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Financial Services

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HIRE PURCHASE MEANING:

Hire purchase is a method of selling goods. In a hire purchase transaction, the goods are let out on hire by a finance company(creditor) to the hire purchase customer (hirer). The buyer is required to pay an agreed amount in periodical installments during a given period.

FEATURES OF HIRE PURCHASE:

- The buyer takes possession of goods immediately and agrees to pay the total hire purchase price in installments.
- Each installment is treated as hire charges.
- In case the buyer makes any default in the payment of any installment, the seller has right to repossess the goods from the buyer and forfeit the amount already received treating it as hire charge.
- The hirer has the right to terminate the agreement any time before the property passes.

LEGAL POSITION OF HIRE PURCHASE:

- Payment is to be made in installment over a specified period.
- The possession is delivered to the purchaser at the time of entering into a contract.
- The property in the goods passes to the purchaser on payment of the last installment.
- The hirer is free to return the goods without being required to pay any further installments falling due after the return.

HIRE PURCHASE AGREEMENT :

- Hire purchase agreement has to be in writing and signed by both parties to the agreement. A hire purchase agreement must contain the following particulars;
- The description of goods in a manner sufficient to identify them.
- The hire purchase price of the goods.
- The date of commencement of the agreement.
- The number of installment in which hire purchase price is to be paid, the amount, and due date.

HIRE PURCHASE AND CREDIT SALES:

Higher purchase transaction is different from credit sale. In case of actual sale, the title in the property, i.e., ownership and possession is transferred to the purchase simultaneously, in hire purchase, the ownership remains with the seller until last installment is paid.

HIRE PURCHASE AND LEASING:

Ownership: In a contract of lease, the ownership rests with the lessor through out and lessee(hirer) has no option to purchase the goods.

Method of financing: Leasing is a method of financing business assets and hire purchase is a method of financing both business assets and consumer articles.

Depreciation: In leasing, depreciation and investment allowance cannot be claimed by the lessee. In hire purchase, depreciation and investment allowance can be claimed by the hire.

Tax benefits: The entire lease rental is tax deductible expense. Only the interest component of the hire purchase installment is tax deductible.

Salvage value: The lessee, not being the owner of the asset, dose not enjoy the salvage value of the asset. The hirer, in purchase, being the owner of the asset, enjoy the salvage value of the asset.

Deposit: Lessee is not required to make any deposit, whereas 20 per cent deposit is required in hire purchase.

Rent-purchase: With lease, we rent and with hire purchase we buy the goods.

Maintenance: The cost of maintenance of the hired asset is to be borne by the hirer himself. in case of finance lease only, the maintenance of leased asset is the responsibility of the lessee.

Reporting: the asset on hire purchase is shown in the balance sheet of the hirer. The leased assets are shown by way of footnote only.

BANK CREDIT FOR HIRE PURCHASE:

Customer: the subsidiary should take care to make the assessment of the standing and financial position of the business customer.

Purpose: in the event of default, the bank may reconsider repossessing the goods and selling them to clear the advance. Thus , if the goods can be readily sold elsewhere.

Amount: bank subsidiaries taking up hire purchase business would do well to discourage small individual loans.

Period: the facility will normally be extended over to three years.

Repayment: repayment are spread evenly, or agreed, over the loan period. The repayment should be adaptable to the hirer's needs.

Security: technically ,hire purchase advance is against hypothecation of equipment/vehicles and pledge of hundis /promotes and lodgements of hire purchase agreements.

Monitoring and control: one or two months in arrears may be acceptable but more than that suggest that the particular hirer is in permanent default.

DEFINITION OF LEASING:

'Lease is a form of contract transferring the use or occupancy of land, space, structure or equipment, in consideration of a payment, usually in the form of a rent'. "Dictionary of business and management".

STEPS INVOLVED IN LEASING:

- First, the lessee has to decide the asset required and select the supplier.
- The lessee, then enters into a agreement with the lessor. the lease agreement contains the terms and conditions of the lease such as,
    1. The basic lease period during which the lease is irrecoverable.
    2. The timing and amount of periodical rental payments during the lease period.

3. Details of any option to renew the lease or to purchase the asset at the end of the period.
4. Details regarding payment of cost of maintenance and repairs, taxes,insurance and other expenses.

- After the lease agreement is signed, the lessor contacts the manufacturer and requests him to supply the asset to the lease. the lessor makes payment to the manufacturer after the assets has been delivered and accepted by the lessee.

TYPES OF LEASE:

Financial lease: A financial lease is also known as capital lease, long-term lease, net lease and close lease. In a financial lease, the lessee selects the equipment, settles the price and terms of sale and arranges with a leasing company to buy it.

Operating lease: An operating lease is also known as service lease, short-term lease or true lease. In this lease, the contractual period between lessor and lessee is less than the full expected economic life of equipment.

Leverage lease: A leverage lease is used for financing those assets which require huge capital outlay. The outlay for purchase cost of the asset generally varies from Rs.50 lakh to Rs.2 crore and has economic life of 10 years or more.

Sale and lease back: under this type of lease, a firm which has an asset sells it to the leasing company and gets it back on lease. The sale and lease back agreement is beneficial to both lessor and lessee.

Cross-border lease: Cross-border lease is international leasing and known as transnational leasing. The lessor may be of one country and the lessee may be of another country.

Wet lease and dry lease: A wet lease is one where the lessor is responsible for full control and maintenance of leased asset. A dry lease involves the payment of insurance and maintenance costs by the lessee.

Vendor leasing: A vendor leasing is on where the retail vendors tie-up with the lease finance companies which give financing option to the customers of the vendors to purchase a product.

ADVANTAGES OF LEASE:

Permit alternative use of funds: A leasing arrangement provides a firm with the use and control over asset without incurring huge capital expenditure. The firm is required only to make periodical rental payments.

Faster and cheaper credit: Depending on tax structure of the lessee, it costs less than other methods of acquiring assets. Hence, acquisition of assets under leasing agreement is cheaper and faster then any other source of finance.

Flexibility: Leasing arrangements may be tailored to the lessee's needs more easily than ordinary financing.

Facilitates additional borrowings: Leasing may increase long-term ability to acquire funds. Hence ,the lessee can go for additional borrowings in case need arises.

Protection against obsolescence: A firm can avoid risk of obsolescence by entering into operating lease agreement.

No restrictive covenants: The restrictive covenants such as debt-equity ratio ,declaration of dividend, etc., which are usually imposed under debenture or loan agreement are absolutely absent in a lease agreement.

Hundred per cent financing: Lease financing enables a firm to acquire the use of an asset without having to make a down payment.

Boon to small firm: The firms which are either small or have uncertain records of earning are able to obtain the use of asset through lease financing.

LEGAL ASPECT S OF LEASING:

As there is no separate statute for equipment leasing in Indian, the provision relating to bailment in the Indian Contract Act govern equipment leasing agreements as well. Essentially ,these provision have the following implications for the lessor and the lessee.

- The lessor has the duty to deliver the asset to the lessee, to legally authorize the lessee to use the asset, and to leave the asset in peaceful possession of the lessee during the currency of the agreement.

- The lessee has the obligation to pay the lease rentals are as specified in the lease agreement, to protect the lessor's title, to take reasonable care of the asset, and to return the leased asset on the expiry of the lease period.

PROBLEMS OF LEASING:

Unhealthy competition: The market for leasing has not grown with the same pace as the number of lessors. As a result, there is over supply of lessors leading to competition.

Lack of qualified personnel: Leasing requires qualified and experienced people at the helm of its affairs. Leasing is a specialized business and persons constituting its top management should have expertise in accounting, finance, legal and decision areas.

Tax considerations: Most people believe that lessees prefer leasing because of the tax benefits it offers. In reality, it only transfer the benefit ,i.e., the lessee's tax shelter is lessor's burden.

Stamp duty: The states treat a leasing transaction as a sale for the purpose of making them eligible to sales tax. Accordingly , a heavy stamp duty is levied on lease documents.

Delayed payment and bad debts: The problems of delayed payment of rents and bad debts add to the costs of lease. These problems would disturb the prospects of leasing business.

PROSPECTS OF LEASING:

The world leasing industry grew at a rate of about 10 per cent. As the economy is opened up, there will be substantial demand for a variety of leasing products such as foreign currency lease, cross-border lease, leverage lease, etc. leasing companies are bound to go for substantial growth in line with international trends. Leasing has a great prospects in India.

MEANING IF VENTURE CAPITAL:

Venture capital is long-term risk capital to finance high technology projects which involve risk but at the same time has strong potential for growth. Venture capitalists pool their resources including managerial abilities to assist new entrepreneurs in the early years of the project.

FEATURES OF VENTURE CAPITAL:

- Venture capital is usually the form of an equity participation.
- Investment is made only in high risk but high growth potential project.
- Venture capital is available only for commercialization of new ideas or new technologies and not for enterprises.
- Venture capitalist joins the entrepreneur as a co-promoter in project and share the risks and rewards of the enterprise.
- There is continuous involvement in business after making an investment by the investor.
- Once the venture has reached the full potential, the venture capitalist disinvests his holdings either to the promoters or in the market.
- Venture capital is not just injection of money but also an input needed to set up the firm, design its marketing strategy and organize and manage it.
- Investment is usually made in small and medium-scale enterprises.

SCOPE OF VENTURE CAPITAL:

Development of an idea – seed finance: Venture capitalists provide seed capital for translating an idea into business proposition.

Implementation – start-up finance: The first and second stage capital is used for full scale manufacturing and further business growth.

Fledging stage – additional finance: The firm has made has some headway and entered the stage of manufacturing a product but faces teething problems.

Establishment stage – establishment finance : At this stage , the firm is established in the market and expected to expand at a rapid pace.

IMPORTANCE OF VENTURE CAPITAL:

Advantages to investing public:

- To reduce risk significantly against unscrupulous management.
- Investors have no means to vouch for the reasonableness of the claims made by the promoters about profitability of t he business.
- To ensure that the affairs of the business are conducted prudently.

Advantages to promoters:

- Venture capital provides a solid capital base for future growth by injecting long-term equity financing.
- Public issue of equity share has to be preceded by lot of efforts.
- Eliminating costs.

METHODS OF VENTURE FINANCING:

- Equity participation.
- Conventional loan.
- Conditional loan.
- Income notes.

THE INDIAN SCENARIO:

Companies promoted by all India FIs

- Venture capital division of IDBI.
- Risk capital and technology finance corporation ltd.(RCTC)
- Technology development and information company of india ltd.(TDICI)

Companies promoted by state FI

- Gujarat venture finance ltd.(GUC)
- Andhar Pradesh industrial development corporation venture capital ltd.(APIDC)

Companies promoted by banks

- Canara bank venture capital fund.
- SBI venture capital fund.
- Indian investment fund.
- Infrastructure leasing.

Companies in private sector

- Indus venture capital fund.
- Credit capital venture fund (India) Ltd.
- 20th century venture capital corporation Ltd.,
- Venture capital fund.

MEANING OF FACTORING:

Factoring is a continuous arrangement between a financial institution ,(namely the factor) and a company(namely the client) which sells goods and services to trade customer on credit.

DEFINITION OF FACTORING:

According V.A. Avadhani, " Factoring is a service of financial nature involving the conversion of credit bills into cash.

TERMS AND CONDITIONS:

- Assignment of debt in favour of the factor,
- Selling limits for client,
- Conditions within which the factor will have recourse to the client in case of non-payment by the trade customer,
- Circumstance under which the factor will have recourse in case of non-payment,
- Details regarding the payment to the factor for his services, say for instance, as a certain percentage on turnover,
- Interest to be allowed to the factor on the account where credit has been sanctioned to the supplier, and
- Limit of any overdraft facility and the rate of interest to be charged by the factor.
- Functions of factoring:
- Purchase and collection of debts,
- Sales ledger management;
- Credit investigation and undertaking of credit risk;
- Provision of finance against debts, and
- Rendering consultancy services.

TYPES OF FACTORING:

- Full service factoring or without recourse factoring.
- With recourse factoring.

- Maturity factoring.
- Bulk factoring.
- Invoice factoring.
- Agency factoring.
- International factoring.
- Suppliers guarantee factoring.
- Limited factoring.
- Buyer based factoring.
- Seller based factoring.

BENEFITS OF FACTORING:

- Financial service.
- Collection service.
- Credit risk service.
- Provision of expertised ‘ sales ledger management’ service.
- Consultancy service.
- Economy in servicing.
- Off-balance sheet financing.
- Trade benefits .
- Miscellaneous service .

MEANING OF FORFAITING:

Forfeiting is another source of financing against receivables like factoring. This technique is mostly employed to help an exporter for financing goods exported on a medium-term deferred basis.

DEFINITION OF FORFEITING:

Forfaiting has been defined as ‘the non-recourse purchase by a bank or any other financial institution, of receivables arising from an export of goods and services’.

FACTORING VS. FORFEITING:

- Factoring is a always used as a tool for short-term financing, where as forfeiting is for medium-term financing at a fixed rate of interest.
- Factoring is generally employed to finance both the domestic and export business. But , forfeiting is invariably employed in export business only.
- The general theme of factoring is the purchase of the invoice of the client, where as it is only the purchase of the export bill under forfeiting.
- Factoring is much broader in the sense. On the other hand forfeiting mainly concentrates on financing aspects only and that too in respect of a particular export bill.
- Under factoring, the client is able to get only 80 per cent of the total invoice as ’credit facility’, where as the 100 per cent of the value of the export bill is given as credit under forfeiting.
- Forfeiting is done without recourse to the client, where as it may or may not be so under factoring.
- The bills under forfeiting may be held by the forfaitor till the due date or they can be sold in the secondary market or to any investor for cash. Such a possibility does not exist under factoring.
- Forfeiting is a specific one in the sense that it is based on a single export bill arising out of an individual transaction only. But , factoring is based on the ’whole turnover’, i.e., a bulk finance is provided against a number of unpaid invoices.

BENEFITS OF FORFEITING:

- Profitable and liquid.
- Simple and flexible.
- Avoids export credit risks
- Avoids export credit insurance
- Confidential and speedy
- Suitable to all kinds of export deal
- Cent per cent finance
- Fixed rate finance

DRAWBACKS OF FORFEITING:

- Non-availability for short and long periods
- Non-availability for financially weak countries
- Dominance of western currencies
- Difficulty in procuring international bank's guarantee

FORFEITING IN INDIA:

Forfeiting, as a source of finance, has gained substantial momentum abroad. Though it had its origin in 'Zurich', it has been well established in all the financial centres of the world. Some of the important forfeiting centres are London, Zurich, Hong Kong, Singapore and Frankfurt. It has become a popular source of finance among Europeans.