

CREDIT CARDS IN MEXICO: CORRECT USE OF PLASTIC MONEY**Arturo CORDOVA***Universidad Politécnica de Aguascalientes, Mexico
arturo.cordova@upa.edu.mx***Arturo GARCÍA-SANTILLÁN***Universidad Cristóbal Colón, México
agarcias@ucc.mx***Abstract**

It can be said that the use of credit cards is on the rise and one of the studied markets is that of college students, the greater part of them being first-time users of credit cards. Card usage tendencies are mentioned throughout the study, as well as the description of their general good or bad use. Also, causes are identified as to why they are incorrectly used sometimes, which results in risks to their users. In addition, the study mentions some points to be considered for a better credit card management in order to obtain the best possible benefit from this purchase resource, which can also be a financing resource if it is known how to properly use it. The conclusion is that we must be aware of our own financial situation and know how to distinguish when we are able to acquire a certain good and when we are not; besides, we need to be patient and try not to be someone else through superfluous possessions that lead us into debt in an irresponsible way.

Keywords: *Credit cards, risks and benefits, correct use of credit cards.*

JEL Classification: *G120*

I. INTRODUCTION

For a while now, the market of college students has been the subject of study by many experts, specifically since 1985. One particular study reveals that between 1985 and 1986 half of the undergraduate population possessed a credit card (Churaman, 1998).

When the boom of credit cards started, these financial institutions determined that issuing credit cards to college students was an excellent way to promote long-term loyalty to the brand (Joo, et al. 2003). Others sustained that college students represented a lucrative market for financial institutions as an immediate income source (Amato-Mcroy, 2006). The fact that undergraduates are young adults, and perhaps with little experience in the area of financial management, supports the notion established by experts that students are not qualified to use credit options wisely (Borden, et al. 2007). Furthermore, too many people ignore the importance and impact that their financial decisions have in their credit records.

II. PROBLEM STATEMENT

In many medium to high-income countries, a tendency to opt for electronic payment options over cash has been observed. Many financial institutions and authorities consider this tendency to be beneficial for the economy. The reason behind this is that electronic payments have lower operational costs than cash payments, besides being fast and secure. Particularly, this benefits households by substituting checks and cash for electronic transfers and credit or debit cards as a payment means, reducing the cost of certain day-to-day transactions. A rise in the possession and use of electronic payment options has been observed in Mexico among households in recent years, particularly that of credit cards.

By the end of 2008, the number of issued credit cards reached 25.2 million, a number 3.2 times bigger than that observed during the same quarter of 2002. At the time, the number of annual transactions conducted through this payment option registered in point of sales terminals (POS terminals) reached a total of 301 million pesos, which means a growth of 435% during the same period. Even so, the extent of credit card use in Mexico is still low compared to other countries. For example in 2007 in Mexico, the average number of credit card operations per person was 8.03, while in Brazil and Spain this number went up to 11.3 and 23.1 respectively.

Estimated number of operations in 2002, according to data published by the Bank of Mexico

Credit cards have now become an important part of life for many Mexicans. Nowadays, it is the most widely used financial product in the country, thanks to the advantages it offers as a substitute for cash and easier access in contrast to other financing options. Generally speaking, credit cards are used to finance every-day expenses, monthly groceries or to “treat” oneself to something such as clothes, the latest gadget or family

vacations; also, the bank allows for certain purchases to be covered in interest-free monthly payments. However, what very few people realize is that this instrument can also be a determining factor when undergoing a personal project: anything from catalog sales to homemade candy. Provided certain rules are followed, it can become your main and sometimes only financing source.

For this reason, different articles from various authors were analyzed to detect if there are differences in the theory about the correct use of plastic money. Being college students the main focus for this study, it is important to mention that they are an immature population that usually doesn't account for long-term consequences related to the bad use of credit (Holub, 2002).

In general, students start their college careers without having had absolute responsibility for their own finances (Cunningham 2000, Mae 2002). Peer pressure, convenient use, family background and learned behavior are some of the most relevant causes for incorrect use and management of credit cards among undergraduate students.

III. LITERATURE REVIEW

Initially, we will start by briefly explaining how a credit card is used, which in we will abbreviate as CC from now on.

The credit card is a financial instrument issued to clients by a commercial or banking institution, pending a previous socioeconomic and credit record inquiry; afterwards, the client is considered to be eligible for one of their issued credit cards. The user of this service is known as a cardholder, by signing the cardholder agreement for a line of credit (LOC) the user will be able to conduct purchases and payments in establishments that have a device called a POS terminal. This device identifies the credit card data, which afterward sends the data to the banking institution that issued the CC; who in turn, authorizes the operation according to the credit limit established in the aforementioned contract. This operation allows households to cover the expenses derived from changes in their current income, behavior that can be deduced from the permanent income hypothesis of Friedman (1957). His model states that current consumption is proportional to the permanent income; therefore, households with these financial instruments can face unanticipated changes in their income, thus allowing them to maintain their consumption level.

On the other hand, Fusaro and Cirillo (2011) use a sample of bank accounts to search for determining factors in the use of debit and credit cards. Empirical evidence shows that consumers tend to use their debit card more when they need to limit their expenses (especially if it is difficult for them to estimate a budget) and therefore, avoid the payment of interests due to an unscheduled debt. However, if the total amount for the operation is large (and it is possible that the consumer had already anticipated this expense, as it usually happens with durable goods), it is more likely to be paid off in installments.

Why in Mexico are there more credit cards than before?

Certain analysts point out that the middle-class has strengthened and thus, more and more people are legible for their first credit card. Although, some studies also claim that the decision of the spent amount depends significantly on the availability of POS terminals (Castellanos, 2013).

Joo, Grable, and Bagwell (2003), cited in Castro-González, Delgado-Ortiz, Rodríguez-Madera (2014), find that 70% of college students own credit cards. Mae (2007) states that 17% pay their cards in full every month and Mae (2005) says that 60% ignore the amount owed.

A study conducted with 255 university students in Puerto Rico, showed that the majority of the students manage and make good use of their cards, even though this contrasts with the fact that 60% of them admit their monthly payments are covered by other people when they themselves are unable to.

Based on authors previously mentioned and the article “Aprende a manejar tu tarjeta de crédito” (Learn to manage your credit card) by Mayer (2010), this author concludes that improper management of CC among college students is due to the lack of financial education. He also made the following ten points for the proper use of CC.

1. A credit card is not an additional income.

Establish income and expenses in such a way that an excess is generated which in turn will be destined to pay the card.

2. Don't use the card for ordinary expenses.

When using your card be cautious when encountering sales, such as the 6 to 12 interest-free monthly installments sales, because you don't really gain big benefits and on the contrary, these can hinder your proper finances management.

3. Don't cover the monthly minimum payment only.

Monthly minimum payment is actually a very small percent (usually 5 to 10% depending on the bank) of the total debt, which is what the bank considers as an ordinary payment. That payment is only enough to cover ordinary interests generated initially, then the VAT (16% over ordinary interest) and finally (and if there is even enough) to cover capital. The recommendation made by certain analysts is to cover double the minimum

payment, my recommendation is to try and cover enough so as to not generate interests. By doing so you will cover all the interests, VAT and ordinary capital, which would otherwise lead to more interests on the next cutoff date.

4. Don't think that in purchases done with interest-free installments, you won't pay any interests at all. This is a publicity trap used by all businesses. These types of purchases have an approach that is rarely taken into account which is, the annual membership fee: each year, there is a fee to be paid for the membership, which more often than not is higher than what was acquired with "interest-free installments".

5. Don't wait for the deadline to make your payment. Pay before the due date stated in your credit card statement and avoid late charges, try also to cover at least double the minimum payment required, so the debt is reduced.

6. Don't rely on the credit card statement to arrive in order to know the due date and amount due of the corresponding payment.

Have a strict control of expenses made using the card and safe keep all proof of purchase printouts. Check with the aforementioned documents that your balance checks out with your prior card statement and that all purchases incurred are reflected in such statement for the period in question. Furthermore, compare the amount spent with the proof of purchase printouts you kept.

7. Do not throw away your proof of purchase or invoices for done purchases. A study conducted with 250 university undergraduates revealed that nearly 22% never kept evidence of their transactions, while almost half of them stated not to be aware of expenses incurred in their cards (Joo, et al. 2003). Another thing that could happen is that the payment is not registered correctly by the issuing bank and therefore, by keeping evidence of transactions it can be proven that the payment was done in due time and form.

8. Compare benefits, commissions and interest rates of all credit cards. There are loyalty reward programs, which for each purchase with your card a low percentage, regularly between 0.5% and 2%, is awarded in purchase points or travel miles. When enough is accumulated we can exchange them for products, e-wallet, paid trips, etc. These points have an expiration date and in some cases, you must be registered in these loyalty programs.

In the comparison table extracted from CONDUSEF (2016), we can evaluate interest rates of CC and we can see that there are some cards such as the one from Santander bank which apparently has the lower interest rate (31.6%) but it has a high annual fee (\$530); not so the card belonging to INBURSA with an interest rate of (36%), but which has no annual membership fee. Although, in order to make a comparison it is imperative to talk about Total Annual Cost [TAC] (Costo Anual Total [CAT], in Spanish).

TAC is calculated from the resource flows between the client and the lending institution.

$$\text{Equation: } \sum_{j=1}^M \frac{A_j}{(1+i)^{t_j}} = \sum_{k=1}^N \frac{B_k}{(1+i)^{s_k}}$$

Where:

i = TAC expressed as a decimal.

M = Total number of loan disposals.

j = Consecutive number that identifies each loan disposal.

A_j = Amount of the j -th loan disposal.

N = Number of total payments.

k = Consecutive number that identifies each payment.

B_k = Amount of the k -th payment

t_j = Time interval expressed in years and fractions of the year passed between the start of contract date and the j -th loan disposal.

s_k = Time interval expressed in years and fractions of the year passed between the start of contract date and the k -th payment.

\sum = Symbol used to express the sum of the amounts indicated.

$$\sum_{j=1}^M \frac{A_j}{(1+i)^{t_j}} = \sum_{k=1}^N \frac{B_k}{(1+i)^{sk}}$$

Where:

$\sum_{k=1}^N$ The summation.

B_k : Amount of each payment.

$(1+i)$: Present value

sk : Fractions of the year

The TAC is the numerical value of i , expressed as a percentage which satisfies the following equation: The left side of the equation represents the sum of the present value of loan disposals, considering the time frame during which they are conducted.

The right side of the equation represents the sum of the present value of the loan payments, considering the time frame in which these are done.

9. Do not own more than 2 credit cards.

Specialists advise not to have more than two plastics: one for everyday use and another with enough positive balance to tackle unforeseen events, such as an accident or the loss of the other card. What does not make any sense is that you keep a card you never use, that will bring you no benefit whatsoever. That will not help you at all with building a good credit record and on top of it, it will generate fixed expenses such as the annual membership fee (Suárez, 2017).

10. Threaten to cancel your CC in order to get informed about unconventional offers.

This is something I have not seen published anywhere but is part of the internal operating procedure manual within banks: Whenever a client with a consistent payment behavior has a balance of zero in his CC and then calls to cancel his credit card, customer service advisors then transfer you to a higher echelon called cancellations. In this area, the advisors have a very different way of treating cardholders when dealing with clarifications and complaints; the cancellations area has a strong standing order of not letting the cardholder cancel his card. For this, they have a number of unconventional benefits-offers which include the elimination of the annual membership fee for the coming year; a gift of higher than \$200.00 amount as e-money; include within an arranged period, future purchases to an interest-free monthly installment plan, among others.

IV. CONCLUSION

With this theoretical study it is concluded that credit cards are a great financial instrument as long as we know how to use them, just as stated in the points above, their use should not be abused least it brings us several difficulties. The main difficulty is being unable to pay the monthly fees, which would result in a bad credit record and at a young age this may not receive the importance it deserves. However, later on life when attempting to buy a car at the dealership or to buy a house with a bank mortgage that little stain will remain in their credit record and prevent them from achieving these goals. Also, the unpaid debt will have now become a larger debt due to default interests, collection costs and other unthinkable additional commissions, which most likely means their initial debt has doubled or even tripled by now.

We must be aware of our own financial situation and know how to recognize when we can acquire certain assets and when we can't; we should be patient and try not to pretend to be someone we are not through the acquisition of superficial material things that will get us into debt irresponsibly.

V. REFERENCES

1. Amato-McCoy, D. M. (2006) Back to School—Wacovia Targets Students with All-in-One College ID and Bank Card, *Bank Systems & Technology*, vol. 43, p. 17–18.
2. Borden, L., Lee, S.-A., Serido, J., & Collins, D. (2007) Changing College Students' Financial Knowledge, Attitudes, and Behavior through Seminar Participation, p. 23-40.
3. Castellanos, S.G. y Garza-García, J.G. (2013) Competition and Efficiency in the Mexican Banking Sector, Working Paper N° 13/29 Madrid, October 2013. BBVA Research. Retrieved of: https://www.researchgate.net/publication/257936660_Competition_and_Efficiency_in_the_Mexican_Banking_Sector.
4. Castro-González, K. C., Delgado-Ortiz, C. y Rodríguez-Madera, J. (2014) Uso y manejo del crédito en estudiantes universitarios, *Revista internacional administración & finanzas*. Volumen 7, Numero 5.

5. CONDUSEF (2016) Comparativo del CAT y Tasa Promedio en Estados de Cuenta de TC, Retrieved of: <http://www.gob.mx/condusef/prensa/recuerda-en-abril-bancos-deben-mostrar-comparativo-de-cat-y-tasa-promedio-en-estados-de-cuenta-de-tc>.
6. Cunningham, J. (2000) College student credit card usage and the need for on-campus financial counseling and planning services, Undergraduated Research Journal for the Human Sciences. Retrieved of: <http://www.kon.org/urc/cunningham.html>. Tomado el 17 de marzo de 2013.
7. Churaman, C. V. (1998) College student use of consumer credit. Proceedings of the American Council on Interests, (Ed. By V Hampton), p. 107-113. ACCT. Columbia, Mo.
8. Fusaro, M.A. y P. J. Cirillo (2011) Do Payday Loans Trap Consumers in a Cycle of Debt?. Retrieved of: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1960776.
9. Friedman, M. (1957) A Theory of the Consumption Function, Princeton University Press. ISBN: 0-691-04182-2. <http://www.nber.org/books/frie57-1>. Chapter Title: The Permanent Income Hypothesis. Retrieved of: <http://www.nber.org/chapters/c4405>. (p. 20 - 37).
10. Holub, Tamara. & ERIC Clearinghouse on Higher Education. (2002) Credit Card Usage and Debt Among College and University Students, Washington, DC: ERIC Clearinghouse on Higher Education. Retrieved of: <http://www.eric.ed.gov/contentdelivery/servlet/ERICServlet?accno=ED466106>.
11. Joo, S., Grable, J. E., & Bagwell, D. C. (2003) Credit card attitudes and behaviors of college students, College Student Journal, 37, 405-4.
12. Mae, N. (2002) Undergraduate students and credit cards: An analysis of usage and trends, Retrieved of: http://www.nelliemae.com/library/ccstudy_2001.pdf. Tomado el 17 de marzo de 2013.
13. Mae, N. (2005) Undergraduate students and credit cards in 2004: An analysis of usage rates and trends. Braintree, MA: Author. [accessed 23 April 2010]. Retrieved of: <https://www.salliemae.com/>.
14. Mae, N. (2007) Graduate students and credit cards in 2006: An analysis of usage rates and trends. Braintree, MA: Author. [accessed 23 April 2010]. Retrieved of: <https://www.salliemae.com/>.
15. Mae, S. (2009) How Undergraduate students use credit cards, Sallie Mae's National Study of Usage Rates and Trends 2009, [accessed 10 February 2011]. Retrieved of: <http://www.salliemae.com/NR/rdonlyres/0BD600F1-9377-46EA-AB1F-6061FC763246/10744/SLMCreditCardUsageStudy41309FINAL2.pdf>.
16. Mayer, R. G. (2010) Aprende a manejar tú tarjeta de crédito, Retrieved of: <https://www.entrepreneur.com/article/263160>.
17. Suárez, L. (2017) Conectando ideas y emprendedores, Retrieved of: <http://lauraemprende.com/autor/laura-mx/>