

Case Analysis

Direction: Analyze the case and answer the given questions.

Malaya Inc. Corp, one of the leading producers of meat products in the Philippines, was incorporated last 2015. In the initial years of operation, it was only restricted to the collection and distribution of beef. The company is considering adding chicken and pork in its product line. The company believes that it will gain a reasonable market share by offering a diverse range of meat products.

However, this will require P150 million to fund the expansion, an amount that will greatly impact the company's liquidity if this is to be sourced internally. The company has minimal debt and its return on equity is currently at 8% but is estimated to go up to 10% with the addition of new meat products, assuming the same debt to equity ratio is maintained. The company's owners would like to achieve a return on equity ratio of 10% due to the additional risk the company will entail from the product expansion.

The company's Chief Financial Officer, Eric Manalastas, is exploring various options to raise sufficient capital. He was able to identify the following options:

1. Generate funds internally from current business operations
2. Borrow money from the bank
3. Issuance of a commercial paper
4. Issuance of bonds
5. Offer additional authorized capital stock

Eric consulted you to help him identify the best option.

Questions (30 points):

1. Identify the advantages and disadvantages of each option **(5 items x 5 points)**.

Options	Advantages	Disadvantages
<i>Generate funds internally from current business operations</i>	The business won't have to take on further debt. By doing so, the company's current financial structure is preserved, and the risk brought on by excessive debt levels is reduced.	It will adversely influence the company's cash flow, which might be used for working capital requirements or for potential investments. In the short term, this can limit the company's flexibility and the ability for growth.
<i>Borrow money from the bank</i>	Borrowing money from the bank provides Malaya Inc. Corp with immediate access to funds. Unlike sourcing funds internally, borrowing externally helps preserve the company's liquidity.	The company must meet regular repayment obligations, which could strain finances and make the company vulnerable to economic downturns or unforeseen setbacks.

Options	Advantages	Disadvantages
<i>Issuance of a commercial paper</i>	Issuing a commercial paper helps preserve the company's liquidity. It allows them to maintain cash reserves for operational needs and emergencies and gives Malaya Inc. Corp a quick access to fund.	Refinancing risk, as commercial papers are short-term debt instruments, and failing to refinance or repay them upon maturity could lead to financial difficulties. Additionally, the interest rate on commercial papers is influenced by market conditions and the company's creditworthiness, meaning unfavorable conditions or a deteriorating credit rating could result in higher borrowing costs.
<i>Issuance of bonds</i>	Issuing bonds allows Malaya Inc. Corp to secure long-term financing for its expansion, providing stability and a longer repayment horizon compared to short-term options.	The company must meet periodic interest payments and repay the principal amount when bonds mature, which could strain its finances if not managed properly.
<i>Offer additional authorized capital stock</i>	Offering additional authorized capital stock has no interest costs, unlike debt financing options like bonds or loans.	Issuing additional capital stock typically requires approval from existing shareholders, which may not be guaranteed and could delay the funding process. Moreover, when new shares of stock are issued, existing shareholders' ownership may potentially reduce their control and earnings per share.

2. Which do you think is the best option to be taken by the company? Justify your answer. (1 item x 5 points)

The best option for the company is to borrow money from the bank. This option allows Malaya Inc. Corp to quickly access the required P150 million, maintaining ownership and control. Additionally, it can take advantage of tax deductions on interest payments.

Rubric for grading:

CRITERIA	PERFORMANCE INDICATORS	POINTS
Content	The answer is based on principles of economics and finance which is supported by facts and real-life examples.	3
Organization of Ideas	The answer is concise.	2
Total		5