Financial Management

MS109

UNIT 5 SOURCES OF LONG TERM AND SHORT TERM FINANCE

MBA Second Semester

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Long Term Finance

- Every business organisation requires funds to buy fixed assets like land, building, plant, machinery, furniture etc.
- These assets may be regarded as the foundation of a business. The capital required for fixed assets is called **fixed capital**.
- A part of the working capital is also of a permanent nature. Funds required for this part of the working capital and for fixed capital are called long term finance.

Purpose of long term finance

Long term finance is required for the following purposes:

1. To Finance fixed assets

2. To finance the permanent part of working capital:

3. To finance growth and expansion of business

Sources of Long Term Finance

- **Equity Shares**
- **Preference Shares**
- **Debentures**
- **Retained Earnings or Ploughing back of Profits**

Equity Shares

- **Equity Shares** also known as ordinary shares.

The holders of these shares are the real owners of the company.

They have a control over the working of the company. Equity shareholders are eligible to get dividend and dividend is paid to them after the payment to preference shareholders.

The rate of dividend on equity shares is not fixed as its depend upon the profits of the company. The equity shareholders take more risk than preference shareholders.

Preference Shares

Preference Shares are the shares which carry preferential rights over the equity shares. These rights are (a) receiving dividends at a fixed rate, (b) getting back the capital in case the company is wound-up. Investment in these shares is safe, and a preference shareholder also gets dividend regularly

Debentures or Bonds

- Whenever a company wants to raise long term finance, it can borrow from the general public by issuing loan certificates called Debentures. Debentures are the acknowledgement of debt.
- A debenture holder is termed as the creditor of the company. A fixed rate of interest is paid on the debentures.

Retained Earnings or Ploughing Back of Profits

- The ploughing back of profits means that companies do not share all its profits among the shareholders as dividend rather some part of profit is kept aside. Such profit is retained or reinvested by the company for the its further development. Such a phenomenon is also called Self Financing, Internal Financing or Inter financing.

Other Popular Sources of Long Term Finance

- Lease Financing
- Hire purchase
- Venture Capital
- Private Equity

Short term Sources of Finance

- Trade Credit
- Commercial Banks
- Customers’ Advances
- Instalment credit
- Loans from Co-operative Banks

References:

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