

SOURCES OF WORKING CAPITAL

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LONG TERM SOURCES

- ✘ Issue of Equity Shares
- ✘ Issue of Preference Shares
- ✘ Issue of Debentures or Bonds
- ✘ Retained Earnings
- ✘ Loans from Financial Institutions

BENEFITS OF FUNDING BY EQUITY ISSUE

- ✘ Permanent source of financing
- ✘ Increases the flexibility of the firm
- ✘ Additional equity capital can be raised by making a rights issue
- ✘ No mandatory payments for equity shareholders

TYPES OF PREFERENCE SHARES

- ✘ Cumulative/ Non-Cumulative Preference Shares
- ✘ Redeemable/Non-redeemable Preference Shares
- ✘ Convertible/Non-Convertible Preference Shares

ADVANTAGES OF PREFERENCE ISSUE

- ✘ Does not affect the market perception of the firm
- ✘ Lends a leveraging advantage (it is the result of employment of an asset or funds to pay fixed costs or return)
- ✘ Managerial control not diluted
- ✘ Redemption of preference shares after expiry of the period

TYPES OF DEBENTURES

- ✦ Convertible/ Non- Convertible Debentures
- ✦ Partially Convertible – Ratio and time of conversion fixed by the issuer
- ✦ Secured/ Unsecured Debentures
- ✦ *INDENTURE – or Debenture Trust Deed – a legal agreement between the Issuing Company and Debenture Trustee/Debenture holders*

MERITS OF DEBT FINANCING

- ✘ Cost of debt is cheaper than cost of equity or preference capital
- ✘ It is treated as an expense and passes on the benefit of tax
- ✘ Investors expect a lower return on debenture investment
- ✘ Does not dilute managerial control
- ✘ During inflation, debenture issue is ideal
- ✘ DRAWBACK – is the financial risk that is linked with the firm

SHORT TERM SOURCES

✦ INTERNAL SOURCES

- Depreciation Fund
- Provision for Taxation(time lag between creating the provision and actual payment of tax)
- Outstanding Expenses – ability to “play float” by postponing expenses

SHORT TERM SOURCES

✘ EXTERNAL SOURCES

- TRADE CREDIT – 15 to 90 days credit
- Based on an “Open Account”, without any collateral security
- Interest charged is reasonable
- In working capital- readily available; flexible means of financing; easy accessibility for small firms even when the economy has a tight circulation of funds

EXTERNAL SOURCES- CONTD...

- ✘ COMMERCIAL PAPER (CP)- It is a “usance Promissory Note, issued by the firm and approved by the RBI
- ✘ Negotiable by endorsement and delivery
- ✘ Issued at a discount on face value
- ✘ Certified by the banker after verifying the signature of the executors
- ✘ Credit period- few days to a few months
- ✘ Normally issued in multiples of 5 lacs

EIGIBILITY CRITERIA FOR CP

- ✘ Tangible net worth of not less than Rs 4 crores as per the last Balance Sheet
- ✘ Working Capital limit not less than Rs 4 crores
- ✘ Current Ratio should not be less than 1.33 times

- ✘ Such rating should not be more than 2 months old from the date of issue of the CP
- ✘ Financing/Banking company to categorise the borrowing account of the firm as “Standard Assets”.

OTHER CONDITIONS FOR CP

- ✘ CP should not be issued for a period less than 15 days from the date of issue.
- ✘ No grace period is allowed for CPs
- ✘ Maximum maturity period revised by RBI from 6 months to less than 1 year period from date of issue of CP.
- ✘ Lack of several investors due to absence of secondary market

EXTERNAL SOURCES- CONTD....

- ✘ ADVANCES FROM CUSTOMERS – cost free source of working capital – (eg) down payments in case of construction business
- ✘ BANK CREDIT
 - ❖ Cash Credit – against security of inventory on a continual basis
 - ❖ Bank Overdraft – right to recall at short notice by banks

CONTD.....

- ❖ Bills Discounting
- ❖ Bills Acceptance
- ❖ Line of Credit – bank commitment to lend on demand with maximum limit specification
- ❖ Letter of Credit
- ❖ Bank Guarantee