Importance of diversification

Trade Credit – is a short-term mediumfinance, which encompasses the supply of goods and services without immediate payment once such supply is made. Granting credit is a frequent trading practice in the business world. Indeed is commonly termed as ‘ spontaneous finance’. An organization usually grants credit and receives credit. It receives credit from its suppliers and grants credit to its customers. Such credit is normally established in the absence of interest. However, in case of late payments interest may be charged on overdue accounts.

The creation of trade creditors and trade debtors via trade credit led to the development of an important area of finance, known as working capital management. It is a vitalresponsibilityof the finance director to ensure a sound financial position, which is highly influenced by trade credit. Meticulous organizations frequently try to extend the trade credit received by creditors, while at the same time diminish the trade credit granted to debtors. The management of trade debtors is a very serious topic, because it holds a direct effect on the sales revenue of the company.

Therefore management adopt techniques that stimulate early payment but refrain from putting a wrong image on the business enterprise. A typical technique utilized to shorten the debtors’ collection cycle is offering cash discounts for early payments. The main aim of widening the gap between creditors payment and debtors collection is to enhance the operating cash cycle (Pike et al. 1999, pp 421-422). ii. Overdraft Facility – encompasses a sum ofmoneygranted to a company by an authorized bank normally in order to finance the working capital of the organization.

Unlike a bank loan, an overdraft facility holds flexibility in the amount of money granted. For example, if a client gets a bank loan of $15, 000, he will be forwarded the money, which he will utilize normally for a pre-arranged feature. If the customer was granted an overdraft facility of $15, 000, this means that he can take how much he needs of those $15, 000 and is not required to utilize the full amount. The interest will thus be charged on the amount of money used.

A bank overdraft is repayable on demand and does not hold a specified maturity date like a bank loan (Weetman 2003, p 40). Security may sometimes be required by banks for material overdrafts. Such security can either be a fixed charge or a floating charge. A fixed charge arises whenever an overdraft is secured over a specified asset. A floating charge takes place when the security is general on all the assets of the organization (Pike et al. 1999, p 424). iii. Commercial paper – encompasses unsecured promissory notes issued by reputable corporations.

These securities hold a maturity lower than 270 days, normally between 20 to 45 days in order to refrain registration with the Securities and Exchange Commission, which will thus reduce administrative expenditure for issue. Similar to Treasury Bills, Commercial Paper Securities are issued on a discounted basis. The corporation’s objective behind commercial papers is to finance loans extended to clients. For example, General Motors Acceptance Corporation and other organizations in the automobile industry utilize commercial papers in order to provide car loans to customers acquiring their cars (Eakins 2002, p 34). iv.

Transaction Loan – this basically comprises an unsecured short-term bank loan. Being short-term the duration of such a loan is normally in the range of one to six months, even though it may extend to a year. Being unsecured such loan is highly risky for the bank since there are no assets to act as security. However the amount lent is normally not material. Attention yet should still be kept by the finance manager of the bank because in events of high demand by the public to withdraw cash the bank may face a cash shortage if it is unable to collect from borrowers (Pike et al. 1999, p 425). References: Ameritrade (1999).

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