

7-1 Buying Plans**OBJECTIVES**

- *Explain the advantages of using a buying plan.*
- *List the steps of a buying plan.*
- *Set criteria for selecting one item over another to buy.*
- *Explain why comparison shopping leads to better buying decisions.*
- *Create a buying plan.*

There are many benefits to using credit, such as building a solid credit history. Several credit sources are available to consumers, but some cost more to use than others. When you use credit, you may pay more for goods and services. The added cost can be major, especially when you make only minimum payments on a credit account. You can pay credit bills in many ways. Some ways are more convenient and less expensive than others. Unwise use of credit can lead to overspending and other problems. To avoid credit problems, you must understand and avoid the pitfalls related to using credit. You should also be aware of credit laws that help protect consumers.

Chapter 7 is about making good buying choices and using credit. Credit can be a helpful tool in managing finances. Misuse of credit, however, can lead to overspending and impulse buying. There are many sources of consumer credit. Some sources are inexpensive and easy to use. Others are restrictive and can lead to high payments and interest charges. High interest, fees, penalties, and rising rates are often imposed on those who do not use credit wisely.

PURCHASING CHOICES

Buying goods and services can be a fun activity. Sometimes you are happy with your purchase, and it meets your needs and goals. Sometimes you are unhappy with a purchase and wish you had not bought that item. When a purchase will affect you in the future, take some time to make the decision. Some people say that any purchase over \$50 should be considered carefully. Impulse buying is when you do not think about a purchase ahead of time. You see an item that looks appealing and buy it right away. This type of buying often leaves the buyer feeling dissatisfied and wishing he or she had chosen more wisely. Following a buying plan can help you make better buying choices. Using a buying plan, you can identify your needs and the items or services that can fill those needs. A plan can also help you avoid impulse buying.

A BUYING PLAN

A buying plan is a method for making good buying decisions. It will help you stretch your limited resources. It will also help prevent buyer's remorse, which is regret over a buying decision you have made. A buying plan may be a more detailed extension of a budget. For example, you may have allowed \$500 in a yearly budget to buy a washer and dryer. In the buying plan, you will consider details of the purchase, such as features of the product and when to make the purchase.

EVALUATE WANTS AND NEEDS

Items you buy should be selected to meet your wants and needs. By evaluating your wants and needs before you shop, you will be better prepared to make good buying decisions. This process is especially important when buying items that cost a large amount of money. Because your resources will likely be limited, you should consider the opportunity cost of the item. What other items must you forgo buying in order to buy this item? Consider how the item relates to meeting the goals you have set in your budget or financial plan.

Set Criteria. Once you have decided to buy a good or service, you should set criteria for the item. Criteria are standards or rules by which something can be judged. In the case of an item to purchase, the criteria would be the features, functions, and quality of the item. To be sure the criteria are being met, list the features, functions, and quality that are required in an acceptable choice.

Set A Timeline. For each item you want to buy, decide how soon you want to make the purchase. The timeline may depend on some activity, such as buying a new dress for graduation. It may also depend on someone else doing something. For example, you may wait to buy a particular item until a store places the item on sale. Putting a time frame on each planned purchase will help you prioritize. You may choose to drop some items from your list because buying them is not practical.

Set A Spending Limit. A spending limit is the maximum amount you are willing to pay for an item. Based on the need or want that is being met, how much money are you willing and able to spend? By setting an amount, you know the spending limit. You will not be tempted to spend more than you have planned.

GATHER INFORMATION

When you know what type of item or service you need to buy and how much you are willing to spend, you can start to gather specific information. You will want to know what products and services are available, along with their features and prices. You may find that you need to revise your spending plan. For example, you may learn that a product with the specific features you want is not available within your spending limit. You must change either the criteria or the spending limit.

Comparison Shopping. Comparison shopping leads to better buying decisions. You can make a better choice when you know all of the options available. Check several sources to find data on prices and features of the product or service. You may find that some items are on sale or offer rebates. A rebate is a refund of part of the purchase price of an item. You may also find a wide range of features available. The Internet is a good place to do product research. You can browse sites with product data at your own convenience and need not feel pressured to buy. Compare the product or service features to the criteria you have set. Determine which product or service has all the features and the quality you need at the lowest price. Remember to add taxes, handling charges, and shipping fees when considering the total cost. Some catalog and Internet companies offer free shipping. You may not have to pay sales tax on some items purchased by catalog or on the Internet. Be aware that the lowest price is not always the best price. Compare the warranties and return policies from the various sellers. On expensive items, having a good warranty can be an important criterion. Consider the seller. Is the seller a reputable and established company that you can expect to deal fairly with you? Be wary of buying at low prices from a seller you do not know much about. If the item is damaged or of poor quality, the seller may not allow a return or refund.

Payment Methods. Each purchase involves two choices—what to buy and how you will pay for it. Sometimes your only payment option is cash. At other times, you can choose among payment methods. You may be able to write a check or pay with a debit or credit card. You might choose to buy at one store instead of another because one store takes credit cards and the other does not. Knowing in advance how you will pay for a product or service puts you in a better position to bargain. Some merchants will sell a product or service at a lower price if you pay in cash. For some items, such as a car, you may borrow money to pay for the purchase. This is often called financing the item. Always compare financing options that may be available through the seller with options from other sources. You will learn more about the advantages and disadvantages of different payment methods in Chapter 8.

MAKE THE PURCHASE

Consider all the information you have gathered, and choose a product or service. Once you have decided on the product or service that will best meet your needs, it is time to buy. Check the item carefully to be sure it is in good condition. If the item is in a box, the box should be sealed. It should be clear that the box was not opened before and resealed. If the box has been resealed, take the item out and examine it. Ask about warranties and return policies. Be sure to keep the receipt. Know the time within which a product can be returned should you find something wrong with it. Sometimes delivery will cost extra. You might be able to save money by picking up a product yourself.

EVALUATE THE PURCHASE

Once you get the product or service and try it out, you may feel differently about it. The excitement of buying is now gone. Ask yourself how satisfied you are with the purchase. Did you follow a buying plan? Did you get good value for the money you spent? Does the product or service meet the want or need for which you purchased it? Are there ways you could have done a better job in selecting or buying? Learn from each buying experience so you can continue to make good buying decisions.

7-2 Sources and Benefits of Credit

OBJECTIVES

- *Explain the purpose of credit.*
- *Compare sources of consumer credit.*
- *Complete a sample credit application.*
- *Describe the benefits of using credit.*

SOURCES OF CREDIT

Credit is the ability to borrow money with the agreement to pay it back later. The repayment usually includes interest. The purpose of credit is to allow buyers to purchase items at the present time and pay for them in the future. Several sources of credit are available to consumers. Once a consumer begins using credit, banks and other companies often offer to provide other sources or types of credit. The person who borrows money is called a debtor. In most cases, the debtor must fill out a credit application to be approved by the lender. The lender is also called the creditor.

On a credit application, the borrower provides data needed by the lender. Personal contact data, such as name, address, phone number, and date of birth, are given. The borrower's work information, other credit sources, and bank account information are also included. When completing a credit application, give complete and honest responses. Read all the information carefully. The back of the application or additional pages may describe the terms of the credit agreement. Be sure you understand and agree to the terms before you sign and submit an application.

SERVICE CREDIT

Service credit is the ability to receive services and pay for them later. Examples of service credit include the use of electricity, water, sewer, and other utilities. You may also receive service credit from doctors, dentists, and others. You may not think of it as credit, but you are receiving services now and paying for them later. Some companies that offer service credit require you to pay a deposit when you begin using the service. After your payment history is known, the deposit may be refunded to you.

BANK CREDIT CARDS

Credit cards are available from banks and other companies. These cards are usually issued through a provider such as VISA or MASTERCARD. With a credit card, you can buy products or get cash at ATMs around the world. Bank credit cards are a type of revolving credit. With revolving credit, the account holder can charge to the account as often as desired, up to a certain dollar limit. The account holder makes payments, usually each month. The entire debt or part of the debt can be paid each month. This means that the account can have an ongoing balance. However, a minimum monthly payment is usually required. Interest is charged on outstanding balances. Interest on credit cards can be quite high. Bank cards also often charge an annual fee.

STORE ACCOUNTS

Department stores, gas companies, and other retail merchants may offer their own credit accounts. The account holder may receive a credit card to use in making purchases. Unlike bank credit cards, store accounts allow you to charge items or services only at that store or with that merchant. These accounts often have high interest rates and require monthly payments. Using store accounts can lead to less comparison shopping when people simply buy where they have accounts. Store accounts can be revolving credit accounts, or they can be installment plans. With installment credit, an amount is set for the purchase. Payments are made and the balance is paid off in a set period of time. For example, a customer might buy a refrigerator for \$800 and agree to pay 18 percent yearly interest on a 3-year payment plan.

CHARGE CARDS

A charge card is a form of credit card because you buy now and pay later. With charge cards, however, you pay the balance in full each month. Because there is no interest or service fee, these cards often require a large annual fee (\$50 to \$100 or more). Examples of charge cards are American Express and Diners Club.

LOANS

Banks and other companies loan money to consumers. Consumers can get different types of loans. An installment loan is similar to an installment plan for a store purchase. A set amount is borrowed at a certain interest rate for a set period of time. For example, a consumer might borrow \$1,000 at 8 percent interest for 1 year. The debtor makes regular payments for the set period of time to repay the loan. The repayment includes the amount borrowed and interest. Handling fees may also be charged.

A single-payment loan also has a set amount borrowed at a certain interest rate for a set period of time. With this type of loan, however, the entire amount plus interest is repaid in one payment on a certain date. The terms of a loan may allow the consumer to use the money borrowed as desired. Other loans may specify how the money is to be used. For example, the loan may be for home repairs or for the purchase of a car.

The lender may require the borrower to offer security for the loan. Property that can be used as security for a loan is called collateral. Land, a house, and a car are examples of items that can be used as collateral. The lender can sell the collateral to get the money due if the borrower does not repay the loan. If the borrower does not have the needed collateral, the lender may require that the loan have a cosigner. A cosigner is a person who signs the loan agreement along with the borrower. This person agrees to repay the loan if the borrower does not.

LINES OF CREDIT

A line of credit is a preapproved amount that a debtor can borrow when needed. It is available through banks, credit card companies, and other lenders. The borrower must fill out a credit application. The maximum amount that can be borrowed is set. No interest is charged until the debtor uses the line of credit. A line of credit is a good thing to have so you know how much you can borrow for something such as a car or a remodeling project.

BENEFITS OF CREDIT

People use credit for a variety of reasons. Using credit has both benefits and costs or advantages and disadvantages. In this part of the chapter, you will learn how consumers can use credit to take advantage of its benefits. You will learn about the costs of credit in the next section.

CONVENIENCE AND REWARDS

Credit cards and store accounts offer convenience to consumers. Many people prefer to use credit cards for purchases instead of carrying large amounts of cash. Some companies to which consumers make regular payments accept credit cards. The account can be set up to be billed to a credit card each month. Utility companies and Internet service providers are examples of businesses that offer this option. Paying one credit card bill each month is easier than paying several bills to different companies. Consumers can get cash advances with some credit cards. This is convenient for consumers traveling far from home. Many bank credit cards and store accounts have rewards features. With a rewards program, you get points or other bonuses, such as cash back, when you use the card. Points can be redeemed for merchandise or other goods or services.

INCREASED SPENDING POWER

Without credit, many people would have lower standards of living. They would have to wait to buy things that can save them time and money. For example, a consumer might have to save money for a year to have the purchase price of a washer and dryer. By using credit, the consumer can purchase the washer and dryer when needed. A small down payment might be required. The remaining cost, along with interest, can be repaid over the course of a year or two. During this time, the consumer is able to use the washer and dryer. Using credit allows some people to buy expensive items that they might never save enough to pay for at once. For example, many people do not have enough money to pay the full purchase price of a house. Having a home loan, called a mortgage, allows these people to buy a home.

RECORDS AND PROTECTION

Credit card receipts provide you with records of what you have bought using the card. You can use receipts for returning goods, as well as getting adjustments. Having the receipts also allows you to verify your purchases against the credit card statement. Using credit gives you advantages when resolving some disputes with merchants. For example, suppose you purchased an item on the Internet. The seller says you can expect delivery within two weeks. Five weeks go by, however, and you have not received the item. When your credit card bill arrives, you find you have been charged for the item. Because you have used a credit card as payment, you can dispute the charge with your credit card company. The credit card company must resolve the dispute within a certain time. You can withhold payment of the disputed amount during the investigation.

Some credit card companies offer various benefits or protections against risks. The following list gives several examples:

- You pay no charges for any fraudulent use of the card. You do not have to pay for any online purchases made without your knowledge.
- You can withhold payment for disputed items while the dispute is being investigated.
- If a store refuses to refund the price of a returned item within 90 days of purchase, the credit card company will refund the purchase price up to a dollar limit (such as \$500) per eligible item.
- If goods are damaged or stolen within 90 days of purchase, the credit card company will replace or refund eligible items.
- You can receive an emergency replacement for a lost card quickly, often within 24 hours.

7-3 Costs of Credit

OBJECTIVES

- *List costs associated with using credit.*
- *Explain the difference between fixed and variable interest rates.*
- *Use three different methods for computing finance charges.*
- *Describe penalties and fees imposed by credit card companies.*
- *Compare credit card offers.*

CREDIT COSTS

Although using credit can have benefits, it can also have disadvantages and costs. Unwise use of credit can lead to overspending. If you do not make payments on credit accounts on time, your credit rating will suffer. This may mean that you cannot get credit when you need it in the future. If you use credit wisely, costs can be kept to a minimum. For example, credit card companies charge interest on outstanding balances. If you pay the full amount owed on your credit card each month,

you can avoid paying interest charges. Using this strategy, you can enjoy the benefits of using credit with little cost. However, you may have to pay a yearly fee for the privilege of using the card. Interest and fees you pay are also called finance charges. These charges have the effect of increasing the cost of items you purchase on the credit account. There are several different ways of computing interest for credit. Whatever the method used, you will pay interest if you carry a balance on the account.

FIXED AND VARIABLE RATES

A credit account may have a fixed annual rate of interest. With a fixed rate, the interest rate is set and does not change each month or year. However, even with a fixed rate, the credit card company can, with 30 days’ written notice, raise the fixed rate of interest. You can refuse to accept this new rate; but if you do, the company will close your account. When an account is closed, you can pay it off at the old rate, but you can no longer make charges to the account. The daily interest rate and the corresponding annual interest rate are shown on the partial credit card statement to the right.

Summary of Transactions					
Previous Balance	Payments and Credits	Cash Advances	Purchases and Adjustments	Finance Charges	New Balance Total
\$2,102.42	\$2,144.81	\$0.00	\$1,259.61	\$0.00	\$1,217.22
Finance Charge Schedule					
Category	Periodic Rate	Corresponding Annual Rate	Balance Subject to Finance Charge		
Cash Advances					
A. Balance Transfers, Checks	0.043753% Daily	15.97%	\$0.00		
B. ATM, Bank	0.043753% Daily	15.97%	\$0.00		
C. Purchases	0.043753% Daily	15.97%	\$0.00		
Total Minimum Payment Due					
Past Due Amount	Current Payment	Total Minimum Payment Due			
\$0.00	\$15.00	\$15.00			

With a variable rate of interest, the lender or credit card company can change the rate often. Variable rates tend to rise fast when interest rates in general go up. However, rates go down very slowly. Credit cards with variable interest rates should be used sparingly. You do not want to get caught with a large balance when interest rates are rising. When the rates for two cards are the same or close to the same, choose a card with a fixed rate instead of a card with a variable rate.

METHODS OF COMPUTING INTEREST

Three basic methods are used to compute interest on revolving credit accounts. These methods are the adjusted balance method, the previous balance method, and the average daily balance method. Most creditors use one of these methods or a method that is similar. The three methods can result in different interest charges. For example, suppose an account has a \$500 previous balance. During the month, charges of \$30, \$50, and \$80 are made. A payment of \$100 is made. Using the adjusted balance method, the interest charged is \$8.40. Using the previous balance method, the interest is \$7.50. Using the average daily balance method, the interest is \$8.46. Each of these methods is explained in the following sections.

Adjusted Balance Method. With the adjusted balance method, the balance at the beginning of the period is added to charges made during the period. The payment received is subtracted from this amount to find the adjusted balance. The adjusted balance is multiplied by the interest rate and the time to find the interest amount. The interest amount is added to the adjusted balance to find the new balance (amount owed).

Previous Balance Method. With the previous balance method, interest is calculated using the outstanding balance at the end of the previous billing period. Charges in the current billing period are not included. Interest is calculated by multiplying the previous balance times the interest rate times the time. The new balance is the previous balance plus interest plus charges minus any payments made.

Average Daily Balance Method. With the average daily balance method, an adjusted balance is computed for each day of the month. The adjusted balance is the balance from the previous day plus charges and minus payments received on that day. The adjusted balances for all days are added and then divided by the number of days. This amount is the average daily balance. The amount is multiplied by the interest rate and the time to find the interest amount. The interest is added to the balance on the last day of the billing period to find the new balance (amount owed).

MINIMUM PAYMENTS

The minimum payment is how much you must pay each month on a credit account. If you pay only the minimum, it could take many years to pay off a balance. The interest charges could cost you more than the purchase itself. Minimum payments usually are 3 to 5 percent of the balance owed. Thus, if you owe \$1,000, your monthly payment would be \$30 to \$50. This payment includes both principal and interest. Higher minimum payments help you pay off debt sooner. However, higher payments also give you less flexibility in managing your budget. The minimum payment can be changed at any time. The creditor may decide to increase the minimum, and you will have to pay that amount. This could be difficult if your budget is already tight.

PENALTIES AND FEES

If you make a late payment, you will typically be charged a penalty. A penalty is a fee charged for violating the credit agreement. A late penalty is often \$35 or more. Late payments can also cause your interest rate to rise. Many credit agreements state that if you are late with a payment or miss a payment, your interest rate will increase.

Many credit card accounts have a set limit to the amount you can charge at any one time. If you try to charge more than your limit, the charge may be refused. In others words, your purchase is not approved at the time you check out and try to pay using the credit card. The credit card company may approve the charge even though it is over your limit. You will then be charged an over-the-limit fee. This is another type of penalty, and it can also cause your interest rate to rise. You may have to pay the fee every billing period until the outstanding balance falls below your credit limit.

Some credit card agreements have a termination penalty. This penalty may apply if you close the account before a stated time, such as 1 year. Often, the penalty involves raising the interest rate to the highest rate allowed by law. This rate is often more than 20 percent per year. The penalty may apply to cards that offer low introductory rates. It discourages you from closing the account at the end of the low-rate period.

SPECIAL RATES

Credit card interest rates are expressed as annual percentage rates. By law, creditors must clearly state the rate of interest on all credit offers. Variable rates are often tied to the prime rate. Typically, it would be the prime rate plus some percentage, such as 5 percent. Low introductory interest rates often last 6 months to a year. These temporary rates are then replaced with variable or fixed rates. The purpose of these rates is to get you to switch to a new credit card. Be cautious, however, because the regular rate may be higher than the rate for your previous card. Figure 7-3.5 on page 210 shows an example of introductory rates from a credit card application. When you get a new credit card, you can transfer the balance of what you owe on an old card to the new card. Balance transfer rates are sometimes 0 percent. These low rates are offered to entice you to change cards. However, the rates usually apply to the balance from the old card only and only for a short period of time. Sometimes credit card companies provide access checks. These checks look like regular checks, but they are used to borrow money. When you use a check to buy goods or to pay off another credit card, you are transferring the balance to your credit card. When you have more than one rate being charged, credit card companies apply your payment to the balance with the lowest rate first. This means you will pay an overall higher rate than the balance transfer rate.

Details of Rates	
Annual Percentage Rate (APR) for Purchases	7.9% for Gold accounts or 13.99% for Silver accounts The account you receive is determined based on your creditworthiness.
Introductory Rate	3% Introductory APR for balances through your first 12 statement closing dates After that, the standard APR of 7.9% for Gold accounts or 13.99% for Silver accounts applies. The Introductory APR may end sooner if your payment is late.
Balance Transfers and Cash Advance Checks	0% Introductory APR for balance transfers and cash advance checks through your first 12 statement closing dates After that, the standard APR of 7.9% for Gold accounts or 13.99% for Silver accounts applies. The Introductory APR may end sooner if your payment is late.

CHECKING CREDIT STATEMENTS

When you receive a credit account statement, you should check it carefully. You want to be sure that the charges, payments, interest, fees, and new balance are correct. Follow these steps to check a credit statement:

1. Compare the charges listed on the statement with your sales receipts and records of online or telephone purchases. Make sure the amounts are the same.
2. Verify that payments you have made are shown on the statement.
3. Verify that credits (such as for returned items) are shown on the statement.
4. Take note of any fees or penalties you have been charged. Determine whether the creditor is allowed to charge these fees according to the credit agreement.
5. Verify that the interest amount and the new balance (amount owed) are correct. If you find what you think are errors on the statement, contact the company using the method given in the credit agreement. You will typically be required to make the complaint in writing. A form may be provided on the back of the statement to use in filing complaints. You will learn more about consumer rights regarding credit and credit disputes in Chapter 9.

FOCUS ON: Credit in America

Credit today is easy to get, and many creditors want your business. Merchants encourage their customers to use store credit. They offer discounts and price reductions to get customers to open and use a credit account. The ease of buying over the Internet has opened new uses of credit. Online purchases at reputable sites are fairly secure and no more risky than in-person purchases. Either way, you are vulnerable. Dishonest people can get your private data and use the data to steal in your name. As long as you maintain a good credit record, you will receive many credit offers. These offers will come from established as well as new companies. Credit offers may also pose a security threat. If someone steals your mail, she or he can open accounts in your name and charge products. You will then have a serious problem. If you do not manage your credit responsibly, you will find the electronic age to your disadvantage. For example, if you make a late payment to one creditor, other creditors may learn about it. Other lenders may be less likely to extend credit to you. Once you are refused credit at one company, this is a signal to others that you are not a good risk. If you use credit too freely and cannot make the payments you owe, you will soon find it very hard to get or use credit. Manage your credit wisely so you will have it when you need it.

Chapter Summary

- *Following a buying plan can help you make better buying choices. It helps you identify your wants and needs and the items or services that can fill those wants and needs.*
- *Impulse buying brings little or no satisfaction and often results in buyer's remorse.*
- *Buying criteria are features that you want in products or services you have decided to buy.*
- *Gathering information is the second step of a buying plan; it begins with comparison shopping.*
- *Making a purchase involves careful checking and asking questions, keeping receipts, and knowing about warranties and return policies.*
- *Evaluating a purchase will help you make better choices in the future.*
- *Credit is the ability to borrow money with the agreement to pay it back later. The repayment usually includes interest.*
- *The purpose of credit is to allow buyers to purchase items at the present time and pay for them in the future. Use of credit allows*
- *consumers to buy products that they otherwise could not purchase.*
- *In most cases, the borrower must fill out a credit application to be approved by the lender.*
- *Bank credit cards are a type of revolving credit. The account holder can make charges up to a set credit limit and make periodic payments.*
- *Store accounts can be revolving credit accounts, or they can be installment plans. With installment credit, an amount is set for the purchase.*
- *Payments are made and the balance is paid off in a set period of time.*
- *Charge cards are a type of credit, but the balance is paid in full each month.*
- *Using credit has many advantages, such as convenience and increased spending power. Credit receipts and statements provide good records of purchases made.*
- *Property that can be used as security for a loan is called collateral.*
- *Interest and fees you pay for the use of credit are called finance charges.*
- *A fixed rate of interest does not go up and down frequently, but it can change with proper notice to customers.*
- *A variable rate of interest goes up and down at the discretion of the creditor.*
- *Three basic methods are used to compute interest on revolving credit accounts. These methods are the adjusted balance method, the previous balance method, and the average daily balance method.*
- *Borrowers are charged penalties and fees for violating any term of the credit agreement, such as for making a late payment or spending over the credit limit.*
- *When you receive a credit account statement, you should check to be sure that the charges, payments, interest, fees, and new balance are correct.*