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शक्ति उत्थान आश्रम लखीसराय बिहार

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Classification of Sources of Funds

Period Basis

On the basis of period, the different sources of funds can be categorised into three parts. These are long-term sources, medium-term sources and short-term sources. The long-term sources fulfil the financial requirements of an enterprise for a period exceeding 5 years and include sources such as shares and debentures, long-term borrowings and loans from financial institutions. Such financing is generally required for the acquisition of fixed assets such as equipment, plant, etc.

Where the funds are required for a period of more than one year but less than five years, medium-term sources of finance are used. These sources include borrowings from commercial banks, public deposits, lease financing and loans from financial institutions. Short-term funds are those which are required for a period not exceeding one year. Trade credit, loans from commercial banks and commercial papers are some of the examples of the sources that provide funds for short duration. Short-term financing is most common for financing of current assets such as accounts receivable and inventories. Seasonal businesses that must build inventories in anticipation of selling requirements often need short-term financing for the interim period between seasons. Wholesalers and manufacturers with a major portion of their assets tied up in inventories or receivables also require large amount of funds for a short period.

Ownership Basis

On the basis of ownership, the sources can be classified into 'owner's funds' and 'borrowed funds'. Owner's funds means funds that are provided by the owners of an enterprise, which may be a sole trader or partners or shareholders of a company. Apart from capital, it also includes profits reinvested in the business. The owner's capital remains invested in the business for a longer duration and is not required to be refunded during the life period of the business. Such capital forms the basis on which owners acquire their right of control of management. Issue of equity shares and retained earnings are the two important sources from where owner's funds can be obtained. 'Borrowed funds' on the other hand, refer to the funds raised through loans or borrowings. The sources for raising borrowed funds include loans from commercial banks, loans from financial institutions, issue of debentures, public deposits and trade credit. Such

sources provide funds for a specified period, on certain terms and conditions and have to be repaid after the expiry of that period. A fixed rate of interest is paid by the borrowers on such funds. At times it puts a lot of burden on the business as payment of interest is to be made even when the earnings are low or when loss is incurred. Generally, borrowed funds are provided on the security of some fixed assets.

Source of Generation Basis

Another basis of categorising the sources of funds can be whether the funds are generated from within the organisation or from external sources. Internal sources of funds are those that are generated from within the business. A business, for example, can generate funds internally by accelerating collection of receivables, disposing of surplus inventories and ploughing back its profit. The internal sources of funds can fulfill only limited needs of the business. External sources of funds include those sources that lie outside an organisation, such as suppliers, lenders, and investors. When large amount of money is required to be raised, it is generally done through the use of external sources. External funds may be costly as compared to those raised through internal sources. In some cases, business is required to mortgage its assets as security while obtaining funds from external sources. Issue of debentures, borrowing from commercial banks and financial institutions and accepting public deposits are some of the examples of external sources of funds commonly used by business organisations.