E-Content for B.Com Part-I

SUBJECT-BUSINESS ORGANISATION

Paper-Subsidiary

TOPIC-SOURCES OF BUSINESS FINANCE

PART-B

Sources of Short Term Business Finance

S.S Prasad

Associate Professor

Vanijya Mahavidhalaya

Patna University, Patna

E-mail:ssprasad1421@gmail.com

Mobile No: 9431662241

Every business enterprises, whether big, medium or small needs capital to carry on its operations and to achieve its targets. In fact capital is indispensible today that it is rightly said it is the life blood of an enterprise without adequate capital no business can accomplish its objective.

In every business concern there are two methods of raising capital viz, (1) Raising of owned capital and (2) Raising of borrowed capital. These financial requirements may be long term, medium term or short term.

Long term business finance is that which is required in a business enterprise-either permanently or for a long period of time, say 20 or 25 years or so. Long term business finance is needed usually for investment in fixed assets such as land and building, plant and machinery etc., and for financing expansion programs.

Short term finance is a business is needed for a period-maximum up to 1 year. This type of finance is called working capital finance. The operating cycle of business is complete within a maximum period of 1 year i.e., purchase of raw materials, payment of wages to workers etc.

Medium term business finance which is neither permanently nor a period of short-period (up to 1 year). It may be needed for a period ranging from 2-5 or 7 years. Some example- modernization of plants, advertising campaign, development of a new product or innovation etc.

Classification of Financial Requirement

A. **Long term**

1. Issue of shares
2. Issue of debentures
3. Ploughing-back of profits
4. Loans from specialized financial institutions

B. **Middle terms**

1. Issue of debentures
2. Issue of preference share
3. Term loans from Banks
4. Public Deposits
5. Loans from financial institutions

C. **Short term**

1. Commercial Banks
   - Loans
   - Cash-credits
   - Overdraft
   - Purchasing and Discounting of Bills
2. Indigenous Banking
3. Trade Credits
4. Installment Credit
5. Advances

Commercial Banks

Commercial banks are the most important sources of short-term capital. The major portion of working capital loans are provided by commercial banks. They provide a wide variety of loans tailored to meet the specific requirements of a concern. The different forms in which the banks normally provide loans and advances are as follows:

(a) Loans
(b) Cash credits
(c) Overdraft
(d) Purchasing and Discounting of bills

(a) Loans

When a bank makes an advance in lump sum against some security, otherwise, it is called a loan. In case of a loan, a specified amount is sanctioned by the bank to the customer. The entire loan is paid to the borrower either in cash or by credit to his account. The borrower is required to pay interest on the entire amount of the sanction. A loan may be repayable in lump sum or installment. Interest on loans is calculated at quarterly rests and where repayments are stipulated in installments, the interest is calculated at quarterly rest on the reduced balances. Commercial banks generally provide short-term loans up to one year for meeting capital requirements. But now-a-days loans exceeding one year are also provided by banks. The term loans may be either medium-term loans or long-term loans.

(b) Cash Credit

A cash credit is an arrangement by which bank allows his customer to borrow money up to a certain limit against some tangible securities or guarantees. The customer can withdraw from its cash credit limits according to his needs and he can deposit any surplus amount with him. The interest in case of credit is charged on the daily balance and not on the entire amount of the unit. For these reasons, it is the most favorite mode of borrowing by industrial and commercial banks on 28th March 1970, prescribing a commitment charge which banks should levy on the unutilized portion of the credit limits.

(c) Overdrafts

Overdrafts means an agreement with a bank by which a current account holder is allowed to withdraw more than the balance to his credit up to a certain limits. There are no restrictions for operation of overdraft limits. The interest is charged on daily overdrawn balances. The main differences between cash credit and overdraft are that overdraft is allowed for a longer period. Overdraft accounts can either be clean overdrafts, partly secured or fully secured.

(d) Purchasing and Discounting of Bills

Purchasing and Discounting of Bills is the most important form in which a bank lends without any collectral security. Present day commerce is built upon credit. The seller draws a bill of exchange on the buyer of goods on credit.

Such a bill may be either a clean bill or a documentary bill which is accompanied by documents of titles of goods such as a railway receipt. The bank purchases the bills payable demand and credits the customer‘s account with the amount of bill less discount. At the maturity of the bill, bank presents the bill to its acceptor for payment. In case the bill is discounted is dishonored by non-payment, the bank recovers the full amount of the bill from the customer along with the expenses in that connection.

Indigenous Bankers

Private money-lenders and other country bankers used to be the only sources of finance prior to the establishment of commercial banks. They used to charge very high rates of interest and exploited the customers to the largest extent possible. Now-a-days with the development of commercial banks they have lost their monopoly. But even today some business houses have to depend upon indigenous bankers for obtaining loans to meet their working capital requirements.

Trade credits

At present day commerce is built upon credit, the trade credit arrangements of a concern with its suppliers is an important source of short-term finance. The main advantages of these sources are: it is a very convenient method of finance; it is flexible and it may be possible to obtain favorable terms. However, the biggest disvantage of this method of finance is charging of higher prices and loss of cash discount.

Installment Credit

This is another method by which the assets are purchased and the possession of goods is taken immediately. Thus the payment is made in installment over a predetermined period of time. Generally, interest is charges on the unpaid price or it may be adjusted in the price. But in any case it provides fund for some time and is used as a source or short-term working capital by many business houses which have difficult fund position.

Advances

Some business houses get advances from their customers and agents against order and this source is a short-term source of finance for them. It is a very cheap source of finance and in order to minimize their investment in working capital, some firms having long production cycle, specially the firms manufacturing industrial products prefer to take advances from their customers.

References:

1. Business Organisation
   - R.K Sharma
   - Shashi K. Gupta

     (Kalyani Publication)
2. Business Organisation
   - Dr. F.C Sharma

     (SBPD Publication)
3. Business Organisation and Management
   - M.C Shukla

     (S.Chand & Co. Pvt Ltd.)
4. Business Organisation and Management
   - R.N Gupta

     (S.Chand & Co. Ltd.)

Points to remember:

In fact, there is no fixed time period for intermediate finance. It may extend to any time period; but not a permanent period. It all depends on the nature and purpose of investment activity, for which medium term finance is needed.

***