Sources of Working Capital

There are different sources through which a business firm goes to raise working capital. These sources are short term and long term. Sometimes, it is classified as Bank sources and non bank sources. In addition to ,new modes of Financing are also there to raise working capital. These sources are as follows:

(1) Short term sources: Working capital is generally arranged for the duration of one year which is known as short-term financing .This goes to meet the short-term financial requirements of the business such as purchasing raw materials, payment of labour and other operating expenses. It is generally arranged through internal and external sources which are as follows:

(A) internal sources:

(1) provision for depreciation: It is generally charged on fixed assets such as plant machinery, building, furniture etc. The provision for depreciation is generally made for the purpose of replacement of fixed assets where this amount is always available with the business firm. Hence, it is considered as a good source of fund for working capital till the date of its actual utilisation for the acquisition of assets.Thus, depreciation means decrease in the value of assets due to their constant use in business .Charging depreciation against profit is a non cash expenses and it does not represent any cash outflow, hence, this part of the profit adjusted for depreciation can be used by management to increase any of the current assets or pay taxes, dividend etc.

(2)Provision for taxation :According to Income Tax Act every business firm which is liable to pay tax on the amount of the profit earned by the firm during the particular period. Tax is payable at the rate prescribed for the same as per finance act passed every year. Hence ,once the net profit has been calculated immediately provision for the payment of tax is made out of the said profit. However, actual payment is generally made after sometime. Thus,there is a time lag between the creation of the provision for taxes and their actual payment and during this period the amount can be used as a source of working capital.

(3) Accrued expenses: Expenses which are payable but their actual payment is deferred for shorter period and during this period this amount can be used as a source of working capital.

(4) Reserves and provisions: In addition to depreciation and taxation, there are some other provisions also which are made against profit for meeting prospective losses or liabilities. Not only that but some reserves are also created in the business for meeting unseen liabilities and to strengthen the financial position. Thus,this amount available with the business firm can be used as working capital. Sometimes, this amount is not kept as additional working capital but is invested in some outside securities which is called reserve fund.

(B)External sources

In addition to internal sources, working capital is made available from the sources existing outside the business firm. These sources are:

(1) Trade credit : It is a most common source of raising working capital where buying firm goes to avail credit facility from the vendor firm and payment is not required to be made on the date of delivery. It is generally seen that in practice most of the business firm purchases raw material, semi finished goods, finished goods etc. on credit where the percentage is very high, hence, this is found to be the the largest source of temporary working capital .This trade credit is made available in the form of open account credit arrangement and acceptance credit arrangement where buyer's signature is formal in the case of acceptance credit arrangement which is never required in the case of open account credit arrangement.

(2)Bank credit: Bank provides credit in the different forms such as overdraft, discounting of bills, cash credit, pledge, mortgage, hypothecation etc. Thus, a larger portion of the working capital financing is made by the bank which is playing a pivotal role in providing short-term and medium term finance to the corporate concerns.

(3)Accounts receivable Financing: Under this arrangement the financing company goes to purchase the accounts receivable of the business firm. In other words ,we can say that money is financed on the basis of the security of accounts receivable. Normally, 60% of the value of accounts receivable pledged is advanced by the Finance Companies. However, if there is any bad debts losses it is generally borne by the business concern itself.

(4)Installment credit :Under this arrangement some portion of the cost price of the assets is paid at the time of delivery and the balance is paid in number of installments along with interest. This facility goes to provide the working capital by reducing the working capital requirement during the period.

(5) Government assistance :There are different activities for which financial assistance is made by the government.

Government goes to launch the different programs or projects such as acquisition and installations of energy conversion equipment and Solar plant development and use of indigenous Technology etc. where subsidies, tax concessions, facility of granting loans are given by the government. Hence, it is also known as the source of raising working capital because working capital requirement is reduced to the greater extent by this assistance given by the government.

(6)Commercial paper :This commercial paper is issued as a promissory note by the company for raising working capital. The size of the commercial paper is minimum rupees 5 lacks and maximum rupees 25 lakh. The duration of this paper is minimum 15 days and maximum for one year. This is the most common source of raising working capital but this is going to be beneficial for the most profitable and large-scale trading companyonly.A small business firm cannot be benefited from this source.

(7)Factoring :It is a financial service which is generally provided by the third party who undertakes the responsibility of realising credit sales from the customers. A factor is just like an agent who assures the seller to collect the money from the customer against the credit sales. Thus, factor takes the risks for collecting receivables. This factor goes to advance the seller against the receivable where money will be collected in future and this advance becomes the source of working capital for the supplier of the goods .In this way, we can say that factoring is a contract between the third party and the supplier of goods where third-party providers Finance in advance to the supplier against the book debt and third party is authorised to realise the credit sale from the debtors . There are different types of factor where some factor takes all types of risks relating to book debts but in some cases they do not take the risk of bad debts .Thus, Factoring is a type of financial arrangement which is made by the supplier from the factor by giving the authority to collect the money under certain terms and conditions.