Credit: What It's All About and How You Can Improve It

In reality, credit is a double-edged sword. Having a good credit score allows you to receive loans, mortgages, and purchases at lower interest rates. But the flip side of the coin is that the ease of buying now and paying later often leads to debt that can paralyze you financially.

How Your Credit Score is Calculated

Your credit score determines the amount you can borrow and the interest rate you pay. This score is a numerical figure that tells lenders your likelihood and ability of repaying what you owe to your creditors.

The type of score most widely used is known as a FICO score, which is a scoring system developed by Fair, Isaac & Co. These scores are provided to lenders by the three main national credit bureaus: Experian, Equifax and TransUnion.

If you're unsure of what your credit score may be,**click here** to receive a free credit report from Experian.

There are five main components you receive points for that determine your FICO credit score:
1. Your payment performance history which reflects whether or not you have paid at least the minimum balance on time during the last 6 to 12 months. This accounts for 35% of your score.
2. The total amount of debt you owe in comparison to your total credit limit. This accounts for 30% of your score.
3. The age of your credit history - 15%.
4. Your pursuit of new credit - 10%.
5. The type of accounts in your credit report - 10%.

How To Improve Your Credit Score

There are steps that you can take to improve your credit score. These include:

1. Verify and correct any mistakes that appear on your credit report, such as misspellings of names and payments that are wrongly labeled as late. These errors can be corrected by requesting a complete copy of your credit report and carefully going over all personal information to determine if it is correct. Mistakes can take as long as 30 days to be corrected in your report.

2. Reduce your total credit card balances. The total amount of money that you owe on your credit cards in relation to your total credit limit is an important factor in determining your credit score. Some credit experts advise you to keep your balance at or below 35% of your total credit card limit.

3. Pay your bills on time. Paying your credit card bills on time offers a crucial indication of how you manage your finances. A single missed payment during the last twelve months will not, in most cases, have a negative impact on your score, but consecutive missed payments that are recent will definitely lower your score.

4. Pay off debt rather than moving it around. The ratio of your credit card balance to your credit limit is key! Hence, it is better to pay off your credit balance over time rather than closing an account and transferring the balance. The reason for this is that if you close an account, you will more than likely increase the percentage ratio of money that you owe, which in turn will lower your score.

Say, for example, you owe a combined total of $2,000 on four credit cards, with each card having a $2,500 limit. Your total credit limit in this instance would be $10,000 and the total balance that you owe is $2,000, which accounts for 20% of your total debt. However, if you transfer all your balances to two cards and cancel the other two, your total credit limit is reduced to $5,000, and your $2,000 balance now accounts for 40% of that limit, which will reduce your credit score.

5. Do NOT close unused credit card accounts. Unfortunately, the most common, and most incorrect, advice given to improve your credit score is to close unused credit card accounts. Having unused open accounts helps you to establish the age of your credit history and indicates that you can control your spending.

Some Interesting Facts About Credit Cards

The first widely accepted plastic charge card was issued in 1958 by American Express.

The first general use credit card that allowed balances to be paid over time was the BankAmericard (which later changed its name to Visa in 1977), issued in 1959.

There are more than 1.3 billion credit cards in circulation in the U.S.

The average American household consumer debt averaged $11,840 in 2005.