

Chapter

5

Sources of Income

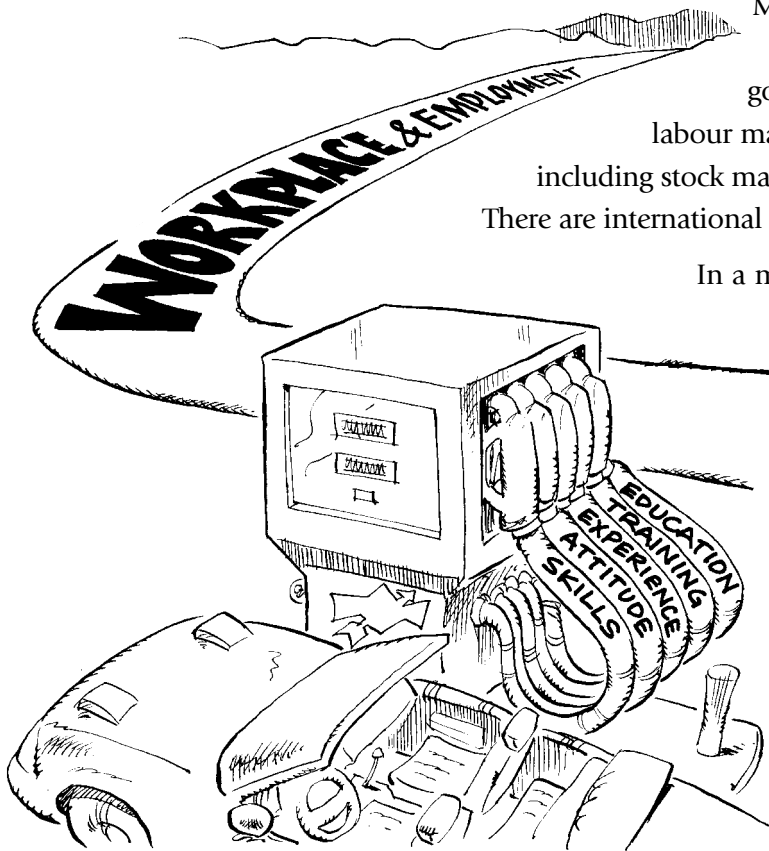
Obtaining money is a task most of us wish was easier than it is. (Have you seen the line-ups at the lottery ticket windows lately?) However, when you stop to think of it, most people will earn one to two million dollars over the course of their lifetime — so it's important that they make the most of it. Most of your lifetime income will likely come from your hard work and labour. There are other sources, but income from employment (working for others or self-employment) will be the primary source for most of us — at least in the first half to two-thirds of our working lives. If we plan effectively, and are able to secure a reasonable income, it is possible for investment income to play a bigger role in life as we get older. In fact, by the time we retire, investment income plays a very key role. Later on, we'll look more closely at the topic of investment. For now, let's take a quick look at these possible sources of income.

EMPLOYMENT INCOME: WORKING FOR OTHERS

WAGES AND SALARIES

Most of us will earn income from our labour. Through education, training, and experience, most of us will develop some talent or skill. We then seek to provide our knowledge and skills in return for income paid as a wage or salary (a wage is paid hourly, a salary is paid on the basis of one year's work).

If we provide our services to others, we enter into the labour market. Here, the forces of supply and demand, along with other influences, operate to affect the wage or salary we might earn.



Markets are at work in many aspects of our economy. There are markets for all of the various goods and services that are produced. There are labour markets. There are various investment markets including stock markets, bond markets, and money markets. There are international markets, foreign exchange markets, and so on.

In a market, there will be sellers and buyers. In the case of the labour market, a person offering his/her services for an income is part of the “supply.” An individual is the “seller” of the labour services. Employers looking to hire people and pay a wage or salary represent the “demand.” They are the “buyers” of labour services. In general, the higher the demand for a particular skill in comparison with the supply, the higher the wage or salary will be. Therefore, you would ideally want to be looking for work in an area where there is a relatively high demand compared with supply.

There are other factors that can influence wages and salaries, too. Let’s take a look at these.

FACTORS AFFECTING EMPLOYMENT INCOME

- the level of education, training, and experience that is required to do a particular job
- the level of demand that exists for the type of labour you are skilled/trained/educated to provide
- the number of others who have similar or better skills who can compete for the job
- how good you are at what you do
- how long you have been working — your experience, your seniority
- your work habits, reliability
- the state of the economy
- government legislation, particularly wage legislation such as minimum wage
- the effectiveness and impact of unions on the negotiated wages
- the region in which you work and the labour market conditions in that region

- the profitability and success of the organization for which you work
- chance — being at the right place at the right time or the wrong place at the wrong time



A Supply and Demand Face-off

Identify some of the key factors that you believe influence the salary of a professional hockey player.

There are, of course, other factors, some of which are even illegal but, nevertheless, can be at work in affecting income. For example, in many cases women are still paid at lower levels than their male counterparts; there may be discrimination also on the basis of age, race, or colour. Authorities, in many cases, are trying to prevent situations of wage discrimination. But some still exist and pose challenges to those who face prejudice and discrimination.

OTHER BENEFITS

When you work as an employee for a company, other benefits may be provided. It is certainly not the case that all companies offer attractive benefits packages. Benefits packages vary a great deal from company to company, industry to industry, and even occupation to occupation. Since they can be quite significant, the benefits that are available should be factored into employment decisions.

The possible benefits can include the following:

- paid vacation holidays
- paid sick days
- paid provincial government medical premiums (covering your health insurance)
- extended health care insurance
- disability income insurance (short-term and long-term)
- life insurance
- dental insurance
- profit sharing (employees receive a share of the company's profits)
- payroll savings plan (convenient plan to help build savings)
- stock option purchase (become a part owner of the company through owning shares)
- registered pension plan (to help build a retirement fund)

- group registered retirement savings plan
- educational expense reimbursement (cover costs of additional education and training)
- provision of an automobile or funds for travel expenses
- benefits for a spouse
- access to financial advice



You've Only Just Begun

Calculate the approximate income you have received in your life so far. Consider the following sources from which you may have received money.

- ▶ Allowances
- ▶ Business income
- ▶ Employment income
- ▶ Investment income
- ▶ Awards
- ▶ Gifts
- ▶ Inheritances

SELF-EMPLOYMENT: WORKING FOR YOURSELF

The income that those who set up and operate businesses are able to earn over and above their costs is called profit. Profits are another possible source of income.

In Chapter 7, we will explore in some detail the self-employment option of entrepreneurship. For now, note that an entrepreneur is someone who, in order to accomplish his/her goals, sets up and operates a venture. In many cases, this means starting a business. There are thousands of Canadians, and the number is increasing all the time, who have set up and run their own businesses. It is an attractive option for those who can make it work. But a great deal of thought and planning go into setting up a business. Anyone who chooses this route can't do so on a whim and with just a good idea in mind.

Most of today's large companies were started by one or more entrepreneurs. Over time, though, as a business grows and requires more money for growth and improvement, the original entrepreneur(s) will often sell shares of ownership to raise the additional funds needed. Eventually, the original entrepreneur(s) may sell all of his/her/their shares of ownership. In this way, large

companies often become owned by a large number of shareholders. Shareholders are people who invest part of their financial resources in shares of the company. As shareholders, they receive a share of profits — called dividends. Each shareholder receives a share of the profits of the company or corporation according to the number of shares owned.

You may some day set up and operate your own business — some of you may have done so already. Some of you may one day buy shares of a corporation and, thereby, invest in the stock market (some of you may have also tried this or been provided with some shares by a family member). If or when you do, the income you earn in this way is a result of profits earned by companies.

INVESTMENT INCOME

CAPITAL GAINS



Taking Stock

Select a newspaper and turn to the section that provides information on stock prices. Learn how to read the stock table. Select a single stock and assume you purchased 100 shares of that stock today. Follow the price of the stock on a daily or weekly basis for the period of a month. At the end of the month, determine whether the 100 shares of this stock would have provided a capital gain or a capital loss.

In addition to a share of the profits from a company (paid as dividends), you can also earn income in another way from investing in the shares of a company. For example, if you buy shares of a company at \$10 a share and sell those shares later at \$12 a share, the difference is referred to as a capital gain. This can occur with any investment (for example, real estate, mutual funds, art), not just investments in a business. Capital gains can be earned any time you take ownership of an asset (something of value) for a period of time and then sell that asset later at a higher price (you may also sell it later at a lower price and end up, that's right, you guessed it, with a "capital loss"). If, instead of taking ownership of an investment, you lend funds to others who maintain the ownership, you don't earn dividends or capital gains. You earn the next category of income — interest.

INTEREST

Interest is the income you receive when you provide someone with use of your money for a particular period of time. That time period may range from a matter of days to years. As an example, you may provide the funds to a bank by depositing the funds with the bank. The bank pays you interest because the bank will lend a good portion of your money out to borrowers. Those



Very Interest-ing!

Next time you are in a financial institution, look for the posted interest rates. Examine the interest rates. How do the rates offered to savers compare with the rates charged to borrowers? Why do they differ? Are different interest rates available to savers? If so, why do these differences exist?

borrowers will then pay interest to the bank. (Don't worry, banks and other financial institutions keep enough money on hand to give you yours back if and when you need it. Depositors' insurance also helps protect depositors up to \$100,000.)

You may also lend money to a company by buying a company's bonds. Bonds are like an I.O.U. You may lend the government money by buying government bonds. You can also lend the government money by buying Treasury Bills, which is the way the government borrows funds for periods of less than a year (they use bonds to borrow funds for periods of more than one year).

Interest, then, is the income you earn by lending money to others for a period of time.

INHERITANCE

At some point in their lives, many Canadians receive inheritances. At times, these amounts can be quite significant because they often come from parents who have spent an entire lifetime acquiring their assets, investments, and so on. The value of inheritances will also vary based on the number of benefactors as well as any taxes that may apply, charitable donations made by the estate, and so on. Furthermore, inheritances will often be in the form of fixed assets rather than money, assets such as houses, cars, cottages, and furniture. Although it is difficult to factor income from inheritances into one's financial planning, it is a form of income that affects many peoples' lives.

GOVERNMENT TRANSFERS

Many government programs provide money or goods and services. Child tax benefits are an example of a government transfer paid to many parents with children under age 18. There are other government transfers, such as welfare, that go to those who are in particular need and who are able to provide evidence to the government that they are in need of financial assistance. Governments will also subsidize (pay part of the cost of) such things as education and health care. Although this subsidy isn't money received, it represents money that doesn't have to be spent — which is the next best thing.

It is, however, important to note that income or goods and services that are received from government do not fall mystically out of the air. Canadian taxpayers pay for those programs through the money that they pay in taxes. Taxes are something you probably already know a lot about (because you already pay them — provincial sales tax and/or federal sales tax) and will likely learn a lot more about in the future.

LOTTERIES

Good luck if you try!

WHAT PATH TO TAKE?

These, then, represent some of the major sources for obtaining income. Before we look at the self-employment route to obtaining income, let's take a look at some things to think about when deciding your career path.