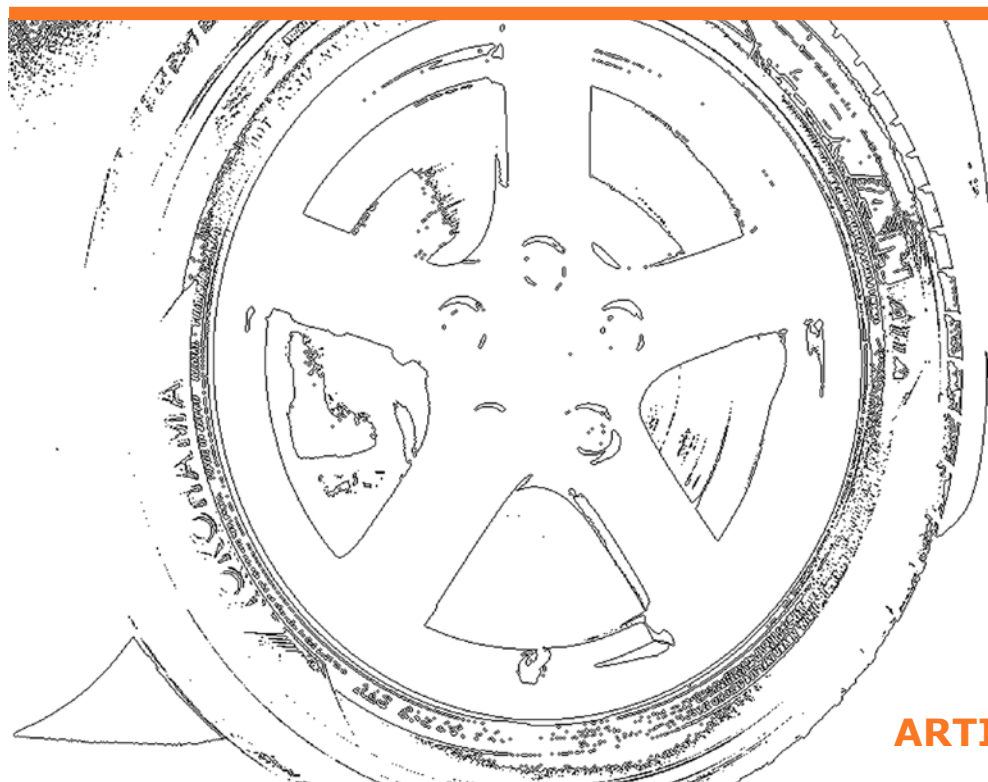


# Knowledge

# BANK



**ARTICLE 14**

A background guide to outright purchase

# A background guide to outright purchase

## Outright purchase background

Traditionally, when companies needed vehicles, they simply went out and bought them. Despite the growing popularity of other methods of acquisition and particularly contract hire, outright purchase is still the favoured acquisition method for around half of business vehicles in the UK.

No review of vehicle finance products can commence before we consider this important method of vehicle finance.

## Advantages

Companies choose to buy their own vehicles for a variety of reasons. For many, it is simply the approach they have always adopted. Some are suspicious about involving a third party in the process ('Surely it must cost more? They have to make a profit too'). Others buy their vehicles because they like the idea of 'ownership' and all that this implies, including the ability to place an asset on their balance sheet and have complete control of when to sell. Some like the idea of keeping the full sale proceeds. And there are those who like having a close working relationship with a number of local car dealers, who will supply new cars and look after both the client and the vehicles should anything go wrong.

## Disadvantages

The move away from outright purchase has been taking place, slowly but steadily, for decades. It was hastened by changes to the VAT regulations in 1995, which allowed leasing companies to recover VAT on the purchase of new cars. This saving was not available to most other businesses buying cars for their own use, so the net cost of leasing a car fell relative to buying outright and the economic argument tipped more heavily towards leasing.

In the absence of special arrangements made with a fleet management company, if you buy your own cars you are fully exposed to movements in the used vehicles market when you come to sell the vehicle. In other words, you take the residual value risk.

### A background guide to outright purchase

Unless your fleet is very large, when you buy your own cars you will not get the same levels of dealer and manufacturer discounts (called 'volume related bonuses') that leasing companies can attract. These can be significant.

When you buy a vehicle you have to show it as an asset ('capitalise it') on the balance sheet of your business. If yours is a private company this may be of no consequence to you. However, directors of quoted companies are keen to present their financial statements in the most favourable light possible to their shareholders and City analysts. This ensures that the market price of their shares stays high. Analysts use a number of tools to measure the relative profitability of a company compared with others in the same market segment, including return on assets.

If you buy your vehicles you normally have to go out and find them and negotiate the deals. Many companies find this to be an administrative headache. Some avoid this by using products such as contract hire; others have arrangements with fleet management companies that buy the vehicles for them.

Outright purchase may tie up the working capital your company needs for its normal day-to-day trading activity.

The most popular forms of vehicle finance require you to make fixed repayments. Most UK companies use their overdrafts or bank loans as their main form of working capital. These are variable rate forms of borrowing so if you use your overdraft to buy your cars you will be exposed to the vagaries of market interest rate movements.