Advance in Applied Economics and Finance
Vol. 1, No. 1, March 2012

www.worldsciencepublisher.org

Methods of Financial Supply in Companies and Comparison Between them

Rahim Asadian

Azerbaijan National Academy of Sciences, Baku, Azerbaijan Rep.

Email: asadianrahim@gmail.com

Abstract – Decision related to financing is one of decisions that economic unit managers adopt to maximize shareholders' wealth. This kind of decision making relates to capital structure and also determination and selection of the best financing method and its combination. Therefore a financial manager can affect shareholders' wealth through changes in issues such as per share profit, profit sharing policy, scheduling profitability duration and risk, and choice of financing method. Financial resources of each economic unit consist of internal and external resources. Internal resources include cash currents resulting from operations. Asset sales funds and external resources include borrowing from financial markets and equity.

Keywords – financial supply; investment; Short-term financing; long-term financing

1. Introduction

Financing methods usually place in short-term and long-term financing groups. Short-term financing is used for supporting temporary investment in current assets. After investment planning in current assets and predicting resources required for economic unit in next year, financial manager must think about his plan's financing and decide on financing method.

2. Short-term financing methods

Economic unit managers use short-term loan for temporary investment in current assets. Short-term financing methods are:

- *Business credit* (purchasing goods or services on credit)
- *Bank loans* (receiving the required funds from bank)
- *Short-term commercial paper* (bonds) which is without guarantee debt of the publisher of economic unit.
- *Commercial-financial institutions' loans* (receiving the required funds from financial institutions)
- *Issuance of commercial documents* (exchangeable securities by economic units to other units, banks and financial institutions)
- *Financing through collateralizing receivable accounts, stock, land, building, machinery,* (receiving required funds and collateralizing to the trustee, collateral is a receivable account, collateral is stock)
- *Pre-receiving from customers*

3. Medium and long-term financing methods

- *Long-term bank loans* (Bank loans having over one year due)
- *Long-term rents* (renting on condition of ownership, operational renting): it's a contract by which the asset owner rents the asset to the other part of contract to use that asset in exchange of paying certain fees.
- *Financial share* (companies offer their public share to people and common share holders are ultimate owners of the company).
- *Bond* (with and without name, with and without collateral) : documents that their publisher committed to pay specified amount at certain times to the holders and repay the principal amount in due time
- *Ordinary share purchase authority* (a kind of bond that its holder has the right to purchase specified commitment of ordinary share of economic unit to a certain price)
- *Privileged share* (a kind of share that compared to earnings and assets of economic unit, there is a specified and limited right or claim)
- *Loans of credit institutions* (long-term loans which are granted to the company by economic units of insurance and credit institutions.)
- *Government loans.* (loans that are granted by government)

Advantages and disadvantages of financing methods will be discussed and what are effective factors in selecting suitable financing strategy of companies.

4. Advantages and disadvantages for Short-term financing methods

4.1. Commercial credit Method:

4.1.1. Advantages:

- availability
- lack of cost
- no need to collateral
- lack of strict creditors

4.1.2. Disadvantages:
- payable accounts swelling
- loss of cash discount
- reducing credit grade of commercial unit

4.1.3. Users:
- all economic units

4.2. Bank loans Method:

4.2.1. Advantages:
- using bank services
- using financial resources on the deadline
- using whole or part of credit
- repayment possibility pre-due

4.2.2. Disadvantages:
- guaranteed profit of loan is more than many other ways, necessity to have enough investment and cash
- compensatory remains

4.2.3. Users:
- all economic units

4.3. Short-term commercial paper Method (bond)

4.3.1. Advantages:
- not having collateral
- the possibility to set paper due (redemption)
- financing through new bonds

4.3.2. Disadvantages:
- only is executable by valid economic units

4.3.3.Users:
- insurance companies
- joint fund investment
- pension fund

4.4. Financial - commercial institutions loans Method:

4.4.1. Advantages:
- in case of not using bank loans
- this method can be used

4.4.2. Disadvantages:
- guaranteed profit is more than loan
- collateral need for loan

4.4.3. Users:
- all economic units

4.5. Commercial documents issuance Method:

4.5.1. Advantages:
- the guaranteed loan is less than bank loan
- without collateral

4.5.2. Disadvantages:
- only is executable by valid economic units
- having more formalities

4.5.3. Users:
- Great economic units in industrial countries

4.6. Financing through accounts collateralization Method:

4.6.1. Advantages:
- cash availability
- immediate cash availability
- seasonal cash availability

4.6.2. Disadvantages:
- collateralization requires bearing additional costs
- the remained receivable accounts are within acceptable limits
- stock should be sufficient
- the guaranteed bank profit is more than the least interest rate

4.6.3. Users:
- newly built economic units
- economic units that grow rapidly

4.7. Pre-receive of customers Method:

4.7.1. Advantages:
- immediate cash availability

4.7.2. Disadvantages:
- the necessity of having applicant

4.7.3. Users:
- High - applicant units having high quality and low price

5. Advantages and disadvantages for Medium – and long – term financing

In financial management field, short term period is usually related to those depts. That their due is in less than one year interval, but long-term financing statement has not been defined accurately. Some economic units use medium-term for due dates more than one year and less than 10 years, for some it is short-term 8-year loan and for it is considered as long-term. Generally, loans having more than one to two years due will be called long-term.

5.1. Long-term bank loans Method

5.1.1. Advantages:

- Medium – and long-term loan interest is approximately constant
- contract conditions can be negotiated
- good account customer will benefit from the facilities

5.1.2. Disadvantages:
- contract contents of these loans create financial limitations for economic unit
- loan interest rate is usually more than base interest rate
- economic unit collateralization will be limited
- paying annual installments will put cash under too much pressure

5.1.3. Users:
- economic units that want to create fixed assets or long-term investments

5.2. Long – term rents Method:

5.2.1. Advantages:
- using assets and long-term installments payments

5.2.2. Disadvantages:
- interest rate of these loans is more

5.2.3. Users:
- newly built economic units in industrial countries
- economic units of transportation industry

5.3. Ordinary share Method:

5.3.1. Advantages:
- they are due less and always financing
- economic unit does not have legal requirement for paying dividend
- by publishing shares
- control and ownership condition of economic unit do not change

5.3.2. Disadvantages:
- the cost of this method is higher than other financing methods
- paying dividend does not lead to saving
- publishing ordinary share causes that dividend is reduced temporarily and this negatively affect share price

5.3.3. Users:
- all joint stock companies

5.4. Bond Method:
(with and without name, with and without collateral)

5.4.1. Advantages:
- interest cost of bonds is acceptable by tax
- it means that influential cost of bonds is low
- this method is preferred to short-term bank loans
- some bonds are convertible and some are redeemable
- if efficiency rate of economic unit is higher than papers interest rate, it will be a suitable method

5.4.2. Disadvantages:
- if efficiency rate of economic unit is less than papers interest rate
- per share profit will extremely reduce
- inability to pay interest principle and corollary can lead to bankruptcy
- bond contract limitations will create restrictions for economic unit

5.4.3. Users:
- economic units having commercial credit

5.5. Ordinary share purchase authority Method:

5.5.1. Advantages:
- ordinary share purchase authority paper is tradable in the market

5.5.2. Disadvantages:
- this paper can be used in a specified period
- increase the share number of economic unit
- reduce per share profit

5.5.3. Users:
- all joint stock companies

5.6. Privileged share Method:

5.6.1. Advantages:
- the cost of financing through privileged share is less than ordinary share
- privileged share holders have restricted advantages
- privileged share is usually due less
- economic units don't have legal requirement for paying privilege share profit
- privileged shareholders are vote less

5.6.2. Disadvantages:
- if economic efficiency is less than privileged share investment cost
- ordinary share profit will be reduced
- privileged share cost is higher than bond
- accumulated dividends payment may cause problems for the economic unit

5.6.3. Users:
- all joint stock companies in industrial companies

5.7. Credit institutions loans Method

5.7.1. Advantages:
- interest rate of these loans is more than bank loan interest

5.7.2. Disadvantages:

- these loans usually don’t require compensatory remained

5.7.3. Users:

- all economic units of industrial companies

5.8. Government loans Method:

5.8.1. Advantages:

- interest rate of these loans is low

5.8.2. Disadvantages:

- collect loans is difficult

5.8.3. Users:

- public companies related to government

6. Factors affecting selection of appropriate strategy for financing of companies

In case of favorable economic conditions in country, borrowing loan and debt can be the best source of companies’ financing. But as you know, nowadays banks and capital market are two main axes of providing necessary capitals for manufacturing and investment companies. And Banks can no longer meet financial needs of various companies. Funding through bank resources increases liquidity and causes inflation. In fact capital markets can play a significant role in creating anti-inflationary policies. The best source for funding is financial and capital markets that Stocks Exchange Organization is responsible for this task in our country. Of course it should be mentioned that banks and capital market must be in line with achieving a common goal and do not go in opposite direction. Generally the role of capital market in the world is to collect the required liquidity in order to eliminate financial needs of companies on implementing their manufacturing products in the country’s economic development and domestic and foreign investment attraction frameworks in order to strengthen country’s economic bases and also create anti-inflammatory policies to prevent inflammation. Generally, the following cases should be considered in selecting a suitable strategy for providing company’s required resources:

- Resource consumption
- The cost and risk in each of financial methods
- Financial structure of company or institution (the ratio of debts to account holders’ rights)
- The situation of institution’s current debts (present debts due)
- Specific conditions of each of financing methods
- The situation of institution’s profitability and liquidity
- Economic conditions and its probable developments prospects

References

[1] Ghalebi Sadegh,“investigating relative advantage and prioritization of export target markets of skin and leather industries of Iran”, MA thesis on economic development and planning, Tabriz university(1383).

[2] Bank Hamed,”prioritization of Iran's textile industry problems" MA thesis, Amir Kabir industrial University.

[3] Hoseini Seyed Shamsedin and Malekmahmoodi Chehel Kahneh Maryam (1386), " evaluating the relative advantage and competitive of Iran's leather industry in global markets", Quarterly Journal of Business, No. 44, 235-265.

[4] Iranzad Soleyman and Mohammadpor Ali , “The opportunities and threats to Iran's joining WTO“,(1385).

[5] Publications: Management Development and Research “ Crisis Management”, (1386).

[6] Hossein Azimi Arani, Circuits of Under development in Iran’s Economy, Eleventh Edition.

[7] http://www.cbi.ir

[8] http://www.meta.ir

[9] http://www.gio.ir

[10] http://www.edbi.ir