Hire Purchase Finance in India

The Issue? Involved

S K Basu

HIRE purchase is a type of instalment credit the essence of which consists in the consumer agreeing to hire the goods at a stated periodical rental with an option to purchase. It should be sharply distinguished from the other type of instalment credit, known as credit sale. In the credit sale contract there is an absolute binding obligation to purchase, although payment is made in instalments, whereas in typical hire purchase the consumer does not agree to buy but has merely an option to do so. "While in credit sales, property passes immediately to the purchaser, in the hire purchase agreement the seller retains ownership until the final instalment is made. The hirer cannot dispose of the goods and is bound to take care of them while they remain the property of the seller. A distinction may also be drawn between the purchase by these methods of means of production such as farm machinery, machine tools, lorries and other industrial equipment and of durable consumer goods. Although the development of hire purchase finance has not yet assumed the same proportions in India as it has in the U S A, Australia, Canada and U K, a study of the issues involved even at the present stage is likely to prove a fruitful line of research for more than one reason.

Rising Incomes and Consumption

The basic objective of India's Five-Year Plans is to increase the per capita income, to provide a high level of employment and thereby raise the standard of living of the masses of the people. The aim of Government policy also is to establish a welfare state. When our economy is expanding and national income is increasing and efforts are being made to train up more and more technicians, and a redistribution of income in favour of the skilled wage earners is being effected, the demand for hire purchase facilities is likely to increase. Today it is an exception rather than the rule for married women to give up work after marriage. The relatively high earnings of young people, together with the tendency of married women to continue to work after marriage, will serve to increase further the demand for hire purchase as has happened in other countries. The possibilities of hire purchase finance in India's developing economy are immense and will cover a wide field.

The growth of hire purchase or consumer instalment credit raises two important problems, one cyclical, the other long run. Instalment credit may intensify cyclical fluctuations. In anticipation of increases in their incomes, people may be induced to purchase durable consumer goods. Such increased investment in durables would have the usual multiplier and accelerator effects. Similarly in a downswing, with declining incomes and increasing burden of repayments, people may be obliged to spend a decreasing proportion of their incomes on current consumption which would intensify the recession.

Problem for Monetary Control

The growth of hire purchase finance may pose a problem for monetary control. The rise of non-banking financing institutions in the shape of hire purchase or sales finance companies is likely to complicate the whole process of enforcing monetary control measures by the central bank. Borrowers and lenders find ways of circumventing the monetary system. An important question is whether the monetary tools of the central bank would be seriously blunted. A corollary is whether the central bank should be empowered to regulate these non-banking institutions and if so by what methods. A further question is whether controls should operate on the cost or the terms of hire purchase arrangements. In this connection, the respective potency of the effects of general and selective controls over consumer credit would also call for careful evaluation.

The long run problem consists in the possibility of a growth of consumer credit out of all proportion to the rise in the national product. In such an event it would be a 'borrowed' and 'sham' prosperity. In the United States, where consumer instalment debt has grown to enormous proportions, the debt is financed by dealers, finance companies and the commercial banks. Banks there handle more of this business than any other institution and do
so through direct participation as well as by loans to finance companies and retailers. In Australia, banks have, direct participation in the equity capital of finance companies and also grant overdraft facilities. In recent years there has been a decline in bank overdrafts which has been matched by an increase in direct participation. Banks have 40-45 per cent interest in finance companies. Some have wholly owned finance subsidiaries.

'Personal Loans'

In England, although merchant banks had never hesitated to take a direct part in hire purchase finance, the ordinary clearing banks had not generally done so till the first half of 1958. The entry of the British clearing banks into the field of hire purchase finance in the second half of 1958 has been a dramatic movement. It has been due to special circumstances relating to the lifting of the credit squeeze and the official call for the stabilization of hire purchase in the context of an expansionary policy. A number of well-known British banks including the Barclays, Westminster, Martins, the Royal Bank of Scotland in conjunction with William Deacons and Glynn Mills have come to purchase a sizeable interest in the equity capital of hire purchase companies, while the Midland Bank as well as the Royal Bank of Scotland have gone further in the way of direct participation by introducing the system of 'personal loans.'

Some well-known bank chairmen in India have contended that with their mounting deposit resources and declining opportunities for loans and advances, new avenues of employing their funds have to be explored and that the incursion into the field of hire purchase finance would be a safe and profitable venture. A number of Indian banks have already taken steps to participate directly in hire purchase finance by introducing the scheme of 'personal loans' on the lines of the British Midland Bank and more banks are likely to enter into this new sphere of activity. The association of Indian banks with hire purchase finance for the first time in India's banking history raises a number of issues which call for close and careful examination.

Method of Association

What should be the most appropriate method of association of banks with hire purchase finance? Should it be in the form of participation in the equity capital of sales finance companies or in the form of providing ordinary overdraft facilities? Should the banks go in direct for hire purchase business as in U.S.A.? If so, should they do so by establishing a wholly owned subsidiary or by setting up a special department staffed by experts?

Hire purchase business may be akin to but is not entirely the same as banking business. In some respects credit granted to a trader to extend hire purchase facilities to his customers does not differ from other forms of bank credit. Hire purchase conforms to the self-liquidating principle, since, as the seller receives instalments from the buyers, he is placed in funds to repay his bank. The basic difference between banking business and hire purchase lies in the fact that the banker takes into consideration primarily the character and standing of the customer and only secondarily, the collateral security which he offers. But the hire purchase financier looks into security first, second and perhaps for all time. Hire purchase, moreover, may call for its own expertise and may perhaps be better entrusted to specialised institutions or specialised departments of commercial banks.

In the Indian Context

An important point for consideration is whether the Indian banks will at all be justified at the present stage in extending hire purchase finance facilities on a large scale for durable consumer goods which are in short supply. Provision of cheap consumer instalment credit may lead to increased consumer spending and aggravate the prevailing inflationary forces. The increased demand for durable consumer goods as a result of such facilities may also have the effect of diverting scarce resources of capital and critical raw materials from the production of capital goods on which our resources have to be concentrated during the Second Plan. Personal loans or instalment credit available to small industrialists for the purchase of their tools and equipment stand of course in a different category.

It will be useful to undertake a survey of hire purchase financing companies operating in the four principal cities of India, Bombay, Calcutta, Delhi and Madras, concentrating on the following features:

1. Sources of finance of these companies.
2. Types of merchandise they deal in.
3. Legal basis of transactions carried on by hire purchase companies.
4. Methods of finance adopted by them—whether direct collection financing or block discount financing.
5. Principles and methods of their business—the percentage of the down payment required, the number of instalments allowed and the charge on the hire purchase debt.
6. Income and age groups of their customers.
7. What kind of protection, if any, manners of the public have against inequitably worded documents and harsh practices of hire purchase companies.
8. The kind of security enjoyed by hire purchase companies.
9. The regularity or otherwise of instalment payments.
10. Incidence of loss.
11. Rates of return on such business.

A survey on similar lines may also be conducted in respect of the personal loan schemes introduced by several Indian banks.

Such a survey would give us a factual and analytical picture of the existing position of hire purchase finance in the Indian economy. It will help us in formulating an appropriate policy on hire purchase finance which is destined to exercise a profound influence on our economy in the coming years.

Hire purchase companies on their part should welcome such interest and encourage discussion of financial techniques. Detailed studies of the history, practice, finance and law of hire purchase, together with all the attendant problems, have been made in other countries, for instance, by the Board of Governors of the Federal Reserve System in U.S.A. in 1957 and by the Oxford Institute of Statistics, and the Institute of Economic Affairs in Great Britain in 1958. An official survey was also made in South Africa in 1952.