**DEDAN KIMATHI UNIVERSITY OF TECHNOLOGY**

**SCHOOL OF COMPUTER SCIENCE AND INFORMATION TECHNOLOGY**

**BACHELOR OF SCIENCE IN BUSINESS INFORMATION TECHNOLOGY**

**3RD YEAR, 2ND SEMESTER (2022/2023 ACADEMIC YEAR)**

**BCM 2204 FINANCIAL MANAGEMENT**

**ASSIGNMENT 1**

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**Classifications of the sources of fund**

Sources of funds can be classified into four different ways

**Classification according to the duration for which the funds are retained;**

1. Long term sources of funds – they are held for longer period of time e.g. 25 years. They are either refundable or nonrefundable.
2. Permanent sources of funds – they are long term funds which are not refundable as long as the company is a going concern.
3. Short term sources of fund – there are fund held for a short period, for example 2 years and then they are returned refunded to the provider.

**Classification according to the origin**

1. Internal sources of fund – these are funds that are raised within the organization
2. External sources of fund – these are funds that are raised outside the organization

**Classification according to the relationship between the firm and the provider of capital.**

1. Common equity capital- these are funds provided by the owner of the firm, e.g ordinary share capital.
2. Quasi capital- these are fund provided by other people who are not owners of the firm. e.g preference share capital.
3. Debt finance- they are provided by the creditors. E.g. debt holders

**Classification according to the rate of return**

1. Capital with fixed rate of return – this is capital which a pre- specified rate of return is paid each period.
2. Capital with variable rate of return- different rates of return are paid each period depending on the firm’s performance. E.g. the common equity capital.

BASIS OF THE PERIOD

The different sources of funds can be classified into three parts on the basis of period. On the basis of period, sources of funds are;

1. Long-term Sources of Funds
2. Medium-term Sources of Funds
3. Short-term Sources of Funds

**Long term sources of funds**

They fulfill the financial requirements of a business for *a period more than 5 years.*

Such financing is generally required for the procurement of fixed assets such as plant, equipment, machinery etc. Long-term sources of funds include the following.

Shares

A share is the amount of capital to be raised from the public and is divided into units of equal values called SHARES: There are two types of shares

1. Equity shares - These are shares that do not carry any special or preferential rights.
2. Preference shares - Preference share capital is the capital raised by shareholders who are not the true owners of the company and combines features of equity and those of debt capital.

It is so called (quasi-equity) because it combines features of equity and those of debt. It is preference because it is preferred to ordinary share capital—this is because:

a. It is paid dividends first—preferred to dividend.

b. It is paid asset proceeds first—preferred to assets.

**Debentures**

A Debenture is a document issued by the company. It is a certificate issued by the company under its seal acknowledging a debt. It is a loan borrowed by a company from an individual and is sold in the same way as shared.

**Types of Debentures**

*Unsecured (Naked) debentures*: Unsecured debentures are not given any security on assets of the company

*Secured* – these are debentures which are secured against company assets either with a fixed charge, where some specific assets are used as securities or under floating charge, where all the assets generally used as securities, therefore cannot pledge any specific charge to a particular assets.

*Naked/unsecured* – they are not secured by any asset but on good/faith that the company will repay them on the due date Bottom of Form

. They rank after secured debentures.

*Redeemable* – the company can buy them at a given time or any time the company wishes to do so.

*Irredeemable* – they cannot be bought back by the business as long as it’s a going concern therefore they become a permanent source of funds.

*Convertible* – they can be converted into ordinary shares as per the agreement.

*Non convertible* – cannot be converted into ordinary shares or any other security but are usually redeemable.

*Subordinate* – they are subordinate because they rank amongst other debentures and are non-secured. They are treated like ordinary /general creditors during liquidation but rank before share capital in claim. They are attractive therefore issued by financially sound companies.

**Short-term Sources of Funds**

1. Bills of Exchange- Bills of Exchange are a source of finance in particular in the export trade. A Bill of Exchange is an unconditional order in writing addressed by one person to another requiring the person to whom it is addressed to pay to him as his order a specific sum of money.
2. Overdraft Finance - This finance is ideal to use as bridging finance in sense that it should be used to solve the company's short term liquidity problems in particular those of financing working capital (w.c.). Overdraft finance is an expensive source of finance and the over-reliance on it is a sign of financial imprudence as it indicates the inability to plan or forecast financial needs.

**Debt Capital**

Debt capital (Loan Finance) is a source of finance that it includes funds borrowed from external sources and usually attracts a fixed rate of return and is availed in limited quantities. Some of Its features include the following;

a) It earns interest at a fixed rate.

b) Holders do not have voting rights.

c) Redeemable at maturity.

d) Are usually secured.

Debt finance is a fixed return finance as the cost (interest) is fixed on the par value (face value of debt). It is ideal to use if there's a strong equity base. It is raised from external sources to qualifying companies and is available in limited quantities. It is limited to:

i. Value of security.

ii. Liquidity situation in a given country. It is ideal for companies where gearing allows them to raise more debt and thus gearing level.