

- **Short-Term Sources of Financing** Trade Credit, Deferred Income and Accrued Expenses, and Bank Finance. Two alternative ways of raising short-term finances in India are: factoring and commercial paper.
- **Spontaneous Sources of Working Capital Finance** Trade Credit and Deferred Income and Accrued Expenses are available in the normal course of business, and therefore, they are called spontaneous sources of working capital finance. They do not involve any explicit costs.
- **Non-Spontaneous or Negotiated Sources of Working Capital Finance** Bank Finances have to be negotiated and involve explicit costs. They are called non-spontaneous or negotiated sources of working capital finance
- **Trade Credit** refers to the credit that a buyer obtains from the suppliers of goods and services. Payment is required to be made within a specified period. Suppliers sometimes offer cash discount to buyers for making prompt payment. Buyer should calculate the cost of foregoing cash discount to decide whether or not cash discount should be availed. The following formula can be used:

$$\frac{\% \text{ Discount}}{100 - \% \text{ Discount}} \times \frac{360}{\text{Credit period} - \text{Discount period}}$$

A buyer should also consider the implicit costs of trade credit, and particularly, that of stretching accounts payable. These implicit costs may be built into the prices of goods and services. Buyer can negotiate for lower prices for making payment in cash.

- **Accrued Expenses and Deferred Income** also provide some funds for financing working capital. However, it is a limited source as payment of accrued expenses cannot be postponed for a long period. Similarly, advance income will be received only when there is a demand-supply gap or the firm is a monopoly.
- **Bank Finance** is the most commonly negotiated source of the working capital finance. It can be availed in the forms of overdraft, cash credit, purchase/discount of bills and loan. Each company's working capital need is determined as per the norms. These norms are based on the recommendation of the Tandon Committee and later on, the Chore Committee. The policy is to require firms to finance more and more of their capital needs from sources other than bank. Banks are the largest providers of working capital finance to firms.
- **Commercial Paper** is an important money market instrument for raising short-term finances. Firms, banks, insurance companies, individuals etc. with

short-term surplus funds invest in commercial papers. Investors would generally invest in commercial paper of a financially sound and creditworthy firm. In India, commercial papers of 91 to 180 days maturity are being floated. The interest rate will be determined in the market. The yield on commercial paper can be calculated as follows:

$$\text{CP yield} = [\text{Face value} - \text{Sale price} / \text{Sale price}] [360 / \text{Days to maturity}]$$