in and of itself, **inert**. But everywhere it becomes empowered with special meanings, imbued with unusual powers. Psychologists are interested in attitudes toward money, why and how people behave as they do toward and with money, as well as what effect money has on human relations.

The dream to become rich is widespread. Many cultures have fairy tales, folklore and well-known stories about wealth. This dream of money has several themes. One theme is that money brings *security*, another is that it brings *freedom*. Money can be used to show off one's success as well as repay those who in the past slighted, rejected or humiliated one. One of the many themes in literature is that *wealth renders the powerless powerful and the unloved lovable*. Wealth is a great transforming agent that has the power to cure all. Hence the common desire for wealth and the extreme behaviours sometimes seen in pursuit of extreme wealth.

However, it is true to say that there are probably *two* rather different fairy tales associated with money. The one is that *money and riches are just desserts for a good life*. Further, this money should be enjoyed and spent wisely for the betterment of all. The other story is of the *ruthless destroyer of others* who sacrifices love and happiness for money, and eventually gets it but finds it is of no use to him/her. Hence all they can do is give it away with the same fanaticism that they first amassed it. Note the moralism in the story, which is often associated with money.

The supposedly fantastic power of money means that the quest for it is a very powerful driving force. Gold-diggers, fortune hunters, financial wizards, robber barons, pools winners, and movie stars are often held up as examples of what money can do. Like the alchemists of old, or the forgers of today, money can actually be **made** (printed, struck, or indeed electronically moved). Money through natural resources (oil, gold) can be **discovered** and exploited. Money through patents and products can be **multiplied**. It can also **grow** in successful investments.

The acceptability of openly and proudly seeking money and ruthlessly pursuing it at all costs seems to vary at particular historical times. From the 1980s to around 2005 it seemed quite socially acceptable, even desirable, in some circles to talk about wanting money. It was acceptable to talk about greed, power and the "money game". But this bullish talk appears only to occur and be socially sanctioned when the stock market is doing well and the economy is thriving. After the various crashes this century, brash pro-money talk is considered vulgar, inappropriate and the manifestation of a lack of social conscience. The particular state of the national economy, however, does not stop individuals seeking out their personal formula for economic success, though it inevitably influences it. Things have changed since the great crash of 2008.

Money effectiveness in society now depends on people's expectations of it rather than upon its intrinsic or material characteristics. Money is a social convention and hence people's attitudes to it are partly determined by what they collectively think

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everyone else's response will be. Thus, when money becomes "problematic" because of changing or highly uncertain value, exchange becomes more difficult and people may even revert to barter. In these "revolutionary" times long-established, taken-for-granted beliefs are challenged and many people find themselves articulating and making explicit ideas and assumptions previously only implicitly held.

One of the most neglected topics in the whole discipline of psychology, which prides itself in the definition of the science of human behaviour, is the psychology of money. Open any psychology textbook and it is very unlikely that the word money will appear in the index.

An overlooked topic

It is true that not all psychologists have ignored the topic of money. Freud (1908) directed our attention to the many unconscious symbols money has that may explain unusually irrational monetary behaviours. Behaviourists have attempted to show how monetary behaviours arise and are maintained. Cognitive psychologists showed how attention, memory and information processing leads to systematic errors in dealing with money. Some clinical psychologists have been interested in some of the more pathological behaviours associated with money, such as compulsive saving, spending and gambling. Developmental psychologists have been interested in when and how children become integrated into the economic world and how they acquire an understanding of money. More recently economic psychologists have taken a serious interest in various aspects of the way people use money, from the reason why they save, to their strategies of tax evasion and avoidance.

Yet it still remains true that the psychology of money has been neglected. There may be various reasons for this. Money remains a *taboo topic*. Whereas sex and death have been removed from both the social and research taboo lists in many Western countries, money is still a topic that appears to be impolite to discuss and debate. To some extent psychologists have seen monetary behaviour as either relatively rational (as do economists) or beyond their "province of concern".

Lindgren (1991) has pointed out that psychologists have not studied money-related behaviours as such because they assume that anything involving money lies within the domain of economics. Yet economists have also avoided the subject, and are in fact not interested in money as such, but rather in the way it affects prices, the demand for credit, interest rates, and the like. Economists, like sociologists, also study large aggregates of data at the macro level in their attempts to determine how nations, communities, and designated categories of people use, spend, and save their money.

It may even be that the topic was thought of as trivial compared to other more pressing concerns, like understanding brain anatomy, or the causes of schizophrenia. Economics has had a great deal to say about money but very little about the behaviour of individuals. Both economists and psychologists have noticed but shied away from the obvious irrationality of everyday monetary behaviour.

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Lea and Webley (1981) wrote:

> We do not need to look far to understand this negligence. Psychologists do not think about money because it is the property of another social science, namely economics. Economists can tell us all there is to know about money; they tell us so themselves. It is possible, they admit, that there are certain small irregularities of behaviour, certain deficiencies in rationality perhaps. Thus, psychologists can try to understand, if this amuses them. But they are of no importance. As economic psychologists, we disapprove of both the confidence of economist and the pusillanimity of psychologist. (p. 1)

It is, of course, impossible to do justice to the range and complexity of economic theories of money in this book. Economists differ from psychologists on two major grounds, though they share the similar goal of trying to understand and predict the ways in which money is used.

First, economists are interested in **aggregated** data at the **macro** level – how classes, groups and countries use, spend and save their money under certain conditions. They are interested in modelling the behaviour of prices, wages, etc. – not often people, though they may be interested in certain groups like "old people" or migrants. Thus, whereas economists might have the goal of modelling or understanding the money supply, demand and movement for a country or continent, psychologists would be more interested in understanding how and why different groups of individuals with different beliefs or different backgrounds use money differently. Whereas individual differences are "error variance" for the economists, they are the "stuff of differential psychology".

Second, whereas economists attempt to understand monetary usage in terms of rational decisions of people with considerable economic knowledge and understanding, psychologists have not taken for granted the fact that people are logical or rational in any formal or objective sense, though they may be self-consistent. Indeed it has been the *psychological,* rather than the *logical,* factors that induce people to use money the way they do that has, not unnaturally, fascinated psychologists.

A number of books have appeared entitled *The Psychology of Money* (Hartley, 1995; Lindgren, 1991; Ware, 2001). Most reveal "the secrets" of making money, though what was left unsaid was the motive for the writing of that particular kind of book itself! Often those readers most obsessed with finding the secret formulae, the magic bullet, or the "seven steps" that lead to a fortune are the ones least likely to acquire it.

Many famous writers have thought and written about monetary-related matters. **Marx** (1977) talked about the fetishism of commodities in capitalistic societies because people produced things that they did not need and endowed them with particular meanings. **Veblen** (1899) believed that certain goods are sought after as

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status symbols because they are expensive. Yet this demand for the exclusive leads to increase in supply, lowered prices and lessened demand by conspicuous consumers who turn their attention elsewhere. **Galbraith** (1984), the celebrated economist, agreed that powerful forces in society have the power to shape the creation of wants, and thus how people spend their money.

This book is an attempt to draw together and make sense of a very diverse, scattered, and patchy literature covering many disciplines. A theme running through the book is not how cool, logical and rational people are about acquiring, storing and spending money, but the precise opposite.

The history of money

Historians have long been interested in the financial history of the world. Ferguson (2009), like others, was fascinated by manic stock market rises and falls. He noted that all seemed to go through a highly predictable cycle: displacement where economic circumstances offer new and very profitable opportunities for some; euphoria or overtrading; mania or bubble where first-time investors and swindlers get involved; distress when insiders see that expected profits cannot justify the trades and start to sell; and finally revulsion or discredit – when the bubble bursts due to a stampede for the exit.

In many ways the history of money is the story of boom and bust, and how all aspects of the financial system are the result of human behaviour with all its fruitless foibles. In his book *The Ascent of Money: A Financial History of the World*, Ferguson (2009) notes that he had three particular insights.

First, that poverty is *not* the result of wicked, rapacious financiers exploiting poor people but rather an area or country not having effective financial institutions like well-regulated banks.

Second, money amplifies our tendency to over-read, causing swings from boom to bust. The way we use our skill and money causes dramatic inequality between people.

Third, few things are harder to predict accurately than the timing and the magnitude of financial crises. History shows that big crises often happen, but few economists can say when.

The history of money is about the establishment of great financial institutions as well as great and dramatic events like the South Sea Bubble, the Great Depression, etc. Every generation seems to experience national and global crises that affect the whole monetary system. Further, technological changes, such as the invention of automated telling machines or credit cards and electronic money, alter the behaviour of individuals and whole societies. Individuals are products of their time and circumstance, but are not governed by it.

There is a fascinating literature on the history of money as opposed to financial institutions. Most countries have coins and notes. Each has a *history* of when they were introduced; who designed them and the name of the issuing authority. Each has a *function*, which is in effect its nominal value as well as

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the name of the guaranteeing institution. It also has *identity*, including a serial number and information about the conditions under which the value is payable and to whom.

As Gilbert (2005) notes, there is an iconography of national currencies that may self-consciously reflect or attempt to strengthen a sense of national identity. In some countries it is banks that issue notes while in others it is the government. Money, like stamps, can be used to underlie political agendas. Just as countries that move out of one political system to another – colony to dominion to republic – change their flag and state symbols, so they change their money. Note the problem for the design of the Euro!

Earliest human records show evidence of what Adam Smith called "truck, barter and exchange". Bartering, which still goes on today for those who have no cash or wish to avoid taxation, has obvious drawbacks. These include: the necessity of the **double coincidence of wants**: both parties in the exchange must want exactly what the other has. Barter does not help in establishing the **measurement** of worth; the **relative value** of the changed products: whilst it may be possible to exchange multiple items of less worth for a single item of greater worth, it may be that only one item of less worth is required, i.e. it does not work well if things cannot be divided; barter cannot easily be **deferred**: some items perish and need to be consumed relatively rapidly.

Hence as barter transactions grew more sophisticated, people formed the habit of assessing "prices" in terms of a standard article, which in turn came to enjoy preferential treatment as a medium of exchange (Morgan, 1969). Thus cattle, slaves, wives, cloth, cereals, shells, oil and wine, as well as gold, silver, lead and bronze have served as a medium of exchange (see Table 1.1).

Often religious objects, ornaments or model/miniature tools served as the medium of exchange. During the post-war period in Germany, coffee and cigarettes became the medium of exchange, and in the 1980s bottled beer served that function in war-torn Angola. The cowrie shell (as well as pigs) until the middle of this century (in New Guinea) was a very popular Asian medium of exchange.

Using cattle or oxen in exchange for other goods was a cumbrous system. Traders took time to make a settlement (if they reached an agreement at all). The quality of the animals varied, as did the quality of the goods for which they were exchanged. Cattle and oxen, when used as money, were portable and recognisable, but not durable, divisible, or homogeneous.

The next step in the development of money came about when the trading countries around the Mediterranean began to use metal for exchange purposes. The metals were gold, silver, and copper: precious enough to be wanted, useful and decorative enough to be generally acceptable, and their quality did not vary with time. Some believe the earliest people to use metal money were the Assyrians of Cappadocia, whose embossed silver ingots date back to 2100 BC. The Assyrians may even have had a primitive banking system including what we now call "interest": payment for loans and debts.

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TABLE 1.1 Unusual items which have been used as money

Items	*Country/region*
Beads	Parts of Africa and Canada
Boars	New Hebrides
Butter	Norway
Cigarettes	Prisoner-of-war camps and in post-war Europe
Cocoa beans	Mexico
Cowries (shells)	World-wide (South Sea Islands, Africa, America and Ancient Britain)
Fish hooks	Gilbert Islands
Fur of flying fox	New Caledonia
Fur of black marmot	Russia
Grain	India
Hoes and throwing knives	Congo
Iron bars	France
Knives	China
Rats (edible)	Easter Island
Salt	Nigeria
Shells	Solomon Islands, Thailand, New Britain, Paraguay
Skins	Alaska, Canada, Mongolia, Russia, Scandinavia
Stones	South Sea Islands
Tobacco	USA
Whale teeth	Fiji

Source: Furnham and Argyle (1998)

Precious metal

By the eleventh century BC, bars of gold and electrum were traded between merchants. Electrum is a naturally occurring mixture of gold and silver. The bars or lumps of electrum were not coins, for they were of differing weights, but they had great advantages over the exchange of goods by barter and the use of animals as a form of money. Metals do not rot or perish, so deferred payments could be arranged. Yet these metal bars were bulky. They did not easily pass from hand to hand. They were difficult to divide. The quality and quantity of the metal in different bars was not the same. The ratio of gold and silver in electrum varied. Traders in different parts of the world often used different weights, so all metal bars had to be weighed before goods could be exchanged.

Because of the need to weigh metals to ensure that they were of the correct value, traders tried to identify their own metal bars by marking them. Smaller pieces of metal, easily handled, were later produced, and marked in the same way as the larger pieces had been, so that they, too, would be recognisable by traders.

At first it was not clear how much metal should be exchanged for cattle. Eventually the amount of gold, silver, or copper was made equal to the local value

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of an ox. The Greeks called this measure a *talanton* or "talent": a copper talent weighed 60 lb. The Babylonians used shekels for their weights: 60 shekels equalled one manah, and 60 manahs equalled one biltu, which was the average weight of a Greek copper talent.

The process of marking small pieces of metal was probably how the first coins were produced in 700 BC, when the Lydians of Asia Minor gave their electrum pieces the head of a lion on one side and nail marks on the other. From Lydia the use of coins like these spread to other areas such as Aegina, and the states of Athens and Corinth; to Cyrenaica, Persia, and Macedon. China, Japan, and India were also using coinage by about this time.

Some media of exchange were weighed; others counted. Coins eventually compromised between two principles because their characteristics (face, stamp) supposedly guaranteed their weight and fineness and hence they did not have to be weighed.

Metal discs have been found in both the Middle East and China that date back more than ten centuries BC. In the seventh century BC it became possible to stamp coins on both obverse and reverse sides so as to distinguish between different denominations and guarantee quality. As today the coinage of one country could be, indeed had to be, used by others.

Because money could serve as a payment for wages it could bring benefits to a wide section of the community. Even slaves could be paid a ration allowance, rather than being fed by their masters. Precious metal coins have been dated to the Peloponnesian Wars of 407 BC: gold for large transactions, bronze for very small ones. Alexander the Great, who spread the use of money in his empire, was the first to have his face on coins. The Romans varied the appearance of their coinage for political ends but also manipulated its value to suit the financial needs of the state. Nero, amongst others, reduced the weight in coins and caused a crisis of confidence in the currency.

Until this century the means of payment in commercial societies were, with rare exceptions, either coins made from precious metals or notes or bank deposits convertible into coin. The inconvertible paper note and the deposit repayable in such notes is a very recent development, which has now displaced the precious metals for internal transactions in all the highly developed economies of the world. So long as they retain public confidence, they have great advantages in convenience, but they are liable to abuse and, on many occasions in their short history, they have broken down.

Banks have gone bankrupt in many Western countries through bad debt, incompetence or financial crises they could not foresee. Sometimes investors are partly recompensed by government; often they are not! The government that adopts an inconvertible currency, therefore, takes on a heavy responsibility for maintaining its value. Indeed paper money – that is documents rather than actual notes – is now being transferred electronically such that a person might fly 1,000 miles, go into a bank in a foreign country never before visited, and emerge with the notes and coinage of that country.

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There are various ways to approach the history of money. Usually one starts with primitive money, followed by the first use of coinage, then onto banking, credit, and gold/silver standards, and, finally, on to inconvertible paper and plastic money. Chown (1994) has explained some of the concepts associated with money. It costs money to manufacture coins from silver or gold, and the mint authority charges a turn (usually including a profit) known as "**seignorage**". Issuers can cheat, and make an extra profit by **debasing** the coinage. If this is detected, as it usually is, the public may value coins "**in specie**" (i.e. by their bullion content) rather than "**in tale**" (their official legal value). The purchasing value of coins may change without any debasement; the value in trade of coinage metal itself may change. The monetary system may be threatened by **clipping** and **counterfeiting** and, even if rulers and citizens are scrupulously honest, the coinage has to contend with fair wear and tear.

In medieval and early modern time coins were expected (although in some places and times only by the naïve and credulous) to contain the appropriate weight of metal. The use of more than one metal raised problems. This is sometimes referred to collectively as "tri-metallism", but is more conveniently divided into the two separate problems of "bi-metallism" (the relationship between silver and gold) and "small change" (the role of the "black coins"). The new and more complicated coinages also caused problems by definition – "ghost money" and "money of account". For much of the late medieval period, there would be more than one coinage type in circulation in a country. This creates a serious problem for the modern historian, as it presumably did for the contemporary accountant. "Ghost money" units consist of accounts which have names based on actual coins that have disappeared from circulation. They arose, of course, from depreciation and the phenomena of bi-metallism and petty coins.

Money is used as a "unit of account" as well as a medium of exchange and store of value. Some system was needed by which debts could be recorded and settled, and in which merchants could keep their accounts. It was convenient to have a money of account for this purpose. This could be based on a silver and gold standard or, very occasionally, on black money. Two systems often existed side by side. The value of actual real coins could fluctuate in terms of the appropriate money of accounts and this was often based on a ghost from the past. Money could be used as cash or stored in a bank.

Cash

Derived from the French word *caisse*, meaning money-box or chest, cash is often known as "ready or liquid" money. Traditionally it comes in two forms: coins and bank-notes.

(A) Coins: Standard coins, where the value of the metal is equal to the face stamped on the coin, are comparatively rare but used in the collecting world. **Token** coins are more common: here the metal (or indeed plastic) content is worth (far) less than the face value. The Jewish shekel was first a weight of metal,

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then a specific coin. Monasteries were the first mints because it was thought they would be free of theft.

Wars or political crises often lead to the debasing of a country's coinage. Precious metal coins are filed down (shaved), made more impure, or give way to token (non-metallic) coins. But even coins that began as standard could come to a bad end. Unscrupulous kings rubbed off metal from the edge of gold coins, or put quantities of lead into silver coins to gain money to finance wars. In Henry VIII's time the coins issued in 1544 contained one-seventh less silver than those issued in 1543; Henry continued in this way until, by the time coins were issued in 1551, they contained only one-seventh of the original amount of silver.

The idea of a standard coin was that it should be a coin of guaranteed weight and purity of metal. That remained true until coins became tokens in the sense that their intrinsic metal value was not the same as their face value.

***(B) Paper*:** Paper money was primarily introduced because it made it much easier to handle large sums. Second, coins could not be produced in sufficient amounts for the vastly increased world trade that developed from the seventeenth century onwards. Third, trade inevitably demonstrated that there were more profitable uses for metal than as exchange pieces. Finally, it was argued that paper money (cheques, credit cards) reduced the amount of cash in transit and therefore reduced the possibility of theft.

Cash money probably developed from the practice of giving a receipt by a gold or silversmith who held one's precious metal for "safe-keeping". In time this receipt, although it had no real value of its own, became acceptable in payment of debt among the literate. Banknotes, printed by banks, first appeared in the twentieth century. Up till the beginning of the First World War in Britain notes were called **convertible** paper because they could be exchanged for gold. Alas now all notes are **inconvertible** paper. Clearly one of the disadvantages of convertible paper money is that the supply and issue of notes is related to the amount of gold held by the issuing authorities (government, banks) and not to the supply of goods. Another disadvantage of the old convertible money is that prices depend on the world market not simply gold supply. A government cannot control its country's prices without taking account of what is going on in other parts of the world. Equally, imprudent governments can literally print (issue) as much money as they wish, with too much money chasing too few goods leading to a concomitant fall in the value of the money.

China printed money in the Ming Dynasty (1368–1644), while the Swedes were the first Europeans to issue paper money, in 1656. Notes can have any face value and the variation within and between countries is very wide. They have also varied considerably in shape, size, colour and ornamentation. Provided paper money is immediately acceptable in payment of debt, it fulfils the criteria of being money. Cheques, postal orders, credit cards, electronic transfers, etc., are "claims to money", sometimes referred to as **near** money.

***(C) Plastic, virtual and local money*:** For a discussion of this topic see Chapter 2.

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Banks

Goldsmiths were the first bankers. They soon learnt to become fractional reserve banks in that they kept only a proportion of the gold deposits with them and invested the rest. Many failed, as did banks this century, because they could not immediately pay back deposits on demand because they did not have enough reserves or "liquid money". The cash ratios or the amount of actual cash kept by banks is about 6–10% of all the money deposited with them. Another 20–25% of deposits are kept as "near money", which are investments that can be turned back into cash almost immediately.

The Christian church objected to usury and moneylenders, which opened up the profession particularly to Jews (see Shylock in Shakespeare's *Merchant of Venice*). Islam, too, disapproves of interest and has been more zealous than Christianity in trying to discourage it. Some Christians later lent money free for a short period, but if the debt was not paid back at the time promised Church laws appeared to allow the delay to be charged for. The Crusades and the industrial revolution were a great impetus to banking because people needed capital. Goldsmiths, rich landowners, and prosperous merchants pioneered modern banking by lending to investors and industrialists.

By manipulating the liquidity rate and their preferred patterns of lending, banks are inevitably very powerful institutions. However, they are not the only institutions that lend money. Building societies make loans to house buyers; finance houses lend money for hire-purchase transactions; and insurance companies have various funds available for borrowers. The relationship of money to income and capital may be summarised as follows. First money circulates, or passes from hand to hand in payment for:

a. goods and services which form part of the national income;
b. transfers and intermediate payments, which are income from the point of view of the recipients but which are not part of the national income;
c. transactions in existing real assets, which are part of the national capital; and
d. transactions in financial claims, which are capital from the point of view of their owners but which are not part of the national capital.

Money is also held in stock. Stocks are, however, very different in the time for which they are held, and the intention behind the holding. Money in stock is part of the capital of its owners, but it is not part of the national capital unless it is in a form that is acceptable to foreigners. New money can be created by a net addition to bank lending, and money can be destroyed by a net payment of bank loans. For a closed community, income and expenditure are identical, but for an individual they are not. An individual can spend less than his income and so add to his stock of money or some other asset, and he can spend more than his income by reducing his stock of money or other assets or by borrowing.

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For most people the "high street bank" is the primary source of money. They borrow from, and lend to, banks, which are also seen as major sources of advice. Estimates are that over three-quarters of all UK adults have a current bank account or chequing account and in the past five years there has been a considerable increase in such accounts as well as building society accounts.

The cheque (or "check" in the USA) arose about 300 years ago directly out of the use of exchanged receipts or promissory notes and was illegal to begin with and certainly regarded as highly immoral, but the convenience quickly outweighed any moral considerations and the legalities soon followed. Until 1931 there was a national responsibility not to issue more hard currency than could be backed up by gold deposits. So, in effect, until that date if everyone handed in their notes for value, there would have been enough gold to go around. Today, if we *all* demanded our face-value gold, the banks and the nation would go bankrupt overnight. There is currently enough gold on deposit in the Bank of England's vaults to cover around one-third of the issued currency. It is no longer possible, in fact, to receive face value gold.

The biggest difference between a bank in the UK and a bank in the USA is that in the UK, in order to open a bank account, it used to be necessary not only to have money but also to have friends. A reference provided by a bank-account holder had to be furnished before a new account could be opened. The process took about two weeks. In the USA, and now in most developed countries, anyone can walk into almost any bank and open an account on the spot, receive a cheque book and use it, provided they deposit enough money in the account to cover the cheques. One of the reasons why this is so is that in New York State it is a crime to write a cheque without having funds to back it. In the UK, however, a bouncing cheque will not send you to prison.

In addition, in the USA, with some of the competing banks, opening an account and depositing a fixed amount of cash will bring you free gifts. British banks have copied this trend, especially in attempting to lure young people (i.e. students) to open accounts with them.

Banks all over the world lend money to each other. This is called the Interbank lending system and it occurs because the larger banks have more money on deposit than the smaller ones, and all banks must balance their accounts each day – so they borrow and lend among themselves. Thus, if you leave a lot of money in your current account each day, even though the banks are not paying you any interest on that money they are making interest on it through the overnight Interbank lending market – about 11% per annum in the UK. In the USA almost all money in all accounts earns interest, if only at a low rate, and this system is slowly happening in the UK too, with various different names. No bank is giving anything away with these accounts; they are simply reducing their profits slightly to attract more custom.

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Themes in this book

There are six themes in this book.

First, people are far from rational in the way they think about, accumulate, spend and save money. They are essentially psychological rather than irrational. Money is imbued with such power and meaning that people have difficulty thinking rationally about it.

Second, we all apply a range of (sometimes unhelpful) heuristics when thinking about money. These short cuts or rules of thumb explain why we make so many "mistakes".

Third, many of these money beliefs come from childhood and early education. We learn about money and its power and allure early on in life and carry these ideas and associations into adulthood.

Fourth, money and happiness/well-being are only tangentially related. Many factors contribute to our unhappiness and money is only one factor.

Fifth, money is a more powerful demotivator than a motivator at work. If people are paid equitably, given their comparative inputs, money has surprisingly little motivational power.

Sixth, a knowledge of how people think about and use their money in typical (and arational) ways has meant businesses often try to "exploit" them. These processes and procedures can be understood in order to help people guard against any form of attempted manipulation.

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2

MONEY TODAY

Human capital has replaced dollar capital.

Michael Milken

Business ethics is to ethics as Monopoly money is to money.

Harold Hendersen

Beauty is potent, but money is omnipotent.

Anon

Nothing is more admirable than the fortitude with which millionaires tolerate the disadvantages of their wealth.

Rex Stout

Introduction

It is true, as well as a truism, that the world is changing fast. This is as true of money as of everything else. Technological changes have deeply affected how people use, store and spend their money. The world of cash is fast disappearing. People now pay for their car parking from their mobile phone; and transfer high sums of money (legally and illegally) around the world electronically. Currencies change and both appear and disappear. There are now local currencies and virtual currencies.

The distribution of wealth has also changed dramatically. Many countries have many thousands of millionaires and it seems the gap between the rich and the poor is changing dramatically. However, some things are constant, like the bizarre behaviour of (often very rich) people with respect to their money.

This chapter will look at some of the changes in the world of money today.

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The story of the credit card

The use of credit cards originated in the United States during the 1920s, when individual firms, such as oil companies and hotel chains, began issuing them to customers. Early credit cards involved sales directly between the merchant offering the credit and credit card, and that merchant's customer.

Around 1938, companies started to accept each other's cards. Today, credit cards allow you to make purchases with countless third parties. The inventor of the first bank-issued credit card was John Biggins of the Flatbush National Bank of Brooklyn in New York. In 1946, Biggins invented the "Charge-It" program between bank customers and local merchants. Merchants could deposit sales slips into the bank and the bank billed the customer who used the card.

By the early 1960s, more companies offered credit cards, advertising them as a time-saving device rather than a form of credit. American Express and MasterCard became huge successes overnight, allowing the consumers a continuing balance of debt, subject to interest being charged.

These are a few handy facts about credit cards:

- There are 609.8 million credit cards held by US consumers (Source: "The Survey of Consumer Payment Choice", Federal Reserve Bank of Boston, January 2010).
- Average number of credit cards held by cardholders: 3.5, as of year-end 2008 (Source: "The Survey of Consumer Payment Choice", Federal Reserve Bank of Boston, January 2010).
- Average APR on new credit card offer: 14.91% (Source: CreditCards.com Weekly Rate Report, 6 July 2011).
- Average APR on credit card with a balance on it: 13.10%, as of May 2011 (Source: Federal Reserve's G.19 report on consumer credit, released July 2011).
- US credit card 30-day delinquency rate: 3.3% (Source: Moody's, May 2011).
- Forty-one per cent of college students have a credit card. Of the students with cards, about 65% pay their bills in full every month, which is higher than the general adult population (Source: Student Monitor annual financial services study, 2008).
- Eighty per cent of Americans who are 65 or older indicated they used a credit card in the month preceding the September 2008 survey. That's 13 points higher than any other age group. They also used debit cards far less than other age groups. Only 47% of those over 65 said they had used a debit card in the month before the survey, 19 points lower than any other age group (Source: Javelin, "Credit Card Spending Declines" study, March 2009).
- Just 51% of Americans aged 18 to 24 indicated they had used a credit card in the month preceding the September 2008 survey. Seventy-one per cent of that age group said that they had used a debit card in the same period (Source: Javelin, "Credit Card Spending Declines" study, March 2009).

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- One in 12 households in London (or 8%) has used credit cards to pay their mortgage or rent in the last 12 months. Across Great Britain, 6% of households did the same, equivalent to more than one million people (Source: Shelter Media Centre, January 2010).
- There were 60.7 million credit cards in circulation in the UK at the end of November 2009, 69% of which had a balance outstanding (Source: British Bankers Association, January 2010).
- Outstanding credit card balances stood at £63.5 billion in November 2009, nearly £3 billion lower than a year earlier (Source: British Bankers Association, January 2010).

Children as young as 14 carry credit and debit cards. Most adults have many cards and they are often a source of considerable problems.

The story of online banking and shopping

The concept of online banking as we know it today dates back to the early 1980s, when it was first envisioned and experimented with. However, it was only in 1995 that Presidential Savings Bank first announced the facility for regular client use. Inventors had predicted that it would be only a matter of time before online banking completely replaced the conventional kind. Facts now prove that this was an over-optimistic assessment – many customers still harbour an inherent distrust of the process. Despite this, the number of online banking customers has been increasing at an exponential rate. The speed with which this process happens online, as well as the other services possible by these means, has translated into a boom in the banking industry over the last five years.

Seventy-one per cent of survey respondents said they had logged into their credit card account via the Internet (ComScore, 2009).

One of the first known Web purchases took place in 1994. It was a pepperoni pizza with mushrooms and extra cheese from Pizza Hut. When Amazon came on the scene not long after, selling books online was a curious idea, but eventually a revolutionary change in culture and groupthink took place. Buying things online was all about price and selection.

Now 83% of consumers say they are more confident in making a purchase when they have conducted research online as opposed to speaking to a salesperson in a store. And, despite the economic recession, online retail in the USA grew 11% in 2009, according to a March 2010 report from Forrester Research. More than 150 million people – about two-thirds of all Internet users in the USA – bought something online last year. It's a staggering leap for an industry used by only 27% of the nation's online population a decade ago.

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Local currencies

One of the more interesting features of "the new money" is the rise of what are called "local currencies". In London the Brixton Pound (B£) exists in paper and electronic format (also known as Pay by Text). The paper version was launched in September 2009 and the electronic currency was launched in September 2011. Around 200 businesses accept the B£ paper notes and about 100 are signed up to Pay by Text.

The notes are printed on watermarked paper by specialist secure printers. Each B£ is worth £1 sterling, so B£1 = £1, B£5 = £5, B£10 = £10, and B£20 = £20. The sterling backing for all B£ in circulation is held at a local bank. B£ notes are not exchangeable back to sterling, however businesses may redeem them at face value.

Some traders offer B£ customers special offers for using the money (like a loyalty card for Brixton). The 1st Edition of the notes expired on 30 September 2011, with the 2nd Edition being in use since. Pay by Text customers receive a 10% bonus automatically added onto their account every time they credit it. The notes have already become highly collectable items and, together with the Pay by Text service, they are attracting a lot of media attention and encouraging new visitors to go to Brixton.

This currency has the potential ability to raise awareness of prosocial issues (e.g. the importance of shopping locally) rather than its claimed economic effect of keeping more value local by facilitating local spending. The idea is to "keep money in Brixton". By swapping real money for Brixton currency, you are obliged to spend it with local retailers (since no one else will accept it). Arguably it raises awareness of the importance of buying locally as it inevitably gets people talking about the issue (because they have the currency in their pocket and it's newsworthy).

Bristol in England recently introduced the "*Bristol Pound*" in a bid to increase local commerce. By making the currency only available to spend within the city, each spend using the money will in turn force an equivalent spend on local goods and services, unless the money is converted back to British sterling at the 3% fee rate.

Unlike previous attempts at a local currency the Bristol Pound is available to be spent online. More than 350 local companies have signed up, making the Bristol Pound the UK's largest alternative to sterling. In fact, Bristol's mayor is taking his entire salary in Bristol Pounds.

Not far from Bristol, in Stroud, Gloucestershire, a "Stroud Pound" experiment that started in 2009 has failed to take the town by storm, with only half the amount of Stroud Pounds issued last year as in the first year. Local businesses do say, however, that customers have committed to buying locally because of it.

Local currency systems encourage not only local business growth, but local responsibility. The creation of new jobs and new projects in any region will stimulate not only economic but also social growth.

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Millionaires

Traditionally, to be a "millionaire" meant having over £1million in the bank. Yet it seems this definition may be changing. Goldstein (2011) describes how in recent years the term "millionaire" has come to relate instead to someone who earns over £1million a year. There is a considerable difference between the two definitions. Someone earning over £1million a year is much more elite. Barclays Wealth (2011) said there were 619,000 millionaires – including property assets – currently living in the UK at the end of 2010, up from 528,000 in 2008. However, only 11,000 people in the UK earn over £1million each year (Office for National Statistics, 2009). Therefore, changing the definition from assets toward annual income redefines "millionaires", pushing them up the economic ladder. This is highly rational, as having a million pounds does not make you as rich as it used to, with the cost of living having increased dramatically. Today, you would need £17.5million to enjoy the equivalent lifestyle of a person with £1million in 1958 (Table 2.1; Bank of Scotland, 2008).

So who becomes a millionaire? Spectrem Group (2011) found that those with over $1million in assets were more likely to have a degree than those in the lower $100,000–$1million segment. Interestingly, those in the middle affluent segment ($1m–$5m) either currently or have previously worked for more than 60 hours each week, while 47% of those in the well-off segment ($5m–$25m+) worked less than 40 hours per week.

How do millionaires become so wealthy? (Table 2.2).

Spectrem Group (2011) investigated the method through which affluent households believed they had obtained their wealth, with the predominant reason offered being through hard work. Those in households with $1–5million and $5–25million of net worth believed that education and smart investing were the most significant contributing factors. Yet those in households with $100,000–$1million net worth placed more emphasis on frugality than education. Though many mayspeculate that the majority of such wealthy people inherit their money, the four main sources those in wealthy homes believe they gain their riches through are hard work, education, smart investing and frugality. Inheritance was specified as a source of wealth by just a quarter of individuals in each wealth segment.

TABLE 2.1 Today's equivalent to £1m in the past

1958	£17.500m
1968	£12.991m
1978	£4.297m
1988	£2.009m
1998	£1.318m
2008	£1.000m

Note: According to estimates by the economic consultancy, cebr (The cebr Forecasting Eye, 14 August 2006). Figure relates to 2006.

Source: The Cebr Forecasting Eye (2006)

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TABLE 2.2 Reasons for millionaires' wealth accumulation

Reason	*$100,000–$1,000,000**	*$1,000,000–$5,000,000**	*$5,000,000–$25,000,000**
Hard work	93%	95%	95%
Education	71%	89%	92%
Smart investing	67%	83%	85%
Frugality	66%	81%	77%
Taking risks	42%	67%	72%
Being in the right place at the right time	33%	45%	62%
Inheritance	23%	28%	26%

Note: *Not including principle residence.

Source: Spectrem Group, 2011, Affluent Market Insights.

These findings are supported by Skandia (2012) "millionaire monitor" research. Seventy-four per cent of UK millionaires were found to have made their wealth through employment, with 57% acknowledging that investments contributed to their fortune. Fifteen per cent of the surveyed millionaires made their money from their own business. This all indicates that hard work and smart investing are key. However, 41% had inherited money, contributing to their fortunes. The research showed that the top jobs through which wealth was earned were manufacturing (21%), IT/Telecoms (21%), finance (18%) and the service industry (17%). The project found that 29% of UK millionaires made their wealth through setting up their own business.

Interestingly, research shows that the majority of UK millionaires (79%) are wealthier than their parents (Skandia, 2012). The research also found that the majority of millionaires make their fortune when they are young, with 31% of entrepreneurs in the survey making their fortune before they were 30, and over half (53%) of those making their money before they were 25. Hong Kong was the country in which millionaires earned their fortune most rapidly, with two-thirds of entrepreneurs making their money within five years. Whereas in the UK, 60% made their earnings from their business in a decade or less.

What do they do with their money? Data from Skandia (2012) research shows that Britain's millionaires tend to invest their wealth in residential property, with just under a third of money being held here. The next most popular areas that wealth is invested in are cash (18%), shares (16%) and managed investment funds (13%).

Some spend money on moving to a different country. Skandia (2012) research found that almost one in ten millionaires in Italy, France and Dubai say they intend to leave their country (they are considered a millionaire if conversion of their net disposable assets relates to GB£+1million). In the UK almost 45% would consider relocating. A widely stated reason for moving was the weather (22%), with improved living standards also being hoped for (20%).

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There are a few famous examples of eccentric millionaire behaviours:

1. **Salvatore Cerreto:** the 71-year-old property magnate was found to have been defecating in front of shops and restaurants in the dead of night in his local town of North Ryde.
2. **Robert Clark Graham:** the late millionaire optometrist opened a sperm bank in 1980 to be mostly stocked with donations from Nobel laureates, in a bid to create a master generation. When the bank closed in 1999 after his death, none of the children fathered from the stocks had a Nobel laureate father.
3. **Ailin Graef:** this Chinese woman became the first person to make a million from the online avatar community *Second Life* by developing property online and selling it on, converting the online currency to real money as per the game's rates.
4. **Karl Rabeder:** grew up poor, and upon realising his £3 million fortune was making him unhappy, gave it all away, with all proceeds going to charitable foundations he set up in Central and Latin America, from which he will not take a salary.
5. **Gunther IV:** received his inheritance from his father Gunther III, who received it in turn from the German countess Karlotta Liebenstein. Gunther is worth around $372 million now thanks to his growing trust fund. None of which is remarkable, until you find out that Gunther and his father are German shepherd dogs.
6. **Graham Pendrill:** the Bristol millionaire visited Kenya for a month last year, and was awarded the title of elder after helping resolve a conflict. He has since decided to sell his house and move to Kenya to live in a mud hut with the Masai tribe.
7. **Scott Alexander:** the 31-year-old lifestyle millionaire decided to buy his own town in Bulgaria for £3 million and is turning it into a holiday hotspot. He has named the town after himself – Alexander.
8. **Karen Shand:** became the first person to win £1 million live on TV when she won ITV's "The Vault". Despite this, she has not quit her £25,000 job as a nurse in Kirkcaldy, Fife.
9. **Nicholas Berggruen:** known as the "homeless billionaire", Berggruen lost all interest in acquiring material goods, so decided to sell his properties and live in hotels. He plans to leave his fortune to charity and his art collection to a museum in Berlin.
10. **Thaksin Shinawatra:** the Thai Premier's youngest daughter works in McDonald's in Thailand. He got her the job through the president of McThai, but insisted that she be treated like any other employee in order to teach her the value of money.

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