SOURCES OF FUNDS OF HIRE PURCHASE FINANCE COMPANIES 1958-62

One of the most important financial developments of recent years has been the growth of hire purchase. According to the official statistics, total hire purchase and other instalment credit outstanding grew from less than £500 million in the middle of 1958 to a peak of over £950 million in the middle of 1961 and still totalled nearly £900 million in the middle of 1962.[a] Three-quarters of this debt is financed by specialist hire purchase finance companies, widely described as finance companies. The Board of Trade, who have for many years collected statistics of hire purchase debt, recently began to collect detailed statistics of the assets and liabilities of these companies. They published the first set of figures in this series, for December 1961 and March and June 1962, in their Journal for the 19th October, where a full explanation will be found.[b] These figures are summarised in the table which appears on page 262, and some are also mentioned in the text. Previously the only composite statistics of liabilities of finance companies were published in the evidence given to the Radcliffe Committee and related to the years 1954 to 1958. They covered the members of the Finance Houses Association, to which the large finance companies belong, and the Industrial Bankers Association, which embraces about thirty of the medium-sized and smaller concerns. The purpose of this article is to describe the sources of the finance companies' funds and to review the main changes that took place between 1958 and 1962. Before doing so, however, it is worth saying a little about the size and nature of the business that is financed.

Finance companies' lending In June 1962, out of the total debt outstanding of £887 million on hire purchase, finance companies were owed £652 million. Most of this was owed directly to the companies but one-tenth was on hire purchase agreements "block discounted", that is agreements in effect bought for cash by the finance companies from retailers; the latter were owed the remaining £235 million on their own account. About two-thirds of the hire purchase debt owed to finance companies was for private cars and for commercial vehicles, about one-sixth for household goods and most of the remaining sixth for industrial and agricultural equipment. Apart from hire purchase loans, the finance companies had an estimated £114 million outstanding under "Other advances and loans". These included loans to associated companies to finance stocks of goods or to provide bridging finance for new capital investments, and also loans for house purchase. Trade investments etc. are estimated to have accounted for a further £37 million. Only small amounts were invested in marketable securities and no finance company reported any holding of Treasury Bills.

The companies' lending on hire purchase is done for varying periods. The charge is normally fixed when the agreement is signed, but some recent agreements, particularly for large amounts, have provided for variation with changes in Bank Rate. Some hire purchase agreements are for as little as six months but most are for longer periods—up to three years for cars, and five years or more for industrial machinery. Customers, however, frequently pay off the balance outstanding on their agreements before the due date (as when they decide to trade in their current car, still the subject of an agreement, for another). The general experience is that monthly cash receipts represent as much as 8% of outstanding debt.

Although, according to the Census of Distribution, about 1,500 concerns were specialising in hire purchase finance in 1957, business is heavily concentrated among a few large companies. In June 1962 only thirteen hire purchase finance companies had assets of £10 million or more and they accounted for two-thirds of the estimated total of assets.

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[a] Outstanding debt is measured in the official statistics as the sum of outstanding instalments and thus includes the hire purchase finance charges as well as the capital amounts lent.

[b] Later figures in this series will include additional information about the sources of deposits and of some other borrowing.

Sources of funds The companies draw their funds from three main sources: shareholders, depositors, and bank and bill finance. In June 1962 shareholders, judging from the total of issued capital and reserves, contributed about one-fifth of total funds, deposits one-half, and bank and bill finance together about one-fifth.

1. *Issued capital and reserves* The figure estimated for June 1962 is £148 million. The proportion of issued capital and reserves to the total of selected liabilities shown in the table at the end is much the same, about one-fifth, both for companies with assets of at least £10 million and for other companies. Some companies, however, have included provisions for unearned finance charges[a] in the figure for issued capital and reserves. Allowing for this, shareholders of large companies probably provide a smaller proportion of total funds than do shareholders of smaller companies.

In assessing the scale of shareholders' participation it is more useful to look at the ratio of total borrowing to capital and free reserves, a description that in this context normally excludes taxation reserves as well as unearned finance charges. The average for all companies is probably in the region of 6 : 1, but it varies widely and among the large companies is sometimes as high as 10 : 1. The ratio is not governed by any generally accepted convention or rule, though members of the Industrial Bankers Association bind themselves to keep within ratios which vary according to their size, being less restrictive for larger members than for smaller. For larger members, those with a capital of £200,000 or more, the maximum allowed is 7 : 1.

2. *Deposits* These totalled £377 million in June 1962. The finance companies began to take deposits from the public (both firms and private individuals) on a large scale only in the early 1950's. Bank advances were then restricted and new issues of capital severely limited. At first therefore deposits commended themselves as a temporary source of funds free from control. Growing familiarity later persuaded many finance companies that deposits were suitable as a permanent form of finance. Their importance nowadays varies according to the size of the company. In June 1962 deposits accounted for nearly two-thirds of the large companies' liabilities, but for only one-sixth of the liabilities of other companies, which rely much more on bank advances.

Deposit-taking has developed in different ways for large and small companies. The large companies can use the large sums that corporate investors wish to deposit and can guard against the simultaneous withdrawal of critical amounts by phasing maturities smoothly. They do not normally advertise for deposits but obtain their funds through contacts in commerce and industry, and through brokers and banks who operate primarily in the market for local authority short-term borrowing. By taking large deposits they save on administrative costs, and because their names are well known they are able to attract funds at rates of interest that are usually appreciably lower than those offered by smaller companies. The larger companies' rates are of two kinds: fixed rates for money deposited for a fixed term (normally three or six months) and, more usually, fluctuating rates[b] quoted as a premium (which may be raised or lowered in accordance with a company's desire or reluctance to take more money) on Bank Rate for deposits that may be withdrawn at three or six months' notice. The minimum deposit might be £5,000 or more, and anything up to £100,000 might be regarded as normal and taken at market rates. Terms for larger deposits may be individually negotiated.

Small companies, by contrast, have to take a great number of smaller deposits. They are less able to protect themselves from sudden withdrawal of large amounts, partly because their bank facilities are often more fully utilised than those of larger companies. Their minimum deposit may be anything from £5 to £100. Their deposit accounts, like those of large companies, are of two kinds, fixed and at notice, but few small companies quote a rate of interest tied to Bank Rate. Some of them advertise regularly in the Press and much of their money probably comes from private individuals.

The rates paid by finance companies for deposits offer a return that is often attractive to

(a) An allowance for that proportion of the total hire purchase finance charge which relates to future periods.
(b) A spread of fluctuating rates offered by various companies is given in Table 13 of the Statistical Annex.

overseas residents and to U.K. banks holding deposits of overseas residents. As described in the article " Inflows and outflows of foreign funds " in the June 1962 issue of this *Bulletin*, these overseas residents may place money directly with finance companies in this country or indirectly through banks in London. These banks either act on commission for a customer or may themselves take deposits from an overseas resident and decide to employ the funds on their own account with a finance company.

Just as the companies' attitudes to deposits vary according to their size and other circumstances, so does the extent to which they provide against unexpected withdrawals of deposits by holding cash. In June 1962 cash and balances with banks averaged about 4% of deposits, taking all companies together. Many of the large companies are subsidiaries or associates of banks and rely less on cash than on unused overdraft and acceptance facilities, not only with their parents and associates but also with other banks, to meet any sudden demand for the repayment of deposits. They can also stop taking new business and accumulate cash from instalments received on outstanding agreements, if they are content to allow the volume of their business to contract. The medium-sized and smaller companies, however, generally hold much more cash. The members of the Industrial Bankers Association, for instance, are required as a condition of membership to hold cash (or Treasury Bills) equal to 10% of all deposits or 30% of those deposits repayable within fourteen days, whichever is the greater amount.

The emergence of deposit-taking as a regular type of borrowing by a variety of finance companies has raised questions of public policy about the protection of depositors with companies seeking deposits from the public by advertisement. A Bill for the protection of depositors has recently been introduced by H.M. Government.

3. *Bank and bill finance* Bank borrowing is the chief component of " Other borrowing, net ", which came to £152 million in June 1962. (Among other components are debentures and unsecured loans.) The separate analysis of advances by members of the British Bankers' Association shows that advances to hire purchase finance companies totalled £104 million in mid-May and £107 million in mid-August 1962. " Bills discounted with banks and discount houses " came to £61 million in June 1962. (This figure includes some of the companies' liabilities under acceptances granted to customers and from endorsements of traders' bills.)

Bank borrowing is relatively much less important for large companies (which tend to take more deposits) than for small; in June 1962 " Other borrowing, net " accounted for only about one-tenth of the large companies' funds but for about one-half of other companies' funds. Bills discounted etc. were about one-tenth of liabilities for both groups.

Although bank borrowing may be affected from time to time by changes in official policy, it is in many respects a very convenient form of finance. Bank advances are the easiest element to adjust for seasonal and unforeseen requirements. By keeping unused lines of credit at the banks, the finance companies can cope with seasonal withdrawals of deposits or with the increase in their outstanding debt during the main car-buying season, which extends roughly from March to July. The first step to finance this increase may be to draw on the banks, but this extra bank borrowing can later be replaced by a higher level of deposits. The cost of advances may vary between companies, but for most large companies the cost is likely to be much the same as that of deposits, while for most if not all smaller companies bank advances will cost appreciably less than deposits.

Some companies have sufficient standing with the banks to be given facilities for advances in return for a general charge on their hire purchase assets. To other companies the banks advance money against the specific security of hire purchase agreements, though not usually up to the full value of the amounts outstanding; and agreements on which instalments are in arrears are not normally acceptable.

Bill finance is often used as an alternative to bank advances. Bills are drawn by finance companies on banks (not normally the clearing banks and Scottish banks, from which they take advances) and on accepting houses under acceptance credit lines. The bank or accepting house receives an acceptance commission varying in accordance with the finance company's standing, and the company can then discount the bills in the money market. The combined cost—acceptance commission and rate of discount—of bill finance does not usually differ significantly from the cost of a bank advance. Because they are a convenient means of finance, companies are sometimes more concerned to keep acceptance facilities in use in order to guard against their reduction than to save by borrowing elsewhere at slightly cheaper rates.

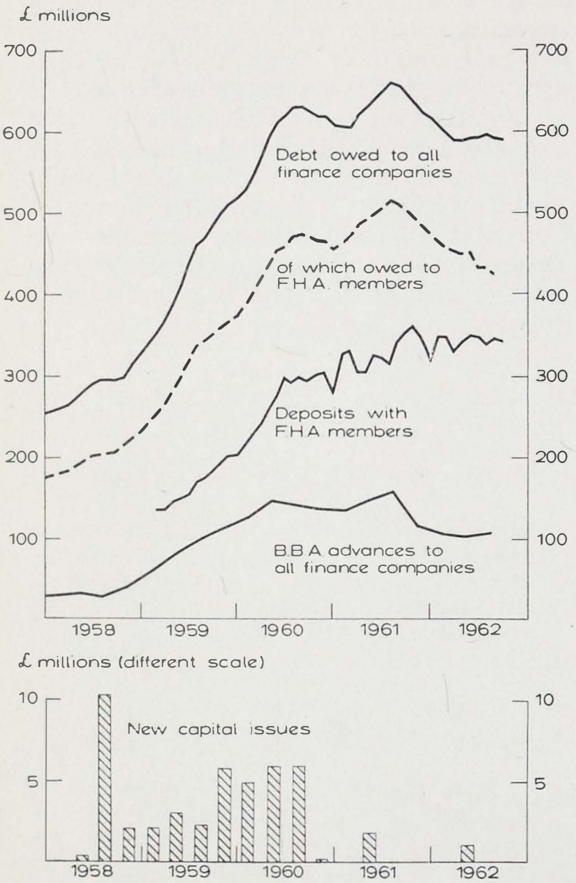
Changes in sources of funds, 1958-62 Because statistics are far from complete, developments between 1958 and 1962 cannot be traced in full detail. In the table below, however, are shown quarterly changes in three main sources of funds: new capital issues, deposits with members of the Finance Houses Association (which account for over 90% of all deposits) and bank advances. As explained in the footnote, the figures are less comprehensive and less uniform than the new official statistics. (Bills discounted, for which no regular figures have been available hitherto, are probably the most important omission.) For the same reasons the changes in debt owed to finance companies, also shown, differ, on occasion substantially, from the net change in funds from these main sources.

£ millions

	SOURCES OF FUNDS				HIRE PURCHASE DEBT OWED TO FINANCE COMPANIES
	New capital issues	Deposits with members of the F.H.A.	Advances by members of the B.B.A. to hire purchase finance companies	Total of Cols. 1 to 3	
	(1)	(2)	(3)	(4)	(5)
Quarter ended:					
1958 August ...	7	. .	− 4	. .	+15
November ...	5	. .	+12	. .	+18
1959 February ...	—	. .	+19	. .	+37
May	2	+13	+24	+39	+60
August ...	4	+25	+18	+47	+58
November ...	6	+27	+14	+47	+43
1960 February ...	—	+29	+12	+41	+34
May	7	+47	+22	+76	+67
August ...	10	+24	− 5	+29	+19
November ...	—	+ 4	− 7	− 3	−13
1961 February ...	—	+28	− 3	+25	−13
May	—	− 5	+13	+ 8	+36
August ...	2	+13	+12	+27	+17
November ...	—	+10	−42	−32	−32
1962 February ...	—	− 2	−11	−13	−30
May	—	+ 3	− 1	+ 2	− 5
August ...	1	− 4	+ 3	—	—

Note.—Changes in Col. 4 do not match changes in Col. 5 for a number of reasons. First, the series are not homogeneous: capital issues, deposits and debt are measured at end-month, whereas advances by B.B.A. members are measured at mid-month. Secondly, they are not complete: the figures for deposits cover members of the F.H.A. only, and other sources of funds such as bill finance, reserves and unsecured loans are not known. The changes in debt relate to a figure which is not fully comparable in that it excludes block discounting but contains on the other hand the hire purchase charge, not all of which needs to be financed. Hire purchase debt is in any case the main but not the only asset of the companies.

SOURCES OF FUNDS AND OUTSTANDING DEBT



Note.—The two series for the F.H.A. are affected by changes in membership, particularly by a reduction in June 1962.

During 1958 all existing restrictions on the terms on which finance companies could do business—the size of the downpayment and the length of the repayment period—and on their sources of finance were removed. From October companies were free to ask for as small a downpayment and to lend over as long a period as they wished. Companies competed keenly with each other, offering increasingly generous terms, and an unprecedented expansion of business followed, which lasted until control of its terms was reimposed in April 1960. This expansion gave rise to severe losses by the companies but such losses are outside the scope of this article.

The companies' capital issues and their borrowing from the banks had already been freed from restriction in July 1958. As well as advancing more money, the clearing banks and Scottish banks soon took steps to acquire either the whole or part of the equity of individual finance companies. Altogether these links represented an investment by the banks of about £38 million in the ordinary share capital of finance companies, of which £14 million represented new money to the companies concerned.

Changes in deposits cannot be traced until after February 1959, but it seems likely that in this early stage of the boom they were comparatively slower in building up than they were later. Thus between August 1958 and February 1959 outstanding debt increased by £55 million, of which about £30 million was financed by bank advances and £5 million by new capital issues.

During the next fifteen months to May 1960 (just after terms control was reimposed) the debt increased by a further £262 million. Over half of this rise was financed by deposits with F.H.A. members, which rose steadily throughout the period, altogether by £141 million. Bank advances, although increasing at roughly the same pace as before, now took a much smaller share, providing about £90 million. New issues provided £19 million.

During the summer of 1960 the debt owed to finance companies rose a little further, but in the autumn the usual seasonal decline in new business was made much more severe than in previous years by the terms controls that had been imposed in April and a slump in used car prices. This low level of business, coupled with a continuing high level of repayments, caused total debt to fall. Business received a stimulus in January 1961 when the maximum repayment period allowed for hire purchase transactions was increased by a year, and as soon as the main car-buying season began debt rose again. By August 1961 debt was £46 million greater than it had been fifteen months earlier, in May 1960. During the early part of this period bank advances fell back slightly whereas deposits, except for heavy seasonal withdrawals by institutional depositors whose balance sheets were drawn up at the end of December, increased again. By the spring of 1961, however, just when hire purchase business was rising, the finance companies began to have difficulty in holding on to their deposits. Some outflow of foreign-owned deposits was reported and in June competition from other borrowers, such as local authorities, increased. The finance companies were therefore turning to the banks for more advances.

Nevertheless the experience of recent years showed that the large companies at least could, if necessary, attract deposits again by bidding up the rates. Accordingly in July 1961, as part of the economic measures then taken, the Bank not only asked the banks to restrain lending for hire purchase (as well as for certain other purposes) but also wrote to the Finance Houses Association and to the Industrial Bankers Association asking them not to seek to replace bank advances by other borrowing, in particular by deposit-taking, except to the extent necessary to carry existing commitments. This was the first time that the Bank had made such a request to the Associations. Between August 1961 and February 1962 bank advances fell by as much as £53 million and deposits with the Finance Houses Association rose by only £8 million. New business and the total debt outstanding declined over this period, partly for seasonal reasons and partly because finance companies, seeking to reduce the risks in their business, provided less finance for older vehicles.

Since February 1962 debt outstanding has changed little. This spring the expansion of new business was slow to appear and then relatively short-lived, partly no doubt because companies were providing less finance and partly because, in a somewhat uncertain economic climate, some prospective borrowers hesitated to take on new commitments. Whatever the reasons, the companies had little incentive to seek new money. At the same time their borrowing remained under official restraint until the beginning of October when, as mentioned in the Commentary on page 237, the Bank wrote again to the banks and to the two Associations. The table on page 259 suggests that the companies' main sources of funds did not change significantly between February and August this year.

In the absence of any detailed statistics of all finance companies' assets and liabilities for earlier years it is impossible to say just how the different sources of their funds have changed in importance over the period reviewed. For the large companies, however, it is possible to make a rough comparison between the distribution of liabilities reported to the Radcliffe Committee by members of the Finance Houses Association and the new figures for thirteen large companies. This shows that the predominance of deposits in financing these companies' business was already established before 1958, deposits accounting for two-fifths of total funds; but they increased their share to nearly two-thirds by June 1962. The contribution made by shareholders' funds fell slightly and bill finance did not change significantly. It was other borrowing—that is mainly from the banks —which declined as deposits rose, from over a quarter of funds at the end of 1957 to barely a tenth at the end of June this year.

The table of selected assets and liabilities of hire purchase finance companies appears overleaf.

SELECTED ASSETS AND LIABILITIES OF HIRE PURCHASE FINANCE COMPANIES

£ millions (Percentages of totals in brackets)

	31st December 1961	31st March 1962	30th June 1962	of which: 13 large companies with assets of £10 million or more	of which: 427 other companies
Selected assets					
Hire purchase, credit sale and other instalment credit outstanding ...	674 (*81*)	652 (*80*)	652 (*80*)	413 (*76*)	162 (*89*)
Assets with U.K. financial institutions other than banks	10 (*1*)	5 (*1*)	7 (*1*)	5 (*1*)	1 (*1*)
Trade investments and investments in unconsolidated subsidiaries ...	36 (*4*)	37 (*5*)	37 (*5*)	30 (*6*)	4 (*2*)
Other securities	5 (*1*)	4 (—)	8 (*1*)	6 (*1*)	1 (*1*)
Other advances and loans	108 (*13*)	113 (*14*)	114 (*14*)	91 (*17*)	14 (*8*)
Total of selected assets ...	833 (*100*)	811 (*100*)	818 (*100*)	545 (*100*)	182 (*100*)
Selected liabilities					
Deposits	337 (*45*)	351 (*48*)	377 (*51*)	342 (*64*)	24 (*16*)
Bills discounted with banks and discount houses	80 (*11*)	72 (*10*)	61 (*8*)	39 (*7*)	16 (*10*)
Other borrowing, net ...	179 (*24*)	165 (*22*)	152 (*21*)	49 (*9*)	80 (*52*)
Issued capital and reserves	148 (*20*)	148 (*20*)	148 (*20*)	102 (*19*)	33 (*21*)
Total of selected liabilities	744 (*100*)	736 (*100*)	737 (*100*)	532 (*100*)	154 (*100*)

Note.—Liabilities fall short of assets chiefly because provisions for finance charges not yet earned are in general omitted, though some companies have included them in issued capital and reserves. The latter are shown as on each company's balance sheet last drawn up before the 31st August 1962. The amount due on hire purchase and other instalment agreements includes the amount due by retailers on agreements block discounted by them with finance companies. Other borrowing is shown net of assets held in the form of cash or balances with banks. The separate figures shown under the 30th June 1962 for 13 large companies and 427 others are derived from the 440 full returns received. They do not therefore correspond with the totals, which have been grossed up to cover all finance companies (1,500 in 1957).