Obtaining Short-Term Financing VS Long-Term Financing

SHORT-TERM FINANCING

- Funds needed for a year or less

Importance

- Purchasing additional inventory
- Paying bills that come due unexpectedly
- Helping firm stay afloat when cash is low

Different sources of Short-Term Financing

- Trade Credit-the practice of buying goods now and paying for them later. Most widely used source of short-term funding.
- Promissory note- a written contract with a promise to pay a supplier a specific sum of money at a definite time
- Family and Friends
- Commercial Banks-lend money to businesses so they can finance their products or services with the firm paying back the money at the end of an agreed due date plus interest.
- Factoring of Receivables-another form of funds is basically the company sells its accounts receivables to a bank at a discount, allowing the company to get the money they need right away.
- Commercial Paper
- Credit Cards

Different Forms of Short-Term loans

- Secured loan-A loan backed by collateral, something valuable such as property. Ex. If you can't pay the loan, I can take your car. Allows banks to take less risk when lending money.
- Unsecured loan-A loan that doesn't require collateral. It's rare to get this type of loan and is usually given to businesses that are highly regarded or long-standing businesses.
- Line of Credit-A given amount of unsecured short-term funds a bank will lend to a business, provided the funds are readily available.
- Revolving Credit agreement-A line of credit that's guaranteed but usually comes with a fee.
- Commercial finance companies-Organizations that make short-term loans to borrowers who offer tangible assets as collateral.

LONG-TERM FINANCING

-Funds needed for more than a year (2 to 5 years)

Importance

- Purchasing expensive assets such as plants and equipment
- Developing new products
- Financing an expansion of a firm

Different sources of Long-Term Financing

Debt Financing-Borrowing money the company has a legal obligation to repay

Borrowing from lending institutions

1. Term loan agreement- A promissory note that requires the borrower to repay the loan in specified installments.
2. Risk/return trade-off- The principle that the greater the risk a lender takes in making a loan, the higher the interest rate required.

By Issuing Bonds

1. Indenture term-The terms of agreement in a bond issue
2. Secured bond- A bond issued with some form of collateral
3. Unsecured Bond- A bond backed only by the reputation of the issuer; also called a debenture bond.

Leverage- raising needed funds through borrowing to increase a firm's rate of return.

Equity Financing

1. Selling stock
2. Financing from retained earnings-Profits from the business
3. Financing from venture capital- Money that is invested in new or emerging companies that are perceived as having great profit potential.

Cost of capital- The rate of return a company must earn in order to meet the demands of its lenders and expectations of its equity holders