SNS COLLEGE OF TECHNOLOGY

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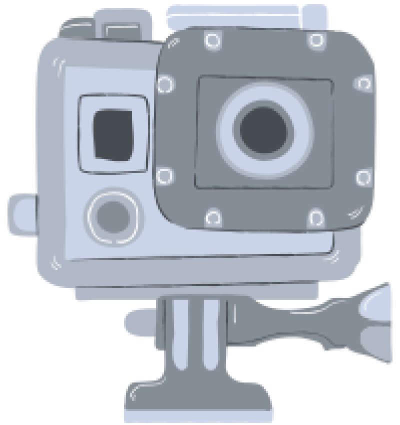
DEPARTMENT OF ELECTRICAL AND ELECTRONICS ENGINEERING

COURSE NAME: 19MEE301/ ENGINEERING ECONOMICS AND COST ANALYSIS

III YEAR / V SEMESTER

Unit 4 –FINANCING

Topic :SHORT AND LONG TERM BORROWING



SHORT TERM BORROWINGS

Definition:

Short-term borrowing refers to loans or credit that is expected to be repaid within a short period, typically less than one year. It is often used to cover immediate financial needs, working capital, or operational expenses.

Examples:

- **Bank Overdrafts:** A facility that allows a business or individual to withdraw more money than they have in their account up to an agreed limit.
- **Trade Credit:** A supplier allows a business to pay for goods or services at a later date, usually within 30 to 90 days.
- **Short-Term Loans:** Loans from banks or other lenders that must be repaid within a year.
- **Lines of Credit:** An agreement with a financial institution to provide access to a fixed amount of credit that can be used as needed.

SHORT TERM BORROWING

Advantages:

- **Flexibility:** Short-term borrowing provides quick access to cash, allowing businesses to meet immediate needs without long-term commitments.
- **Lower Interest Costs:** Since the borrowing period is shorter, the total interest paid tends to be lower than long-term loans.
- **Less Risk:** Because the repayment period is short, there is less risk of being affected by interest rate fluctuations or changes in economic conditions.

Disadvantages:

- **Higher Interest Rates:** Short-term loans often have higher interest rates compared to long-term loans, making them more expensive if not repaid quickly.
- **Repayment Pressure:** The need to repay within a short time frame can strain cash flow, especially if revenues are delayed.
- **Limited Amount:** The borrowing amount is usually smaller compared to long-term loans, limiting its usefulness for larger investments.

LONG TERM BORROWING

Definition:

Long-term borrowing refers to loans or credit that is repaid over an extended period, typically longer than one year. It is often used to finance large capital investments, such as buying property, equipment, or expanding operations.

Examples:

- **Mortgages:** Loans secured by real estate property, typically repaid over 15 to 30 years.
- **Corporate Bonds:** Businesses issue bonds to investors, which are repaid with interest over several years.
- **Term Loans:** Loans from banks with fixed repayment schedules, usually over several years.
- **Equipment Financing:** Loans specifically designed for purchasing equipment, often repaid over the useful life of the equipment.

LONG TERM BORROWING

Advantages:

- **Lower Monthly Payments:** Since the repayment period is longer, monthly payments are generally lower, easing the burden on cash flow.
- **Larger Loan Amounts:** Long-term borrowing allows access to more significant amounts of capital, making it suitable for large investments or expansions.
- **Stable Interest Rates:** Long-term loans often come with fixed interest rates, providing certainty in repayment costs over the loan term.

Disadvantages:

- **Higher Total Interest Costs:** While the interest rate may be lower, the extended repayment period can lead to higher total interest payments over the life of the loan.
- **Long-Term Commitment:** Borrowers are committed to repayment for an extended period, which can be a burden if financial circumstances change.
- **Collateral Requirements:** Long-term loans often require collateral, such as property or equipment, which can be seized if the borrower defaults.

SUMMARY

- **Short-Term Borrowing** is ideal for immediate financial needs and operational expenses but comes with higher interest rates and repayment pressures.
- **Long-Term Borrowing** is suitable for significant investments and long-term projects, offering lower monthly payments but at the cost of higher overall interest and long-term commitment.

Both forms of borrowing serve specific purposes, and the choice between them depends on the borrower's financial needs, ability to repay, and long-term goals.

Thank You!