UNIT 2

SHORT TERM FINANCING

What is Financing?

Financing is defined as a means of obtaining the resources to purchase an item, then paying back the loan in a set time period for a monthly, weekly or yearly set.

What is short term financing?

Arranging of available External funds to meet the needs of a firm for a year or less time.

Why Do Firms Need Short-term Financing ?

- Cash flow from operations may not be sufficient to keep up with growth-related financing needs.
- Firms may prefer to borrow now for their inventory or other short term asset needs rather than wait until they have saved enough.
- Firms may prefer short-term financing instead of long-term sources of financing

Sources of Short term Financing

- Trade credit
- Accrued expenses
- Bank financing
- Factoring
- Commercial paper

1. Trade credit

- It is a credit that a customer gets from supplier of goods.
- It is the spontaneous source o financing.
- In this the buying firm don’t pay immediately.
- Deferral of payments is a short- term financing called “Trade Credit.”

Pros and Cons

- Benefits
  1. Easy availability
  2. Flexibility
  3. Informality
- Costs
  1. Typically receive a discount, if you pay early.
  2. The cost is in the form of the lost discount, if you don't take it.

2. Accrued expenses

It represents the liability that a firm has to pay for those services which have been received earlier.

- **Accrued wages and salaries**
- **Accrued taxes and interest**

3.Bank financing

- Bank overdraft
- Cash credit
- Purchase and discounting of bills
- Short term loan
- Letter of credit

4. Commercial paper

- It is unsecured money market instruments issued in the form of a promissory note.
- It was introduced in India in 1990.
- RBI regulates the Commercial paper.
- Corporates, primary dealers, Indian financial institution are eligible to issue it.
- A corporate firm can be eligible to offer a Commercial paper if it has the value of 10 crore.
- Maturity of Cp in India is 91 to 180 days.

5.Factoring

It is financial transaction where a firm sells its account receivable to any third party.

- **It emphasizes on the receivable financial assets**
- **It involves the purchase of financial assets**
- **It involves three parties**
- **Period for factoring is 90 to 150 days.**
- **In Indian market you can get factoring as low as 1000.**
- **Bad debts are not considered in factoring.**

Factoring companies in India

- Canbank Factors Limited
- SBI Factors and Commercial Services Pvt. Ltd
- The Hongkong and Shanghai Banking Corporation Ltd
- Foremost Factors Limited
- Global Trade Finance Limited
- Export Credit Guarantee Corporation of India Ltd
- Citibank
- SIDBI
- Standard Chartered Bank

References

- Jain, P. K. (1999). *Theory and problems in financial management*. Tata McGraw-Hill Education.
- Srivastava, R. & and Mishra, A. K., Financial Management. Oxford Publishing House, 2/e.
- Pandey, I. M. (2000). Financial Management Vikas. *Publication Ltd*.

THANK YOU