Borrowing 101: An Introduction to Credit

Credit—the privilege of buying something now and paying for it later—carries with it many rewards when handled responsibly. Learn what credit is, the benefits you may enjoy by having access to credit, and how to manage your creditworthiness.

Understanding Credit

Credit is offered by a lender, also called a creditor, to a borrower or a debtor.

Creditworthiness is the degree of financial trustworthiness demonstrated by a borrower, based on how they have historically managed their monetary responsibilities.

A credit report provides a snapshot of a borrower’s creditworthiness and helps lenders calculate the amount of risk they will assume when providing a borrower access to borrowed funds (i.e. a line of credit).

Benefits of Credit

Access to credit (borrowed monies) offers many advantages. Among these are:

- The ability to enjoy a product you could not otherwise afford if you had to pay for it upfront.
- The convenience and safety of not having to carry large amounts of cash.
- The peace-of-mind that comes from having emergency funds for unexpected expenses.
- Simplified recordkeeping with possibly only one monthly bill to pay.
- Optimal interest rates, terms, and a reduction in the relative costs associated with loans, credit cards, insurance, and other financial resources.

The Impact of Bad Credit

If a lender determines your creditworthiness to be low, this may result in a number of negative consequences. Some of these may include:

- Failing to qualify for the purchase of a home, car, or another “big-ticket” item.
- Paying more for a loan because of being charged higher interest rates and fees.
- Difficulty renting an apartment or entering into other contractual arrangements (i.e. obtaining insurance).
- Limited opportunities to access different types of financial resources such as loans, credit cards, insurance, etc.

Tips to Managing Credit Wisely

Maintaining your creditworthiness is not rocket science. Basic tips include:

- Pay your bills on time…pay your bills on time…pay your bills on time!
- Pay your bills in full every month, or if that’s not possible, pay more than the minimum payment, and when possible, apply extra payments toward the highest interest rate debt.
- Limit the amount of debt on your lines of credit.
- Don’t close all of your existing accounts or lines of credit, as your length of credit history has an impact on your credit score.
- Limit the number of times that you apply for credit. The number of credit inquiries also impacts your credit score.
- Check your credit report for errors, dispute any inaccuracies with the credit bureau, and protect yourself against identity theft.

Taking on new financial responsibilities for the first time can be intimidating. Take a look at Setting out on Your Own, a free online publication from the Federal Trade Commission.