Credit

Meaning of Credit

- **CREDIT** - the ability of a consumer to obtain goods and services before payment based on a trust that payment will be made in the future.

- **CREDITOR** - the business or organization that extends (gives) credit
- **PRINCIPAL** - the original amount borrowed

TYPES OF CREDIT

- CASH CREDIT - if you take a *loan* or receive cash

- SALES CREDIT - if you *buy something* now & pay for it later

Secured & Unsecured

- SECURED - loan is backed by property (collateral)
  - Collateral is taken if loan is not repaid
- UNSECURED - higher interest rate

Closed-end & Open-end

- CLOSED-END
  - one time extension of credit
  - specific $ amount
  - time period
  - total interest known at start

- OPEN-END (line of credit)
  - available amount of credit can be used repeatedly
  - interest based on average balance

INSTALLMENT CREDIT

BEWARE balloon payments!

- A set portion of the loan amount is paid at regular intervals

- Examples:
  - "Four easy payments"
  - Credit Cards
  - Car/house loan

- **PROS AND CONS OF CREDIT**
  - Temporary expansion of income
    - use something while paying for it
    - replace broken refrigerator
    - allows large ticket items (car, house)

- **PROS** AND **CONS** OF CREDIT
  - Convenience

    - don’t have to carry lots of cash

    - shop online or by phone
    - easier refund of returned items

    - monthly statement for records

- **PROS** AND **CONS** OF CREDIT
  - Interest & Fees

    - finance charge = cost of using credit
  - Increased Cost of Merchandise

    - offset unpaid debt
    - pay banks to process credit cards

- **PROS** AND **CONS** OF CREDIT
  - Opportunity Cost

- Income expansion turns to income contraction
- Give up current & future buying power to pay off earlier purchases

Background on Credit

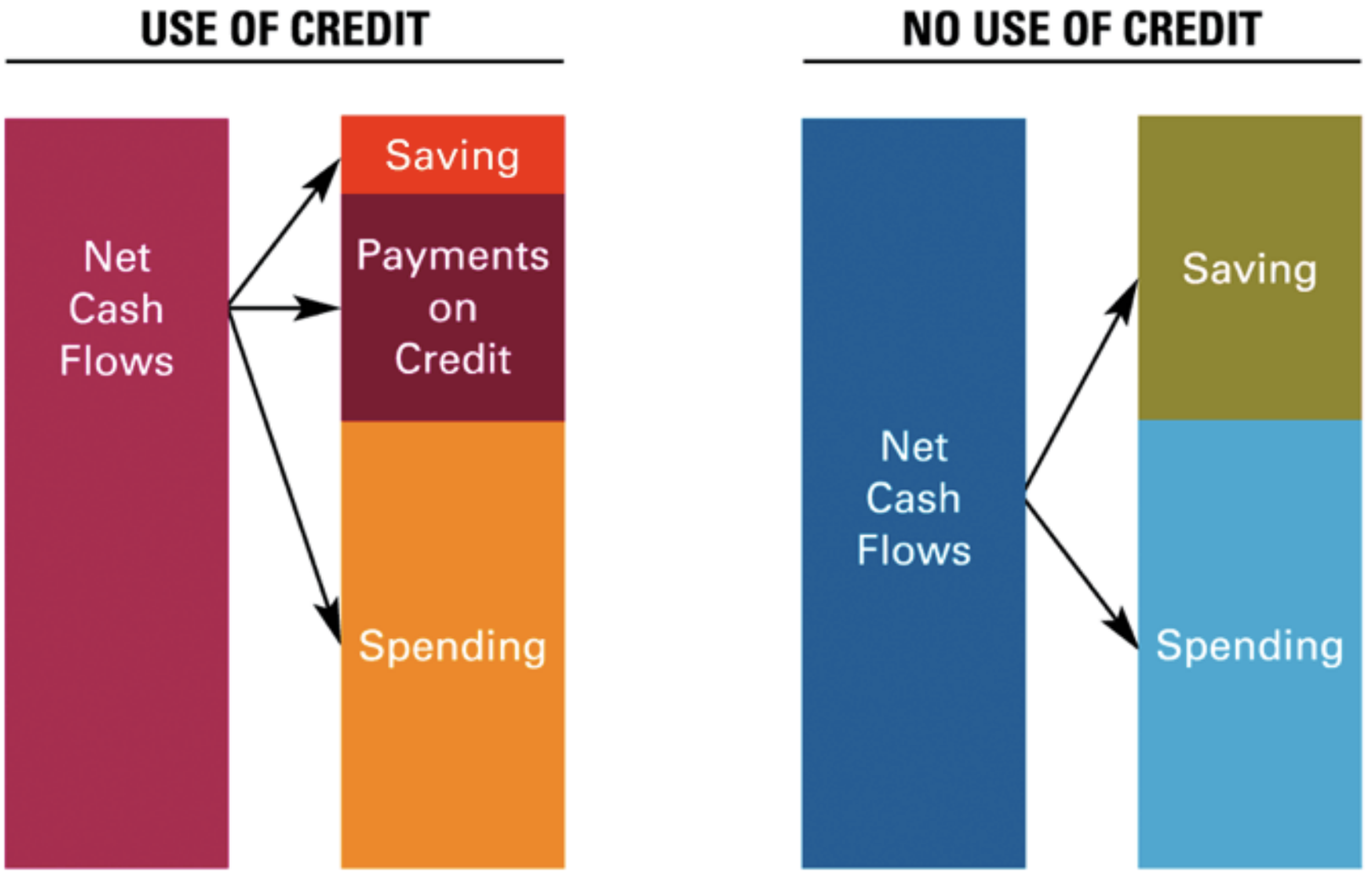

Exhibit 7.1: Impact of Credit Payments on Saving

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OTHER DRAWBACKS

- Security Concerns
  - credit card stolen or used without permission
- Impulse Buying
  - more likely to buy without thought
- Overspending
  - easy to spend too much & debt mounts up