Week 9 – Short Term Sources of Finance

1] Trade credit

Trade credit is finance obtained from suppliers of goods and services over the period between delivery of goods or service and the subsequent settlement of the account by the recipient.

During this time, the company can enjoy the benefits from the goods or service provided without having to pay up. Granting customers a credit period is part of normal trading relationship.

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2] **Bank overdraft**

A bank overdraft is an agreement between a commercial bank and a business to allow its current account to go into deficit up to a pre-determined limit as a means of coping with a seasonal or temporary deficiency in cash inflow (short-term remedy!).

The banks rarely cancel the overdraft facility, only the used limit beyond the maximum amount the company can owe at any point in time.

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3] <u>Factoring</u>

Companies selling goods on credit may have to wait up to 30 or 60 days to receive payment from the customer. In the meantime they have to finance their day-to-day activities, and purchase more supplies.

Factoring organizations help in improving cash flows by speeding up the cash receipts relating to outstanding invoices. The majority of factoring organizations are subsidiaries of commercial banks.

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4] **Invoice discounting**

It is similar to the financing service provided by a factor, except discounter has no responsibility for the administration of the account receivable, or the collection of the debt. The service is totally confidential, the customer's debtors being unaware of the existence of the discounter.

Regardless of whether the customer has paid, the supplying company is committed to handling over the total invoice amount to the finance house and in return receives the remaining 10% less service fees and interest.