# Advantages & Disadvantages of Using Credit



*Overview*
There are many advantages and disadvantages of credit cards. Let us take a close look at the pros and cons of using a credit card.

*Advantages:*

- **Credit building**. Credit card issuers report account details (such as the percentage of credit utilized, timeliness of payments and amount of time the line of credit has been open) to major credit bureaus every month. This gives the card owner a regular opportunity to add positive information to credit reports, which will improve credit standing. Positive credit history can secure a lower interest rate on loans and other lines of credit, ensure the ability to obtain utility services (such as electricity and cellphone plans) and makes obtaining a lease easier, because it conveys a low-risk of defaulting on a payment. Additionally, employers may use credit checks as part of the hiring process to determine financial responsibility, particularly in executive or financially-related positions.
- **Convenience.** Credit cards alleviate the need for carrying cash in most situations. Most merchants accept credit cards. Unlike cash, credit cards are easily replaceable and most credit cards have a $0 liability guarantee for fraudulent transactions. Additionally, in some cases, having the ability to purchase items or services immediately and pay for them later can be helpful if income comes incrementally throughout the month. However, this convenience can lead to overspending.
- **Rewards.** Credit cards often offer rewards for money spent on the card by offering a percentage of cash back, miles to use for airline tickets or points to be redeemed for travel, dining or cash. These rewards are used as a marketing feature to attract users to the card, but can lead to real savings on trips, merchandise, gift cards or credit card bills if the card is paid off every month. These rewards may encourage overspending, so card owners should be careful to avoid spending money they would not typically spend just for the credit card rewards.
- **Benefits.** Credit cards usually come with some benefits built into them for no extra cost. For example, some cards provide insurance for car rentals or refund costs for canceled travel plans. Additionally, a common benefit of credit cards is purchase protection to replace damaged or stolen items bought with the card. Purchases may also receive extended warranties. Benefits vary from card to card.
- **Currency conversion.** Using a credit card can be the cheapest way to convert money from U.S. dollars to another currency while traveling or purchasing products from oversees, if the card offers the “no foreign transaction fees” benefit.

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*Disadvantages:*

- **Easy to overspend.** Studies have shown using a credit card greatly reduces the ability for people to recall how much items cost. Without having to hand over actual cash or see a specific amount pulled from a bank account, purchases on the credit card can feel less expensive and can add up quickly. Debt accumulated on credit cards can be very damaging and difficult to pay back because of high interest rates. Some people can find themselves so limited by credit card debt they must delay important life events, such as starting a family, buying a house or retiring.
- **High interest rates.** If a credit card balance is not paid in full at the end of the month, the credit card company will charge interest on the remaining balance. Those interest charges will accrue at a very high rate. The average interest rate for all new credit card offers is 18.78 percent, the interest is compounded meaning the more interest charges accrued the higher the minimum monthly bill payments will be. These interest rates are significantly higher than most bank loans. Banks and credit unions often offer a large variety of personal, home and business loans which might offer better interest rates, so checking loan options at a reputable financial institution may be a better choice than charging a credit card for large expenses.
- **Fees.** Some credit cards have annual fees, these fees are thought to be associated with more valuable benefits. For example, a card charging $450 in annual fees may offer $300 of travel reimbursement as a benefit. There may also be fees for cash advances (or the ability to withdraw cash on the balance of the credit card). Missed or insufficient minimum payments can lead to costly penalty fees, as well as credit score damage. Make sure the benefits outweigh the costs of fees and interest rates before selecting a card.
- **Fraud.** Criminals can steal credit card information and make purchases in the card owner's name. Checking credit card statements regularly to identify and report unauthorized purchases can help prevent this from being a problem.
- **Confusing terms.** Credit card terms and conditions are not always the easiest to understand. In some cases, people end up being surprised by certain interest rates, charges or limits because the credit card company presented them in a confusing manner.
- **Multiple ways to hurt credit.** Missing payments are not the only way credit is hurt by credit cards. Applying for a card causes credit scores to dip temporarily, and using more than 30 percent of a credit line is also bad for credit scores.

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*Conclusion:*
Though there are disadvantages for using a credit card, the benefits provide more incentive to use credit cards. Understanding the dangers of credit card debt and using financially-responsible decision making, can help you benefit from the use of credit cards and avoid the pitfalls. Here are some suggestions when using credit cards:

- **Use the Island Approach.** This approach has two pieces. First is to use one credit card for nothing but everyday purchases which are always paid off at the end of the month. If you have existing balances on other cards, do not use these cards until the balance is fully paid off. This allows you to decrease interest costs and monitor spending closely. Additionally, the island approach can allow you to utilize credit cards according to their specific benefits. For example, a card with good rewards should be used for everyday expenses if the balance is paid off every month, while a card with a very low interest rate can be used for long-standing balances.
- **Make a budget and pay off your balances every month.** Creating a budget and tracking your spending is the best way to ensure you do not take on credit card debt. There are many apps and websites to help you track expenses. By only spending what you can afford to pay off, you will ensure you get the maximum benefits of a credit card without most of the drawbacks.
- **Pay off cards quickly.** If you have existing credit card debt or life circumstances require you to have an outstanding balance on a card, pay off this debt as quickly as possible. Credit card debt is typically the most expensive type of debt, so prioritize paying it off first. Using techniques like the snowball or avalanche methods can help provide strategies for paying off debt quickly. Make sacrifices when possible to pay down debt before it becomes out of hand.
- **Do your research.** Research the right card for you based on what your habits are and how you plan to use the card. Many experts have published articles on the credit card market, including offering complete breakdowns of the various benefits each major credit card issuer offers with its cards.
- **Protect your credit score.** Setting up automatic monthly payments from a bank account to avoid late payments. Do not apply for a new credit card in the months leading up to mortgage shopping. This will help build your credit score so you will be more appealing to future lenders.