Short term and long term financing

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Short TermFinanceWhat is Short Term Financing? Short term financing is basically refers to additionalmoneyfor a business which requires for running its business for short terms which is usually a period of one year. There are some sources of short term finance which are as following:- Overdraft Overdraft bank basically means a facility that the bank provides to its customers where the customer is given permission to draw money from the banks in surplus of their balance in their heir bank accounts.

When taking overdraft from the bank, the account must be zero to get extras extension of money and the interest rate will be very high and we have to pay back the bank in a very short period of time. Trade Credit Trade credit refers to buying products and servicers of a business which needs in the course of its business on credit, depending on the trade practices prevalent in a particular industry, the nature of the business relationship between the supplier and the company may give a different time period to pay the products and services they buy from different suppliers.

Exactly as companies get their credit from their suppliers, they must also give credit to their customers. The customers are given 50 to 60 days to pay up the bills. After 60 days, interest will be applied on the customers. If the customers are unable to pay, the will be asked for installment plan. Bank Loans Bank Loan means loans which are given to banks which need to repaid their installment over a fixed period of time which may be short or long term period. Even though it is called bank loans, these loans can be move forward by banks or other financial institution.

Usually loans like this are generally given for a certain reason such as purchases of capital equipment. Advantages/ Disadvantages of Short Term

Finance Short term financing is a method to raise funds which involves financialresponsibilitythat is needed to be repaid within a year or less. Short term financing is flexible and a fast way for companies to obtain working capital for their daily operations. The main disadvantage is that a company may be too dependent on short term funds and threatened to high banking fees and interest rate.

This will may affect the profit margins. Speed Short-term loans can be achieved much fast and easier compared to long-term financing. Lenders will not make through an examination of the company’s account for short-term lending compared to the case they do for long-term loans. Medium size companies do not have large amount of cash and are vulnerable to sudden financial shocks such as non-payment by a key debtor. Flexibility Small companies usually have seasonal variations in the cash and need access to capital over that period.

Overdraft protection is one of the form of short term finance where the bank agrees to pay the company’s cash withdrawals, checks, and electronic debits to a certain limit. The lender will charge a fee for this facility on any balance outstanding. The cost of short term finance may be lesser compared to the long term finance where the cost may be higher. Drawback to this type of short-term finance flexibility is that the bank can withdraw the overdraft protection in a short notice. Risk Market circumstances, such as retreat, may cost the small businesses into borrowing a large amount on a short term basis.

Short term finance can be a risk factor for the borrower A short term loan can be renewed by the lender on a certain terms than the original contract.

This does not only cause the businesses to face a high cost of capital, it may not be able to service the amount of debt collected. This will put the company in a weak position where it could cause the company to be bankrupt. Management Lenders who extend their short term financing does not involve themselves in the business decisions about capital investment.

Long-term finance is associate by the number of provisions, such as caps on the salaries of the companies principals or limits on other financial arrangements, which will restrict the business actions. Long-term Finance What is long-term finance? Long term finance is basically holding an asset for a long period of time. Providing the type of security and a long-term asset can be hold as short as 1 year or as long as 25 years or more. Long-term finance also means funding which are obtained for a time frame exceeding the duration of one year.

When business borrows money from a bank using long term finance methods, it will be expecting the loan to be paid back more than one year. Example, making payments on a 20 year mortgage. Long -term finance are usually for expansion of new markets, purchases of assets such as machinery, land and buildings and business growth through the acquisition of other businesses or properties. Its types of long term finance are as following :- Venture capital Venture capital is becoming an increasingly important source of finance for growing companies.

Venture capitalists are generally very wealthy groups of companies or individuals which specifically set up for investment in developing companies. Venture capitalists are usually on the look out for companies with have potential. They are ready to offer money to help businesses to grow, in

return the venture capitalist get some ownership of the company as well as share in the profits made. Venture capitalists usually are prepared to take projects which have a high risk and which some banks might not wan to get involve in.

The advantage of this might be heavier because the possibility of the businesses losing some of their independence in making a decision. Example of venture capitalists who are also called as private equity firms are Hermes Private Equity Debentures If a company wants to borrow a big amount of money for a long but fixed period of time, it can borrow from the general public by issuing loan certificates called Debentures. The total amount borrowed is divided into units of fixed amount. These are debentures are usually offered to the public to subscribe in the same manner as it is done in the case of shares.

A debenture is issued under a seal of the company. It is written for acknowledgement of money borrowed. It also specifies the terms the terms and conditions such as security offered, rate of interest and time repayment. There few types of debentures which are as following :- 1. Redeemable debentures and irredeemable debentures Redeemable debentures These are debentures which are repayable on a pre-arranged date or any time depending to their maturity provided the company wish and gives a notice to that effect. Irredeemable Debentures

These irredeemable debentures are also called perpetual debentures. A company is not bounded to repay the amount during the period of time given. If the issuing company fails to pay the interest, it has to reclaim such debentures 2. Convertible Debentures and Non-convertible Debentures

Convertible Debentures The holders of these convertible debentures are given the options to convert their convertible debentures into equity shares and ratios as decided by the company. Non-Convertible Debentures These non-convertible debentures cannot be converted into shares

Mortgage Mortgage is a loan specifically for the purchase of a property. Usually businesses do not buy property through a mortgage. Mortgages are usually used as a security for a loan. This tend to happen with smaller businesses. Example, A sole trader running a florist shop might want to shift to a larger premise. They will find a shop with a price of $100, 000. To give this sort of money, the bank will want to have some sort of security as a guarantee that if the borrower cannot pay back the money to the bank, the bank will be able to get back their money.

The borrower can use their own property as a security for the loan, it is called taking out a second mortgage. If the business is not able to pay back the bank the loan then the bank has the right to take the house and sell it to recover their money. Using mortgage this way is a good way of rising finance for small businesses but it also carries a big risk. Advantages/ Disadvantages of Long-term finance Stability If we have a long term financing, that means we have a stability and no need to search for financing often compared to short term financing.

This also means that it will be easier to project our cash flows and earnings as we will know our expenses every month. Short term financing does not offer these advantages, because we have to constantly renegotiate the terms of our agreement. Cost of Capital Having a long term financing gives us a better idea of the long term cost of capital. By this way we will have a

better understanding on which projects are worth pursuing or not. IF we don't have long term financing in place, our cost of capital may change all our negotiation of our terms.

This will lead us to more confusion in figuring out what kind of profitability we are looking for in a project. Differences between short term and long-term finance Duration Most of the short-term financing occur over short period of one year, even though some of the sources can last up to three years or more. However long-term financing is like home mortgage which usually have a longer period of time up to 30 years. Interest Short-term financing is repaid over a short period of time, the interest cost to borrow the money will be smaller.

However, long-term sources such as Bank loans which have high interest rate due to the amount of time taken to repay the capital. Types Short-term and long-term sources of financing differ in instrument type. Example of short-term sources includes leases, short-term commercial loans, account payable and bank overdraft coverage. However example of long-term sources includes retained earnings, finance leases, venture capitals and company shares Which one is more preferable to choose short term or long-term finance?

Conclusion, it would be generally be better to choose short-term loan over a long term finance if the school Halls Creek High school budget allows it. This will increase the monthly payments as much as possible to take advantage of the lower interest rate. The combination of bigger the monthly payment and smaller interest rate will allow the school to have a bigger payment on

the outstanding balance. This will help the school to pay less interest on the loan taken and end their mortgage sooner. .