10 Main Sources of Short-Term Fund

For:
M.Com. (2nd Semester)

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Introduction:

Short-term sources: Funds which are required for a period not exceeding one year are called short-term sources.

The major sources of short term funds are:

1. Indigenous Bankers
2. Trade Credit
3. Installment Credit
4. Advances
5. Factoring
6. Accrued Expenses
7. Deferred Incomes
8. Commercial Paper
9. Commercial Banks
10. Public Deposits.

1. Indigenous Bankers:

Private money-leaders 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.

2. Trade Credit:

Trade credit refers to the credit extended by the suppliers of goods in the normal course of business. As present day commerce is built upon credit, the trade credit arrangement of a firm with its suppliers is an important source of short-term finance. The credit-worthiness of a firm and the confidence of its suppliers are the main basis of securing trade credit.

The main advantages of trade credit as a source of short-term finance include:

(i) It is easy and convenient method of finance.

(ii) It is flexible as the credit increases with the growth of the firm.

(iii) It is informal and spontaneous source of finance.

The biggest disadvantage of this method of finance is charging of higher prices by the suppliers and loss of cash discount.

3. Installment Credit:

This is another method by which the assets are purchased and the possession of goods is taken immediately but the payment is made in Installment over a pre-determined period of time. Generally, interest is charged on the unpaid price or it may be adjusted in the price.

4. Advances:

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

5. Factoring:

Another method of raising short-term finance is through account receivable credit offered by commercial banks and factors. A commercial bank may provide finance by discounting the bills or invoices of its customers. Thus, a firm gets immediate payment for sales made on credit.

6. Accrued Expenses:

Accrued expenses are the expenses which have been incurred but not yet due and hence not yet paid also. These simply represent a liability that a firm has to pay for the services already received by it. The most important items of accruals are wages and salaries, interest, and taxes.

7. Deferred Incomes:

Deferred incomes are incomes received in advance before supplying goods or services. They represent funds received by a firm for which it has to supply goods or services in future. These funds increase the liquidity of a firm and constitute an important source of short-term finance.

8. Commercial Paper:

Commercial paper represents unsecured promissory notes issued by firms to raise short-term funds. It is an important money market instrument in advanced countries like U.S.A. In India, the Reserve Bank of India introduced commercial paper in the Indian money market on the recommendations of the Working Group on Money Market (Vaghul Committee).

9. Commercial Banks:

Commercial banks are the most important source 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) Overdrafts, and
(d) Purchasing and discounting of bills.

10. Public Deposits:

Acceptance of fixed deposits from the public by all type of manufacturing and non-bank financial companies in the private sector has been a unique feature of Indian financial system. The importance of such deposits in financing of Indian industries was recognised as early as in 1931 by the Indian Central Banking Enquiry Committee.

Since January 1967, the Government of India has tried to restrict the growth of company deposits through various measures. The primary objective of exercising control over public deposits has been to regulate the growth of deposits outside the banking sector as well as to provide some protection to the investors in such deposits.

But, in spite of the restrictive measures, public deposits with the non-banking corporate sector have become a significant part of corporate financing.


Thank you