AN ANALYSIS OF SOURCES OF SHORT-TERM FINANCING USED IN TRADING COMPANIES

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1. PREFACE

As my Advanced Diploma In Accountancy course requirement, I had chosen the study on, "An Analysis of Sources of Short-Term Financing Used in Trading Companies" for my project paper. This is due to the fact that, finance plays a vital role in survival in the business, for most trading companies or any other companies for that matter.

Such may be the sources of finance, be it internal or external sources, the objectivity of which are the same, that is to reduce losses and optimise gains. It is in the area of short-term external sources that I would be dealing with. Such a study would benefits a company financially and operationally.

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2. INTRODUCTION

The subject of business finance encompasses a critical and important function in every business. Viewed narrowly, it is the task of providing the funds needed by the enterprise on terms that are most favourable in light of the objectives of the business. This concept has the merit of directing attention to the central core of the subject, that of keeping the business supplied with enough funds to accomplish its objectives. It is for such reason that I had chosen the topic, "An Analysis of Sources of Short-Term Financing in Trading Companies" for my project paper.

The need for funds is affected by virtually everything that happens in the business. In order to understand and meet the needs of the business efficiently, the finance manager must understand and keep in touch with all phases of its operations.

Basically, sources of short-term financing refers to working capital management and deals in the investment of short-term assets. Generally speaking, their objectives are :

a) To optimize profitability and liquidity by

   i) maintaining a correct level of cash, debtors and stock in relation to current assets.

   ii) maintaining a correct level of current assets to total assets, to current liabilities and to sales;

   What those correct levels should be will depend on:

   - the size of the sales and assets,

3. WHY SHORT TERM FINANCING ?

The reasons why short-term financing is important are as follows :

a) It is generally acknowledged that a large portion of a financial managers time is spent on short-term investments or working capital decisions .

b) It is particularly important for trading concerns because they cannot avoid investment in cash, debtors and stock although they can minimise investment in fixed assets by renting or leasing plant and equipment.

c) There is a close and direct relationship between sales growth and the need to finance current assets.

   For example, a company's average collection period is forty days and if its credit sales are $1,000 a day, it will have an investment of $40,000 in trade debtors. If sales rise to $2,000 a day, the investment will rise to $80,000. Sales increases produce similar immediate needs for additional inventories and, perhaps, for cash balances.

   All these needs must be financed and since they arise so quickly, it is necessary that the financial manager keeps himself aware of developments in the working capital segment of the firm. Although continued sales increases will require additional long-term assets, which must also be financed, it does not generally have the same urgency as do short-term investments.