

Credit Management¹

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When you hear people say "charge it," "finance it," "buy on time," or "use a payment plan," it is the same as "using credit." Credit means buying something or getting cash now and paying later. When you use credit, you are using products and services before you pay for them. For this reason you need to use with caution.

Should You Use Credit?

There are advantages as well as disadvantages to using credit. Before using credit, it is important to understand the advantages and disadvantages. Some advantages of using credit are listed here.

- It allows you to pay for an expensive item over a period of time. For example, most people buy a car and pay for it in three to five years.
- It allows you to buy items you need when you do not have enough cash to pay for them. For example, you may need to buy a water heater, yet do not have the cash needed to pay for it in full.
- It allows you to use things while you pay for them. The store does not keep the item until it is paid for, you take it and get to use it while you pay for it.

- It allows you to take advantage of sales. You can buy items when they are on sale, even though you do not have the cash on hand.
- It allows you to meet emergencies, such as sickness or unexpected repairs.

There are also some *disadvantages of using credit*, for example:

- It may be tempting to spend more than you can afford. When all you need to do is sign a receipt, you may forget to ask the important question: "Can I Afford It?"
- It is not free. It usually costs more money to buy on credit than to pay cash because of the finance charge.
- It may be tempting to buy items you do not need.
- If you lose your job or are without a job, you may not be able to make payments on time and you may lose what you bought and the money you have already paid on it.

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Who Gets Credit?

Before lenders give you credit, there are some things they will want to know about you to determine whether or not you are worthy of receiving credit from them. The information relates to your Character, Capacity and Capital.

Character. Refers to your reputation. It includes how honest, dependable and mature you are.

Capacity. Refers to your ability to make payments on your account. It includes such things as whether you have a job, how much money you make, how much money you have saved, and your financial obligations. The Equal Credit Opportunity Act forbids denying a person credit because they receive Social Security or public assistance (Welfare).

Capital. Refers to what you own. Do you have a car, a home, furniture, and is it worth more than you want to borrow?

Where Can I Get Credit?

Credit is offered by many places. For this reason it is important to compare the different sources. The following are some of the sources of credit.

Banks. They loan cash. You sign a legal contract when you borrow money. Some loans are made for which you must have a guarantee beyond the promise to repay (such as for a car). Other loans -- usually small amounts -- are made for which only your promise to repay is required.

Bank Cards. They are usually issued by banks or other financial institutions and are used to buy items, services, or receive cash advances. You buy items which are paid for by the bank when you use your card. You pay the bill to the bank (not to the merchant). The bank charges interest on your purchase. These credit cards have a limit on the amount of credit you can use.

Department Stores. You buy the merchandise and the store sends you a bill. If you do not pay the bill in full, an interest charge is added to the next bill.

Credit Unions. You must be a member of the credit union in order to get a loan. The interest rates they charge are usually low.

Finance Companies. A source of credit for people who are "high risk" in terms of their credit rating. These companies usually charge higher interest rates than banks and credit unions.

Illegal Lenders. Some lenders operate outside the law. They may charge higher interest rates than pawnshops. These lenders often take advantage of people.

Appliance and Hardware Stores. Used to buy things that cost a lot, such as a washing machine or a range. You make a down payment and then pay the balance plus interest on a weekly or monthly basis. If you fail to make a payment, the store can take the item away from you.

Pawnshops. To get cash, you must leave an item of value at the pawnshop. You usually receive half its resale value. If you do not pay by the date agreed upon, the item you left will be sold. Pawnshops charge high interest rates.

Rent-to-Own Stores. These stores rent furniture and appliances with option for rental fees to apply to purchase cost, thus renters are purchasers. They service customers with limited funds and poor credit ratings. Costs are high.

What Does It Cost to Use Credit?

Before using credit, you need to find out how much it will end up costing you. To find the dollar cost of credit, subtract the cash price from the credit price. (See Example 1.)

Example 1.

CREDIT PRICE	\$496.00
CASH PRICE	400.00
COST OF CREDIT	\$ 96.00

If you are not given the credit price of an item, but you do know what the down payment and monthly payments will be, you can also figure the cost of credit. For example: *You are planning to buy*

a 27" color television set. The cash price is \$400.00. With installment credit, your down payment is \$100.00 and you sign a contract to pay the balance in 12 monthly payments of \$31.00. In order to figure the dollar cost you need to follow the steps in Example 2.

Example 2.

Multiply the amount of payments by the number of payments.	
\$ 31.00	(amount)
x 12	(number of payments)
\$372.00	
Add the down payment to get the total amount to be paid.	
\$372.00	
+100.00	(down payment)
\$472.00	
Subtract the cash price from the credit price to see how much extra you are paying for using credit.	
\$472.00	(credit price)
-400.00	(cash price)
\$ 72.00	(cost of credit)

Protect Your Credit Rating

A good credit rating is valuable, so **protect it**. If you have used credit in the past, your credit history will be checked through a credit bureau. A way to maintain a good credit rating is by:

- using your charge cards wisely and paying promptly;
- not overdrawing your checking account;
- paying your bills on time. If you cannot pay on time, do not avoid the creditor. Explain to the creditor why you cannot pay before the bill is due. Many creditors will help you make other arrangements to meet current needs.