

INDIAN FINANCIAL SYSTEM
M. COM SEMESTER II
LEASING AND HIRE PURCHASE

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Leasing and Hire purchase



DEFINITION OF LEASING

Lease is a contract whereby the owner of the asset(lesser) grants to another party(lessee), the exclusive right to use the asset usually for an agreed period of time in written for the payment of rent.

CONCEPT OF LEASING

- Lease finance denotes procurement of assets through lease. The subject of leasing falls in the category of finance.
- Leasing has grown as a big industry in the USA and UK and spread to other countries during the present century.
- In India, the concept was pioneered in 1973 when first leasing company was set up in Madras and the eighties have seen a rapid growth of business.
- Lease as a concept involves a contract whereby ownership, financing and risk taking of any equipment or asset are separated and shared by two or more parties.
- Thus, the lesser may finance and lessee may accept risk through the use of it while a third party may own it.
- Alternatively, the lesser may finance and own it while the lessee enjoys the use of it and bears the risk.

FEATURES OF LEASING

- 2 Parties
- ► Selection of an asset
- ► Purchase of an asset
- ► Use of the asset
- ► Rentals and installments payment
- ► Recovering the cost of an asset.
- ► Option of acquiring ownership of the asset.
- A lease is a contractual agreement in which:
 - A party owning an asset i.e. lesser
 - Provides an asset for use to another party i.e. lessee
 - For an agreed period of time i.e. lease period
 - For a consideration i.e. lease rentals.

Leasing In India: Evolution Phases

Pre 1970	1970 - 1995	Post 1995
<ul style="list-style-type: none">- Only HP companies- Automobile financing mainly for commercial vehicles	<ul style="list-style-type: none">- Entry into equipment finance through:<ul style="list-style-type: none">* Leasing* Hire Purchase- Commencement of car finance- Access to Capital Markets	<ul style="list-style-type: none">- Exit of large no. of companies:<ul style="list-style-type: none">* Small & Large* Indian & Foreign- Regulation by RBI- Few companies diversified into related financial services

LEASE FINANCING

- Lease financing is one of the important sources of medium- and long-term financing where the owner of an asset gives another person, the right to use that asset against periodical payments. The owner of the asset is known as lessor and the user is called lessee.
- The periodical payment made by the lessee to the lessor is known as lease rental. Under lease financing, lessee is given the right to use the asset but the ownership lies with the lessor and at the end of the lease contract, the asset is returned to the lessor or an option is given to the lessee either to purchase the asset or to renew the lease agreement.

Marketing of leasing is done by financing many kinds of assets to consumers as well as business which includes:

- ▶ Plant and machinery
- ▶ Business cars
- ▶ Commercial vehicles
- ▶ Agricultural equipments
- ▶ Hotel equipments
- ▶ Medical and dental equipments.
- ▶ Computers including software packages.
- ▶ Office equipments etc.

PROCESS OF LEASING

provides assets for use for an agreed time period.



pays lease rentals for using the asset.

TYPES OF LEASE

FINANCIAL LEASE

- Finance lease, also known as Full Payout Lease, is a type of lease wherein the lessor transfers substantially all the risks and rewards related to the asset to the lessee. Generally, the ownership is transferred to the lessee at the end of the economic life of the asset. The lease term is spread over the major part of the asset life. Here, a lessor is only a financier. An example of a finance lease is big industrial equipment.

OPERATING LEASE

- In an operating lease, risk and rewards are not transferred completely to the lessee. The term of a lease is very small compared to the finance lease. The lessor depends on many different lessees for recovering his cost. Ownership along with its risks and rewards lies with the lessor. Here, a lessor is not only acting as a financier but he also provides additional services required in the course of using the asset or equipment. An example of an operating lease is music system leased on rent with the respective technicians.

SALE AND LEASE BACK- DIRECT LEASE

- In the arrangement of sale and leaseback, the lessee sells his asset or equipment to the lessor (financier) with an advanced agreement of leasing back to the lessee for a fixed lease rental per period. It is exercised by the entrepreneur when he wants to free his money, invested in the equipment or asset.
- A direct lease is a simple lease where the asset is either owned by the lessor or he acquires it. In the former case, the lessor and equipment suppliers are one and the same person and this case is called 'bipartite lease'. In a bipartite lease, there are two parties. Whereas, in the latter case, there are three different parties viz. equipment supplier, lessor, and lessee. And it is called a tripartite lease. Here, equipment supplier and lessor are two different parties.

SINGLE INVESTOR LEASE- LEVERAGED LEASE

- Single investor lease, there are two parties – lessor and lessee. The lessor arranges the money to finance the asset or equipment by way of equity or debt. The lender is entitled to recover money from the lessor only and not from the lessee in case of default by a lessor. Lessee is entitled to pay the lease rentals only to the lessor.
- Leveraged lease, on the other hand, has three parties – lessor, lessee, and the financier or lender. Equity is arranged by the lessor and debt is financed by the lender or financier. Here, there is a direct connection of the lender with the lessee and in a case of default by the lessor. The lender is also entitled to receive money from the lessee. Such transactions are generally routed through a trustee.

DOMESTIC AND INTERNATIONAL LEASE- SUB LEASE

- When all the parties to the lease agreement reside in the same country, it is called domestic lease.
- The International lease is of two types – Import Lease and Cross-Border Lease. When lessor and lessee reside in the same country and equipment supplier stays in a different country, the lease arrangement is called import lease. When the lessor and lessee are residing in two different countries and no matter where the equipment supplier stays, the lease is called cross-border lease.

SUB LEASE

- A sublease is a rental agreement where the original lessee(tenant) rents out the premises to another person called the sub-tenant or sub-lessee. The new tenant gets few rights as the sub-lessee. The original tenant (lessee) can only give those rights to the new tenant (sub-lessee) which he has got from the original landlord (lessor). He cannot pass on more rights of use on the property. The flow of rent is from the sub-lessee to the lessee and the lessor/owner. The risk of rent is always mainly borne by the lessee. In case the sub-lessee is unable to make full or timely payment to the original lessee, the lessor is still entitled to his timely rents and the risk is borne by the lessee.

Advantages of Lease Financing

At present leasing activity shows an increasing trend. Leasing appears to be a cost-effective alternative for using an asset.

To Lessor:

- **Assured Regular Income:**

Lessor gets lease rental by leasing an asset during the period of lease which is an assured and regular income.

- **Preservation of Ownership:**

In case of finance lease, the lessor transfers all the risk and rewards incidental to ownership to the lessee without the transfer of ownership of asset hence the ownership lies with the lessor.

- **Benefit of Tax:**

As ownership lies with the lessor, tax benefit is enjoyed by the lessor by way of depreciation in respect of leased asset.

- **High Profitability:**

The business of leasing is highly profitable since the rate of return based on lease rental, is much higher than the interest payable on financing the asset.

To Lessee:

- **Use of Capital Goods:**

A business will not have to spend a lot of money for acquiring an asset but it can use an asset by paying small monthly or yearly rentals.

Tax Benefits:

A company is able to enjoy the tax advantage on lease payments as lease payments can be deducted as a business expense.

- **Cheaper:**

Leasing is a source of financing which is cheaper than almost all other sources of financing.

- **Technical Assistance:**

Lessee gets some sort of technical support from the lessor in respect of leased asset.

- **Inflation Friendly:**

Leasing is inflation friendly, the lessee has to pay fixed amount of rentals each year even if the cost of the asset goes up.

- **Ownership:**

After the expiry of primary period, lessor offers the lessee to purchase the assets— by paying a very small sum of money.

Disadvantages of Lease Financing

To Lessor:

- **Unprofitable in Case of Inflation:**

Lessor gets fixed amount of lease rental every year and they cannot increase this even if the cost of asset goes up.

- **Double Taxation:**

Sales tax may be charged twice:

First at the time of purchase of asset and second at the time of leasing the asset.

- **Greater Chance of Damage of Asset:**

As ownership is not transferred, the lessee uses the asset carelessly and there is a great chance that asset cannot be useable after the expiry of primary period of lease.

To Lessee:

- **Compulsion:**

Finance lease is non-cancellable and even if a company does not want to use the asset, lessee is required to pay the lease rentals.

- **Ownership:**

The lessee will not become the owner of the asset at the end of lease agreement unless he decides to purchase it.

- **Costly:**

Lease financing is more costly than other sources of financing because lessee has to pay lease rental as well as expenses incidental to the ownership of the asset.

- **Understatement of Asset:**

As lessee is not the owner of the asset, such an asset cannot be shown in the balance sheet which leads to understatement of lessee's asset.

Car **leasing** is something that recently became popular in **India**.

...

There is usually a down payment but because of the ever so increasing competition, a lot of companies offer a zero down payment system.

- ORIX. ...
- Mahindra Finance. ...
- AVIS **Leasing**. ...
- ALD **Leasing**. ...
- SMAS Auto **Leasing India PVT LTD**.

Meaning of Hire-Purchase

- Hire purchase is governed by the **Hire Purchase Act, 1972**. It is a special system of credit purchase and sale. In this buyer pays the price in installments i.e. monthly, quarterly or yearly etc. and also some amount of interest.
- Goods are delivered to the buyer at the time of hire purchase agreement but buyer will become the owner of goods only on the payment of the last installment. Such installments are to be treated as hire of these goods until a certain fixed amount has been paid, when these goods become the property of the hire.
- Either the buyer or the seller has a right to terminate the agreement at any time before the property so passes. Every agreement shall be in writing and signed by all the parties thereto.
- In the case of default, in the payment by the buyer, the seller has got a right to repossess the goods, as ownership lies with the seller, till the payment of last installment.
- The buyer cannot pledge, sell or mortgage the assets as he is not the owner of the assets till the last payment is made.

FEATURES OF HIRE PURCHASE

- ▶ Credit purchase
- ▶ Installment payment
- ▶ Possession at time of agreement
- ▶ Ownership till last installment
- ▶ Right to use goods as a bailer
- ▶ Termination of the agreement
- ▶ Ownership of goods after all installments payment.

HIRE-PURCHASE COMPANY

- Any financial intermediary whose principal business relates to hire purchase transactions or financing of such transactions.
- A method of buying goods through making installment payments over time.
- Under a hire purchase contract, the buyer is leasing the goods and does not obtain ownership until the full amount of the contract is paid.
- Hire purchase combines elements of both a loan and a lease. You reach an agreement with the dealer to pay an initial deposit, typically anything between 10% and 50%, and then pay off the balance in monthly installments over an agreed period of time. At the end of this period, the product is yours.

INSTALLMENT CREDIT system

- ▶ Installment credit, also called Installment Plan, or Hire Purchase Plan in business, credit that is granted on condition of its repayment at regular intervals, or instalments, over a specified period of time until paid in full.
- ▶ The goods are advanced to the purchaser after making initial fractional payment called a down payment.

ADVANTAGES AND DISADVANTAGES OF HIRE PURCHASE

- ► Spread the cost of finance.
- ► Interest free credit.
- ► Higher acceptance rates.
- ► Sales
- ► Debt solutions
- ► Personal debt
- ► Final payment
- ► Bad credit
- ► Creditor enhancement.
- ► Repossession rights.

	LEASING	HIRE PURCHASE
OWNERSHIP OF ASSET	Ownership lies with the lesser. The lessee has the right to use the equipment and does not have an option to purchase.	The hirer has the option to purchase. The hirer becomes the owner of the assets/equipments immediately after the installment is paid.
DEPRECIATION	The depreciation is claimed as an expense in the books of lesser.	Here, the depreciation claim is allowed to the hirer.
RENTAL PAYMENTS	The rentals cover the cost of using an asset. Normally, it is derived with the cost of an asset over the asset life.	The installment is inclusive of the principal amount and the interest for the time period the asset is utilized.

	LEASING	HIRE PURCHASE
DURATION	Lease agreements are generally done for longer duration and for bigger assets like land, property etc.	These agreements are done mostly for shorter duration and cheaper assets like hiring a car, machinery etc.
TAX IMPACT	The total lease rentals are shown as the expenditure by the lessee in the lease agreement.	In hire purchase, the hirer claims the depreciation of asset as an expense.
REPAIRS AND MAINTENANCE	Repairs and maintenance of the asset in financial lease is the responsibility of the lessee but in operating lease, it is the responsibility of the lesser.	In hire purchase, the responsibility lies with the hirer.

	HIRE PURCHASE	INSTALLMENT SYSTEM
OWNERSHIP	Transfer of ownership takes place after the payment of all installments.	In case on installment payment system, the ownership is transferred immediately at the time of agreement.
TYPE OF CONTRACT	The hire purchase agreement is like a contract of hire though later on it may become a purchase after the payment of last installment.	In installment payment system, the agreement is like a contract of credit purchase.
POSSESSION	In case of default payment, in hire purchase system the vendor has a right to back goods from the possession of the hire purchase.	Here, the vendor has no right to take back the goods from the possession of the purchases; he can simply sue for the balance due.

TOP 10 LEASING AND HIRE PURCHASE COMPANIES IN INDIA

[Bajaj Finance](#)

[M&M Financial](#)

[Shriram Trans](#)

[Shriram City](#)

[Cholamandalam](#)

[Manappuram Fin](#)

[Magma Fincorp](#)

[Sundaram Fin](#)

[Capital Trust](#)

[SREI Infra](#)

THANK YOU