Give Credit Where Credit Is Due

Credit and Its Importance

Set some limits

It’s interesting

Cash or convenience?
When a restaurant needs a large amount of food and supplies to cater a wedding, how does it obtain these products without paying cash for them? How can an individual purchase a new home when s/he has only a small amount of money in the bank? How can you buy a television or a refrigerator without having the purchase price on hand? The answer to all of these questions is by using credit.

Credit is the arrangement by which businesses or individuals can purchase a good or service now and pay for it later. Businesses use credit to obtain goods and services to sell, and consumers use credit to purchase those goods and services.

Just my type
Credit users are responsible for finding out what kinds of credit are available to them and who offers credit. There are many different types of credit. Let's take a look at a few of the most common types.

Revolving credit accounts. Under a revolving credit account system, the maximum amount of money that the credit user can owe (also known as the credit limit) is set at the time the credit account is opened. For example, if a customer opened an account with a credit limit of $500, the customer could charge purchases up to that total amount. The customer could then pay off the entire amount at the end of the month or make payments over a period of time. If the customer chooses to pay over a period of time, s/he might be required to pay a minimum amount at the end of each month. The unpaid portion would then be subject to finance charges. Whenever the balance on the account reaches the customer’s credit limit, no further purchases can be charged to the account until some payment has been made.

Installment credit accounts. These accounts are designed to handle one total amount of credit, which is paid in installments within a certain time period. The credit user makes a down payment and signs an agreement to pay monthly installments until the total is paid. Customers usually pay finance charges for the privilege of using this kind of credit.

Installment credit is commonly used to purchase large, expensive items such as furniture or cars. The title, or legal ownership document, for an item purchased on installment credit is made out in the name of the credit user. However, the seller has a lien, or claim, on the title until all installment payments have been made. In most cases, the lender will hold the title until payment is complete. If for any reason the credit user does not pay, the seller can repossess, or take back, the good.
Finance charges. These are the interest charges on accounts that are not paid in full at the end of each payment period. Expressed in percentages, these charges average around 14% per month on the unpaid balance. These costs are expressed as an annual percentage rate (APR) so that it is easier for credit users to compare the costs of various credit plans. In general, interest on credit cards is higher than interest on installment credit or bank loans.

Higher prices. Businesses that offer credit usually charge higher prices for their goods and services than those that do not. The business must cover the expense of operating the credit system and paying the bank’s fees. It must also protect itself against loss from credit customers who do not pay for their purchases. Some businesses require purchases of a certain dollar amount (at least $5, for instance) for customers to be able to use credit cards. Occasionally, you will visit a small business that will offer you a discount for paying cash instead of using your credit card. Both of these measures are attempts to cut down on the costs associated with offering credit.

Interest rates. Interest is the fee the lender charges the borrower for the use of the money. Interest rates go up and down according to the supply of and demand for money. The amount of interest is calculated by multiplying the amount of money being borrowed (the principal), times the interest rate, times the length of time for which the loan is made. The length of time borrowers use to pay off loans plays an important role in determining the costs of credit. The faster a loan is repaid, the less the interest charged.

Look at the difference between the cost of using credit over a one-year period and a four-year period to pay off a loan of $4,000 with an interest rate of 8.3%. As you can see, the difference in cost to the borrower between a one-year loan and a four-year loan is $996.

<table>
<thead>
<tr>
<th>Time</th>
<th>Monthly Payment</th>
<th>Interest</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 year</td>
<td>$361.00</td>
<td>$332.00</td>
<td>$4,332.00</td>
</tr>
<tr>
<td>2 years</td>
<td>194.00</td>
<td>656.00</td>
<td>4,656.00</td>
</tr>
<tr>
<td>3 years</td>
<td>139.00</td>
<td>1,004.00</td>
<td>5,004.00</td>
</tr>
<tr>
<td>4 years</td>
<td>111.00</td>
<td>1,328.00</td>
<td>5,328.00</td>
</tr>
</tbody>
</table>

Summary
Credit is the arrangement by which businesses or individuals can purchase a good or service now and pay for it later. Businesses use credit to obtain goods and services to sell, and consumers use credit to purchase those goods and services. There are many types of credit, including revolving credit accounts, installment credit accounts, regular credit accounts, budget credit accounts, bank credit cards, travel and entertainment cards, service credit, and secured and unsecured loans. Sources of credit include banks, savings and loan associations, credit unions, sales finance companies, and other businesses. Costs of using credit include annual fees, finance charges, higher prices, and interest rates.

Debt is a big problem for Americans. Over 40 percent of American families spend more than they earn each year, and an average household carries a credit card debt at any given time. While credit card companies bombard consumers to feel them in, and the borrowers individuals are “on the hook” for years trying to pay off their debts. Other people say that those who are in debt are to blame. It's everyone's responsibility to manage her/his own finances wisely and not to charge purchases that can’t be paid off. What do you think?
Legislation affecting credit

All businesses and consumers should be familiar with the laws that regulate credit. They should understand what businesses are allowed to do, what they are not allowed to do, what their rights are, and what customers' rights are. Businesses must comply with legislation at the state and federal levels.

State laws. Every state in the United States has varying laws governing credit. The Uniform Commercial Credit Code (UCCC) gives states a model to follow in writing their own sets of credit laws. The UCCC provides rules covering all areas of credit, including credit terms, interest rates, and credit insurance. In addition, most states have enacted Retail Installment Sales Acts (RISA) to regulate installment sales of personal property.

Federal laws. There are several important federal laws concerning credit. These include:

- The Truth-in-Lending Act. This law is also called the Consumer Credit Protection Act. Its main purposes are to protect consumers who use credit and to make it easier for them to compare the terms of different credit systems. This law specifies what information the business is required to give the customer in each of the different kinds of credit systems.

- The Equal Credit Opportunity Act. The main purpose of this law is to make the granting of credit fair by prohibiting the denial of credit based on the applicant's gender, race, age, marital status, or national origin. If a credit application is rejected, the rejection must be made in writing, and the applicant is entitled to know the specific reason for the refusal.

- The Fair Credit Billing Act. This law requires credit-extending businesses to respond within 30 days to any customer's complaint or inquiry about a billing error. The business has 90 days in which to explain or correct the error or misunderstanding.

- The Fair Credit Reporting Act. This law gives consumers the right to inspect the files of their credit history at any credit agency and to have any mistakes corrected. Credit agencies handle a great deal of information, and errors can easily occur. Since credit is often granted or refused based on the information contained in these files, it is very important for consumers to know what is in these files and to make sure they are kept up to date.

1. Why do businesses offer credit?
2. What are the benefits of obtaining credit?
3. What are some laws that govern the granting of credit?