

Consumer Finance and Leasing Companies employ innovative techniques to win market share and one prominent technique is '0% Financing', which offers financing at zero rate or some other concessional rate to consumers.

To offer a '0% Financing' Product, a finance company will need to partner with a capital goods manufacturer (vehicle manufacturer / distributor / importer, for example). Such a partnership benefits both parties: a capital goods manufacturer is able to offer a 'stealth' discount without compromising the listed price of the product and thereby, increase sales. A finance company is able to increase business without compromising margins.

Conceptually, '0% Financing' requires a capital goods manufacturer to compensate a finance company for returns foregone by the finance company as a result of concessional pricing (0%, 2.9%, and so on). The capital goods manufacturer 'throws-in' financing to encourage sale of the product: in the case of a leasing transaction, the compensation could take the form of a discount on purchase price of the lease asset, and in the case of a hp/loan, via a 'purchasing fee' to the finance company – in both cases, the effect is (a) to reduce the amount of principal invested in a transaction, (b) raise the return from the transaction to the non-concessional rate, and (c) offer concessional financing to consumers.

Given information on transaction variables, CI computes the amount of 'compensation' that needs to flow from the capital goods manufacturer to the finance company to maintain the non-concessional rate of return: the lower the finance rate to the end-user, the higher is the amount of compensation. It is upto the two parties to negotiate (a) the non-concessional financing rate of the finance company; (b) the concessional financing rate to the consumer; (c) settlement procedures, and so on.

To carry out the '0% Financing' exercise, the following information is required: (a) principal value of the transaction; (b) term of the transaction; (c) concessional financing rate to end-user; (d) future value (if any); (e) payment type (advance / arrear); (f) payment frequency (monthly, quarterly, half-yearly, yearly); and (g) finance company's non-concessional rate.

With the above information in hand, CI computes (1) an end-user period repayment (incorporating concessional financing); (2) compensation from capital goods manufacturer (to enable a finance company to maintain its normal lending rate). Scroll bars next to the concessional and non-concessional rate text boxes enable a user to easily examine the effect of one on the other – for example, to appreciate the relationship between concessional rate and the amount of compensation needed to support the same.