Mobile Payments: A Cautionary Tale

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Within seconds, the Venmo receipt arrived by email. Transfer date and amount: May 15, 2018 — $80.00. And with a mere tap of her cell phone, high school student Julia Smith had used the Venmo app to transfer cash from her bank account directly to her classmate's Venmo account to help pay for a group prom house in the Poconos.

How simple. How convenient. How long until one easy click left Julia with a negative bank balance?

Mobile payments are payment transactions done with the help of a mobile phone. Think Venmo, Square Cash and Google Wallet, used to transfer money and even to shop at participating retailers – all with the tap of screen. According to a recent global study on mobile payment transactions, the mobile payments market was worth $550 billion in 2015 and is expected to grow more than 39% by 2020. That is explosive growth by any calculation.

Mobile payments are a significant part of the boom in financial technology — a.k.a. FinTech – the broad term for handling money with the help of technology that is experiencing incredible innovation from start-up companies around the world. For example, Greenlight Financial Technology, an Atlanta-based creator of a smart debit card for kids, teens and college students, announced in March that it had reached 100,000 customers after raising $16 million in financing from several investors.

But within all the buzz and investment that is flowing into this industry lies a cautionary tale, one that AnnaMaria Lusardi, director of the Global Financial Literacy Excellence Center (GFLEC) at George Washington University in Washington, D.C., explains like this: "We can make payments with the touch of a button, but the impact of this rapid innovation is not being examined."

Adds Lusardi: "FinTech is not a substitute for financial literacy."

In April, Lusardi and two of her colleagues released a study (*see related links*) that suggests that young people, specifically millennials (age 18-34), who engage in mobile-payment transactions at stores, gas stations or restaurants, are at a higher risk of financial mismanagement. Specifically, the survey involved people who wave or swipe their mobile phones over a sensor at checkout or use some other mobile app at checkout. The practices of millennials provide important perspective for current Generation Z high school students.

Getting into the numbers, the research found that compared to non-users, millennials who use mobile payments are more likely to report that they occasionally overdraw their checking account (33% vs. 19%); they paid fees on their credit cards in the past 12 months (58% vs. 45%); they made withdrawals from their retirement account (37% vs. 9%); and they used alternative financial services such as pawn shops or payday loans in the past five years (50% vs. 23%). All of these suggest poor financial management practices.

These findings, says Lusardi, show how important it is for young people to understand their finances, how to manage their money, and the consequences of money mismanagement. "Young people today have grown up using technology and are technology savvy," notes Lusardi. "I want them to know that it is not just technology but the smart use of technology that matters. In other words, you need financial literacy to make the best use of technology. Our findings should not be interpreted to say that FinTech causes millennials to manage personal finances poorly. It could simply be that those who use FinTech are also those who do not handle their finances well. Again, it is important to handle finances with care, and to make sure one understands the costs associated with the use of financial instruments, even simple ones, like checking accounts."

So, before you make your next mobile payment, here are three important financial truths to help you make smarter choices. Consider these basic money tips a starting point as you become more focused on handling your finances with care and your technology with ease:

- Mobile payment apps can make it easier to spend money that you don't have. Be sure you are aware of your bank balance before you are tapping, swiping or waving your phone to make a mobile payment. If your balance is low, you may have to hold off on that transaction. Negative bank balances, also known as overdrafts, can cost as much as $35 per infraction. The last thing you want is to have to pay more money to repair your poor money management decisions.

- Understand debt, which basically means that you owe money to someone for a product or service. Fall too deeply into debt, and it becomes very difficult to dig yourself out. The most recent GFLEC study found that millennials who use mobile payments are more likely to hold nearly every form of debt noted on the surveys, including auto loans, student loans and home-equity loans. A loan is a type of debt, typically a sum of money that is borrowed and is expected to be paid back (in most cases) with interest**.** A loan involves a lender, who provides the money, and the borrower, who uses the money and then pays it back to the lender over a specified term or period of time. The initial amount of money loaned from the lender to the borrower is the principal. Banks or other entities do not usually lend money for free. They charge interest on loans, which is how they generate revenue, or income. However, different types of loans are structured in different ways with different interest rates and payment plans. Be sure that you study all aspects of a loan before you make a commitment to it.

- The ease of use associated with mobile payments and other types of FinTech underscores the importance of budgeting, which is arguably one of the most vital support beams of strong money management. The goal of good budgeting is to spend less than you earn – and to know what you're saving for. Learning to budget is a key way to avoid being saddled with debt, and allows you to be more in control of your finances. At its most basic level, a budget starts with a record of money earned, versus a record of money spent. If this exercise reveals that more money is spent than earned, conscientious individuals must find ways to reverse the trend. Check out the sidebar with this article for Related KWHS Stories about budgeting and other important links to set you on the road to financial wellness.

And as you improve your money management skills, innovators and lawmakers will also be improving the world of financial technology. "In a digital economy," stresses Lusardi, "we need new forms of financial education and also new consumer protection."