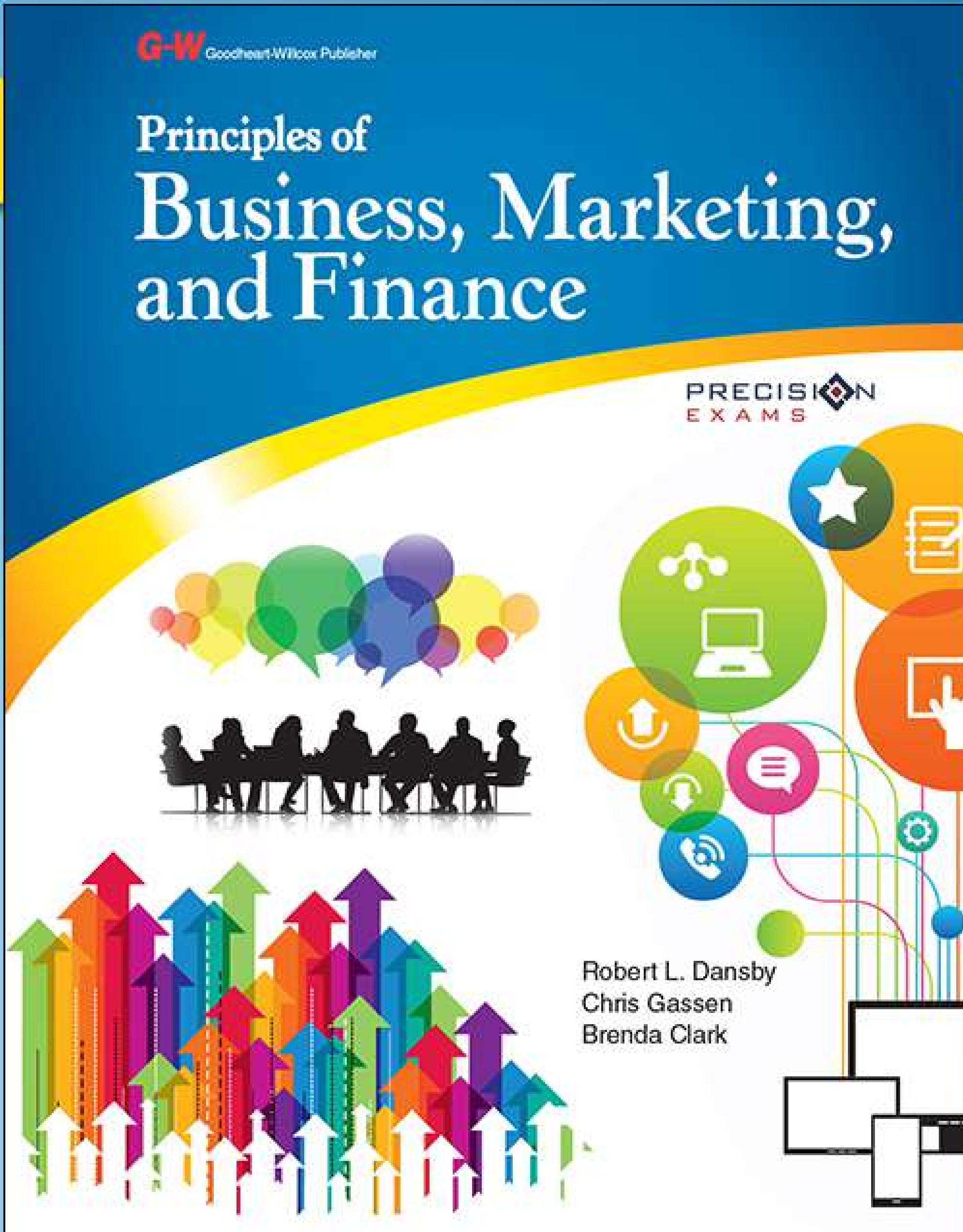

Presentations for PowerPoint

Principles of Business, Marketing, and Finance

G-W PUBLISHER
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Tinley Park, Illinois

16

Credit

Section 16.1

Credit Basics

Objectives

- **Summarize** the purpose and importance of credit.
- **Identify** the types of credit available to individuals and businesses.
- **Describe** the charges associated with using credit.
- **Discuss** the possible outcomes of using credit unwisely.

Key Terms

- credit
- creditor
- debtor
- consumer credit
- business credit
- trade credit
- closed-end credit
- secured credit
- installment loan
- principal
- finance charge
- open-end credit
- unsecured credit
- annual percentage rate (APR)

Essential Question

What are typical terms associated with using credit?

What Is Credit?

- **Credit** is an agreement between two parties in which one party lends money or provides goods or services to another party with the understanding that payment will be made at a later date
  - **Creditor:** The party extending credit; *lender*
  - **Debtor:** The party receiving credit; *borrower*
- A *debtor-creditor relationship* is a legal relationship between two parties based on good faith

What Is Credit?

- **Consumer credit** is credit granted to individual consumers by a retail business
- **Business credit** is credit granted to a business by a financial institution or another company
- **Trade credit** is a business granting a line of credit to another business for a short period of time to purchase its goods and services

What Is Credit?

- Benefits of credit
  - Use goods and services while being paid for
  - Buy costly items
  - Funding for unexpected expenses
  - More convenient to carry than cash

Types of Credit

- Common types are closed-end and open-end
- **Closed-end credit** is a loan for a specific amount that must be repaid with interest by a specified date or according to a specified schedule
  - **Secured credit:** Credit loans that require collateral
  - **Installment loan:** Loan for a specific amount of money that is repaid with interest in regular installments
  - **Principal:** Amount of money borrowed
  - **Finance charge:** Total amount paid by a borrower to a lender for the use of credit

Types of Credit

- *Amortization table* shows interest and principal for each payment

Month	Payment	Principal	9% Interest	Principal Balance
1	$87.45	$79.95	$7.50	$920.05
2	87.45	80.55	6.90	839.50
3	87.45	81.15	6.30	758.35
4	87.45	81.76	5.69	676.59
5	87.45	82.38	5.07	594.21
6	87.45	82.99	4.46	511.22
7	87.45	83.62	3.83	427.60
8	87.45	84.24	3.21	343.36
9	87.45	84.87	2.58	258.49
10	87.45	85.51	1.94	172.98
11	87.45	86.15	1.30	86.83
12	87.48	86.83	0.65	0.00

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Types of Credit

- **Open-end credit** is an agreement that allows the borrower to use a specific amount of credit over a period of time
  - **Unsecured credit:** Credit granted based on a signed credit agreement with no collateral; *line of credit* or *revolving line of credit*

Credit Terms

- **Annual percentage rate (APR)** is the annual cost of credit charged by a lender
- Total amount paid for use of credit is based on three factors:
  - Interest rate charged
  - Amount of credit used
  - Length of the repayment period
- Simple interest formula:

  Principal (P) x Rate (R) x Time (T) = Interest
- Federal and state laws regulate consumer credit transactions

When to Use Credit

- Helps buyer obtain needed items
- Consumers
  - Overusing credit can lead to late payments
  - Lower credit score
  - High interest rates
- Businesses
  - Overusing credit can lead to cash flow problems
  - Unable to pay business expenses
  - Lawsuits
  - Unable to get business credit

Section 16.1 Review

1. Explain the debtor-creditor relationship.

   A debtor-creditor relationship is a legal relationship based on good faith that both parties will uphold their end of the agreement. The debtor must repay the creditor based on the terms of the agreement.

2. Why is credit important in the economy?

   It provides consumers, businesses, and government additional buying power needed to support production and distribution of products. Credit keeps cash flowing through the economy and drives economic growth.

Section 16.1 Review

3. What are the most common types of credit available to individuals and businesses?

   The most common types are closed-end credit and open-end credit.

4. What is the formula used to calculate simple interest?

   Principal (P) × Rate (R) × Time (T) = Interest

5. What is the risk of overusing credit for a business?

   Businesses that overuse credit run the risk of cash flow problems. If most of the cash of a business is going toward loan payments, money may not be available to pay business expenses.

Section 16.2

Business and Credit

Objectives

- **Discuss** the costs and benefits of extending credit to customers.
- **Explain** how businesses obtain and use credit.

Key Terms

- proprietary credit card
- credit policy
- three Cs of credit
- credit report
- credit bureau
- credit score
- credit risk
- accounts receivable
- accounts receivable aging report
- collection agency
- five Cs of banking

Essential Question

Why do businesses extend credit to customers?

Extending Credit to Customers

- Customers may spend more using credit instead of cash
- **Proprietary credit card** can only be used in the stores of the company that issued it
- Bank-issued credit cards
  - Financial institution collects money owed
  - Businesses charged fees to process credit transactions
- *Cost of credit* is variable expense that influences pricing decisions

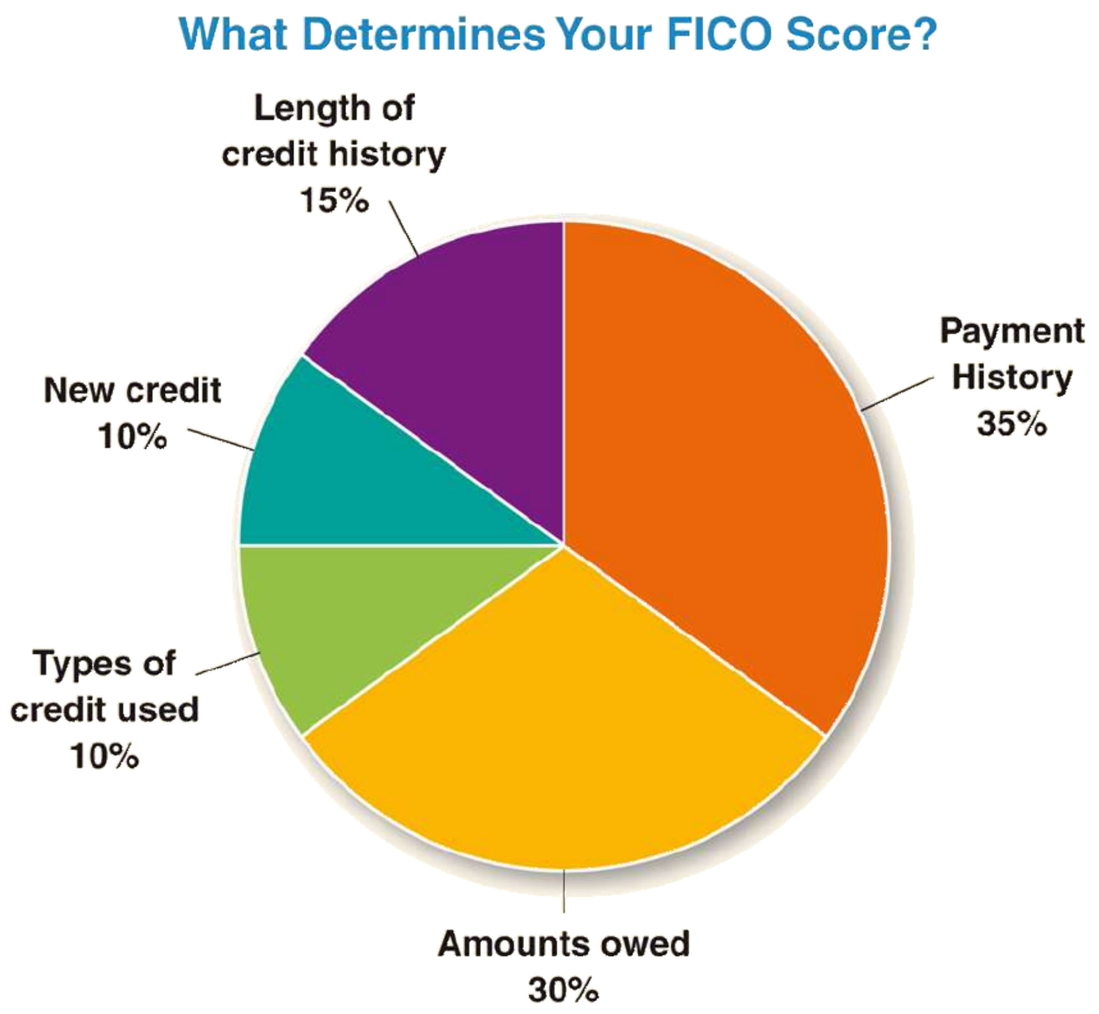
Extending Credit to Customers

- **Credit policy** is written set of guidelines used by an organization to determine how many and which customers will be approved for credit
  - Help guide businesses through process of extending credit
- **Three Cs of credit** are criteria used to evaluate the creditworthiness of consumer credit applicants
  - *Character:* Current debt, payment history, credit score
  - *Capacity:* Regular income and term of employment
  - *Capital:* All assets and liabilities

Extending Credit to Customers

- **Credit report** is a record of credit history and financial behavior for a business or individual
- **Credit bureau** is a private firm that maintains consumer credit data and provides credit information to businesses for a fee
- **Credit score** is a numerical measure of a loan applicant's creditworthiness at a particular point in time

Extending Credit to Customers



Extending Credit to Customers

- Rewards of extending credit:
  - Generating sales
  - Interest charges generate revenue
  - Customer loyalty
- **Credit risk** is the potential of credit not being repaid
  - Creates cash flow problem for business

Extending Credit to Customers

- Monitor accounts receivable
  - **Accounts receivable** is a list of the individuals or businesses that owe money to a company
  - **Accounts receivable aging report** shows when accounts receivables are due, as well as the length of time accounts have been outstanding
- **Collection agency** is a company that collects past-due bills for a fee
  - Additional expense for a business

Obtaining Business Credit

- Businesses may use bank-issued credit cards for short-term credit
- Businesses borrow from banks for long-term credit
- **Five Cs of banking** are criteria lenders use to evaluate the creditworthiness of businesses
  - *Cash flow:* Movement of money into and out of a business
  - *Capacity:* Ability to repay a loan
  - *Capital:* Owner's investment in the business
  - *Collateral:* Property used to secure a loan
  - *Conditions:* Environment in which the business operates

Obtaining Business Credit

- *Trade credit* is credit provided by suppliers; *supplier financing* or *vendor financing*
  - Interest free for 30 or 60 days; *n/30* or *n/60*
  - Discount for early payment
- *Business loan* is money borrowed from a bank for a specific purpose
  - Established repayment schedule
- *Business line of credit* is an established amount of money available to a business whenever needed
  - Can use all or a portion

Section 16.2 Review

1. Why do some businesses prefer to accept bank-issued credit cards, such as MasterCard and Visa?

   An advantage to accepting these cards is that the financial institution is responsible for collecting the money owed, not the business. The financial institution pays the business immediately and then collects the money owed for the sale from the customer.

2. List the three Cs of credit that help evaluate a customer's creditworthiness.

   The three Cs of credit are character, capacity, and capital.

Section 16.2 Review

3. Identify the rewards of extending credit to customers.

   The greatest reward for a business is the generation of sales. Consumers often spend more when using a credit card than if they are paying cash. Another reward of extending credit to customers is building customer loyalty.

4. What are the five Cs of banking that lenders use to evaluate a business seeking credit?

   The five Cs of banking used to evaluate businesses for credit are character, capacity, capital, collateral, and conditions.

Section 16.2 Review

5. Explain the meaning of the trade credit term *n/30*.

   The trade credit term *n/30* means the buyer has 30 days from the date of purchase to pay the net amount of the purchase.