

Undergraduate Diploma in Business Administration

Module 03 Financial Analysis MQF Level 5 (8 ECTS)

Lecture 5

Phase 2: Management, Funding, & Internal Decisions



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Learning Outcomes

1



Identify and classify main sources of finance for Maltese / EU businesses — internal vs external, short vs long-term.

2



Explain how bonds and shares work mechanically, and how each appears on the Balance Sheet.

3



Calculate basic cost of finance (bond interest, dividend yield) and understand gearing / leverage.

4



Differentiate management accounting from statutory financial accounting — purpose, audience, timing, format.

5



Apply these concepts to realistic Maltese and European business scenarios.

Scenario

CLASS DISCUSSION

*Imagine you open a **kiosk** on the **Sliema promenade** selling pastizzi and coffee. What do you need **BEFORE** you sell your first cup?*



Why does a business need finance?

Finance is needed at three distinct moments in a business's life:



STARTING UP

Premises, equipment, stock, licences, initial marketing, working capital for the first months.



OPERATING

Paying suppliers, wages, utilities, rent, VAT — while waiting for customers to actually pay you.



GROWING

Opening a new branch, acquiring a competitor, going online, investing in new machinery.

Key definition

Sources of finance are the channels from which a business obtains the money it needs. Every euro on the right-hand side of a Balance Sheet (liabilities + equity) came from a source of finance.

The Two Big Families: Internal vs. External

Pizza Example

Internal = cash in your own pocket.

External = borrowing from a flatmate, asking mum, or using a credit card. Same pizza — very different consequences.

INTERNAL

Money already inside the business. No outside party required, no debt created.

- ✓ Retained earnings (kept profits)
- ✓ Sale of assets (old van, machinery)
- ✓ Tighter working-capital management

No interest · No repayment · No loss of control

But: limited by how much profit you've actually made.

EXTERNAL

Money from outside the business. Splits into DEBT (repay with interest) and EQUITY (give up ownership).

- ➔ Bank loans, overdrafts, trade credit
- ➔ Shares (equity) · Bonds (debt)
- ➔ Grants, VC, crowdfunding, leasing

Scales with ambition · Many options · But adds cost or dilutes owners

Dimension	INTERNAL Finance	EXTERNAL Finance
Where the money comes from	Generated by the business itself	Obtained from outside parties
Cost	Low or zero explicit cost	Interest, dividends, fees
Control / ownership	Owners keep full control	May have to share control or repay
Speed of access	Usually immediate	Can take weeks or months
Limit	Limited by size of the business	Can be very large
Risk to business	Low	Higher — repayment obligations

Internal Sources of Finance

Internal finance comes from within the business itself. It does not require any outside party to agree, and it does not create any debt. The three main internal sources are:

- 1. Retained Earnings**
- 2. Sales of Assets**
- 3. Working Capital**





(a)

Retained Earnings

Profits kept in the business



Appears in Equity on the Balance Sheet. No interest, no repayment — but limited to profits already earned. A brand-new business has none yet.

When a company makes a profit, it can do one of two things with it:

1. distribute it to owners (as dividends), or
2. keep it in the business.

Profits kept in the business are called retained earnings and appear in the Equity section of the Balance Sheet.

Retained Earnings

Advantages

- no interest cost, no repayment, no loss of control, available immediately.



Disadvantages

- limited to however much profit the business has actually earned; using it means shareholders receive smaller dividends; a new business has no retained earnings yet.



Farsons Example





(b)

Sale of Assets

Convert what you own into cash



Sell an old delivery van, machinery, property, or even a subsidiary. Works once per asset — may sell at a loss if you're rushed.

- A business can raise cash by selling something it already owns but no longer needs — an old delivery van, a piece of machinery, a second property, or even a subsidiary company. This converts an asset into cash without borrowing.

Sales of Assets

Advantages

- no interest, no new obligations.



Disadvantages

- you can only do it once per asset; the asset may have been productive; may sell at a loss if rushed.



Hotel/ Hospitality sector Example





(c)

Working Capital

Free up cash you already have



Stock less inventory · Collect from customers faster · Negotiate longer payment terms with suppliers. Free cash, no borrowing.

- Working capital is the money tied up in day-to-day operations: inventory on the shelves, amounts owed by customers (receivables), minus amounts owed to suppliers (payables). By managing these better, a business can free up cash without borrowing a cent.

Working Capital

Reduce Inventory

- stock less, order more frequently. Cash no longer sitting on shelves.

Collect receivables faster

- chase late-paying customers, offer early-payment discounts.

Negotiate longer payables

- pay suppliers after 60 days instead of 30.



Working Capital – Flour scenario

External Sources of Finance



Bank Loans

BOV, HSBC Malta, APS, BNF. Usually secured on property.



Overdrafts

Go 'into the red' up to an agreed limit. Interest on use only.



Trade Credit

Buy now, pay supplier in 30 / 60 / 90 days. Effectively free.



Share Issues

Sell part-ownership in the company. Covered in Block 3.



Bonds / Debentures

Formal IOUs with fixed interest. Covered in Block 3.



Leasing / HP

Pay monthly to use the asset rather than buying outright.



Grants & EU Funds

Malta Enterprise, MDB, ERDF, ESF+, JEREMIE, EIF.



VC & Angels

Equity for high-potential start-ups. Big in iGaming & FinTech.



Crowdfunding

Many small investors via Kickstarter, Seedrs, ECSPR platforms.



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Group Discussion Questions





Internal and External - Game

Short term vs. Long-term finance

Alongside the internal/external question, every source of finance has a time dimension — how long the business has access to the money before it has to be repaid.

Category	Typical Duration	Used For
Short-term	Under 1 year	Day-to-day operating needs
Medium-term	1 to 5 years	Vehicles, equipment, mid-size projects
Long-term	Over 5 years	Buildings, major expansion, acquisitions

For simplicity we focus on the two extremes: short-term and long-term



Short-Term Sources

Short-term finance covers the cash gaps in normal operations. Flexible, quick to arrange, paid back within a year.

	(a) Bank Overdraft	Most common short-term tool in Malta. Only pay interest on what you actually use.	Most flexible
	(b) Trade Credit	Free if paid on time — but late under EU Directive 2011/7 triggers ECB+8pp statutory interest.	Free (if on time)
	(c) Short-term Bank Loan	Fixed schedule under 12 months. Bridges a specific gap (e.g. awaiting government tender payment).	Structured
	(d) Invoice Factoring	Sell unpaid invoices to a factor at ~95%. Get cash today; factor collects from customer.	For exporters
	(e) Credit Cards	Quick & flexible — 15-20% APR typical. Good for small purchases, painful if you roll balance.	Small amounts

Long-Term Sources

Long-term finance funds things the business will own and use for years — property, production lines, whole subsidiaries. Match the finance life to the asset life.

	(a) Commercial Mortgage	10 / 15 / 25 years, secured on property. Malta rates 2026: ~4-6% depending on risk profile.	10-25 yrs
	(b) Bonds / Debentures	5-15 year maturity, fixed coupon. Many Maltese companies list bonds on the Malta Stock Exchange.	5-15 yrs
	(c) Ordinary Shares	Permanent finance — shareholders are never repaid. The longest possible source of money.	Permanent
	(d) Retained Earnings	Reinvested profits also belong to the business indefinitely.	Permanent
	(e) Leasing & Hire Purchase	3-10 year terms. Matches the useful life of equipment being leased.	3-10 yrs

EXAMPLE — A mismatched disaster

A restaurant owner in St Julian's bought kitchen equipment worth €80,000 (useful life: 8 years) using her business credit card at 17% APR. Within a year, the interest charges alone were crippling the business. The correct tool would have been a 5-year equipment loan at 5%. Same €80,000, but dramatically different outcomes — simply because the finance was mismatched to the life of the asset.



CASE STUDY — MIDI plc — Tigné Point funding

- MIDI plc developed the massive Tigné Point project in Sliema over many years. A project of this scale — apartments, retail, parking — cannot be built on an overdraft. The funding structure MIDI disclosed in its annual reports combined:
 - Long-term bank facilities over 10+ years.
 - Listed corporate bonds on the Malta Stock Exchange.
 - Shareholders' equity — including reinvested profits from phased property sales.
- Customer deposits — buyers paying staged deposits during construction (a form of advance trade credit from customers).
- Every euro used to build Tigné had its maturity matched to the cash flows the project would produce.



Choosing the Right Source — The Decision Framework

- When advising a business on which source to use, four questions drive the decision:

1.Purpose: what is the money actually being spent on? (Short-life expense vs. long-life asset vs. permanent investment.)

2.Cost: what is the effective interest rate, including fees and tax effects?

3.Risk: can the business reliably meet the repayments? What if sales drop?

4.Control: are the owners willing to dilute ownership in exchange for equity?



Group Discussion Questions





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Finance Matchmaker - Game

Bonds and Stocks

Objective: We will understand how bonds and shares work mechanically, how each is recorded in the Balance Sheet, and how they shape a company's capital structure.



Bonds and Stocks

'If I asked you right now to give me €1,000, what would you want in return to say yes?'



Two Fundamentally Different Ways to Raise Big Money

- When a company needs large, long-term external finance, it has two classic options — and the choice between them is one of the most important in all of corporate finance.

Feature	BONDS (Debt)	SHARES / STOCKS (Equity)
What it is	Borrowing — you owe money	Ownership — you sold a slice of the company
Investor becomes	A creditor (lender)	A shareholder (part-owner)
Return to investor	Fixed interest (coupon)	Dividends (if declared) + capital gain
Return certainty	Contractual — must be paid	Discretionary — may be zero
Repayment	Principal repaid at maturity	Never repaid (permanent)
Voting rights	None	Yes (ordinary shares)
Balance Sheet location	Non-current liabilities	Equity
If company fails	Paid before shareholders	Last in line — often get nothing
Tax treatment (company)	Interest is tax-deductible	Dividends are NOT tax-deductible

Bonds – A Deep Dive

What is a bond?

- A bond is a formal IOU issued by a company (or government). The issuer promises two things to the buyer:
 1. To pay a fixed rate of interest (called the coupon) each year.
 2. To repay the original amount borrowed (called the face value or principal) on a specific future date (the maturity date).



Bonds

The four essential terms of any bond

- Face Value (Par Value / Principal) — the amount printed on the bond; usually €100 or €1,000 per bond in Malta.
- Coupon Rate — the annual interest rate as a percentage of face value.
- Maturity Date — the day the issuer repays the face value.
- Issue Price — what the investor actually pays to buy the bond (often, but not always, equal to face value).

Bond Example – Mediterranean Foods Plc



Bonds Terminology

Debenture

In Malta/UK tradition: a SECURED bond — backed by specific assets.

Coupon

The fixed interest rate. Historically, bonds had paper coupons that investors clipped off.

Yield

The effective return if you buy at today's market price (may differ from face value).

Secured vs Unsecured

Secured = has collateral. If the issuer defaults, holders claim the asset.

Gilt / MGS

UK = Gilt. Malta = Malta Government Stock — virtually risk-free government bonds.

Credit Rating

Moody's / S&P rate issuers AAA (safest) down to D (default). Lower rating = higher coupon required.

How bonds are recorded in the books

Account	Debit (€)	Credit (€)
Cash (Asset)	3,000,000	
Bonds Payable (Non-current Liability)		3,000,000

How bonds are recorded in the books

On the Balance Sheet after issue:

- **Assets** increase by €3,000,000 (more cash).
- **Liabilities** increase by €3,000,000 (bonds payable).
- **Equity** is unchanged.

Each year, when interest is paid:

- **Interest expense** appears in the Income Statement, reducing net profit.
- **Cash** decreases in the Balance Sheet.
- **Tax benefit:** interest is deductible for corporation tax purposes, so the 'true' cost is lower.

Case Study – Hili Properties Bond Issue



Hili Properties p.l.c. is a well-known Maltese listed property group. The company has used bond issues on the Malta Stock Exchange multiple times to fund property acquisitions across Malta and overseas.

Why bonds and not a bank loan?

- Bonds can raise tens of millions in a single issue — larger than most bank loans.
- Fixed rate for the whole term — protection against rising interest rates.
- No single bank relationship — funds come from many retail and institutional investors.
- Usually only principal is repaid at maturity — 'bullet' repayment — easier for cash flow.
- *For ordinary Maltese households, MSE-listed corporate bonds are one of the main ways they can earn more than bank deposit rates — which is why prospectus launches often attract massive oversubscription.*



SHARES — A Deep Dive



DIVIDENDS

A portion of profits — but ONLY if the directors declare one. Not a contractual obligation like bond interest.



VOTING

At the Annual General Meeting. Usually one vote per share. Elect directors, approve dividends, auditors, etc.



RESIDUAL CLAIM

If the company is wound up, you get a share of whatever's left AFTER all debts (including bondholders) are paid.

ORDINARY SHARES

Voting rights · variable dividend · LAST in liquidation. The 'standard' shares.

Nominal value (e.g. €0.10, €1.00) ≠ market price. The share premium is whatever you collect above nominal value.

PREFERENCE SHARES

Hybrid: FIXED dividend, paid BEFORE ordinaries. Usually no voting.

Paid before ordinaries in liquidation. Feels a bit like a bond — but is still legally equity.

Shares – Key Terminology

- **Nominal value (par value):** the face value written on the share, often €0.10 or €1.00 in Malta. This is NOT the market price.
- **Share premium:** the amount received above nominal value when shares are issued. If the nominal value is €1 and shares are issued at €3.50, the premium is €2.50 per share.
- **Market price:** what shares trade for on the stock exchange today. Fluctuates constantly.
- **Authorised share capital:** the maximum number of shares the company is allowed to issue under its statute.
- **Issued share capital:** the number actually sold to shareholders.



Example – Issuing Shares – Chocolate factory plc

Account	Debit (€)	Credit (€)
Cash (Asset)	2,000,000	
Share Capital (Equity)		500,000
Share Premium (Equity)		1,500,000

On the Balance Sheet after issue:

- **Assets** increase by €2,000,000 (cash).
- **Liabilities** are unchanged.
- **Equity** increases by €2,000,000, split between Share Capital and Share Premium.

Critical insight

A bond issue increases LIABILITIES. A share issue increases EQUITY. That single difference ripples through every ratio, every risk calculation, and every decision a finance manager ever makes.

Dividends

Unlike bond interest, dividends are not a contractual obligation. Directors decide each year whether to declare a dividend and how much. In Malta, dividends are usually paid twice a year — an 'interim' dividend and a 'final' dividend.

Accounting treatment when a dividend is declared and paid:

- **Retained Earnings** (in Equity) decreases.
- **Cash** decreases.
- **Important:** dividends are paid out of RETAINED EARNINGS, not from the Income Statement. They are not an expense — they are a distribution of after-tax profit to owners.



Capital Structure

What is capital structure?

- Capital structure is the mix of debt (bonds, long-term loans) and equity (shares, retained earnings) that a company uses to finance itself. Look at any Balance Sheet — the right-hand side tells you the capital structure.



EXAMPLE — A simplified Balance Sheet

Company ABC Ltd (extract in €)

EQUITY & LIABILITIES	Amount (€000s)
Ordinary Share Capital	500
Share Premium	1,500
Retained Earnings	2,000
Total Equity	4,000
Corporate Bonds (long-term)	3,000
Bank Loans (long-term)	1,000
Total Non-current Liabilities	4,000
Trade Payables & Overdraft	2,000
Total Current Liabilities	2,000
TOTAL EQUITY & LIABILITIES	10,000

Gearing

Gearing — also called leverage — measures how much of the company's capital comes from debt as opposed to equity. It is the single most-watched metric of capital structure.

Capital GEARING FORMULA

$$\frac{\text{Debt}}{\text{Debt} + \text{Equity}} \times 100$$

A company with €4m debt + €6m equity → gearing = 40%

Capital structure Gearing Ratio Example

- Using Company X figures: $4,000 \div (4,000 + 4,000) = 50\%$
- A gearing of 50% means half the long-term funding is debt, half is equity. Some analysts use a stricter formula (Debt $\div$ Equity); **always check which definition is being used.**



Gearing level	Interpretation	Risk
Below 25%	Low-gearred — very conservative	Low — but may be under-using opportunities
25% – 50%	Moderate — healthy for most industries	Balanced
Above 50%	Highly geared	Higher — vulnerable if profits fall

The Trade-off: Debt vs Equity

- Why not just fund everything with equity (no obligation to repay)? Or everything with debt (owners keep all the upside)? Because each has different consequences:

Factor	More DEBT (bonds)	More EQUITY (shares)
Cost	Lower (interest is tax-deductible)	Higher (no tax shield on dividends)
Risk of bankruptcy	Higher (must pay interest)	Lower (dividends are optional)
Control	Kept by existing owners	Diluted among new shareholders
Returns to existing owners	Amplified — positive AND negative	Spread across more shareholders
Best when...	Profits are stable and predictable	Cash flows are volatile or uncertain

Why leverage cuts both ways

Example

Two companies, both with €10 million of capital invested:

- Company A: 100% equity (€10m shares, no debt).
- Company B: 50% debt (€5m bonds at 5%), 50% equity (€5m).

Lets work it our and understand.



Case Study – Malta Stock Exchange



Group Discussion Questions



Build your company Capital structure - Game



Question 1

Mario's Pizzeria needs €5,000 for a new oven. Which is the cheapest option?"

- A) Bank loan at 7% interest
- B) Use savings already in the business
- C) Sell shares to a cousin
- D) Credit card at 15% interest



Question 2

A company borrows €10,000 from the bank. What happens on the balance sheet?"

- A) Cash goes up, loan goes up
- B) Cash goes up, equity goes up
- C) Cash goes down, loan goes up
- D) Nothing changes



Question 3

A bakery has €80,000 in loans and €20,000 in equity. What's its gearing?"

- A) 20%
- B) 50%
- C) 80%
- D) 100%



Question 4

Interest rates suddenly rise. Who is hurt the most?"

- A) A company funded mostly by shares
- B) A company funded mostly by bank loans
- C) A company with lots of cash savings
- D) A company with no debt at all





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Management Accounts vs. Financial Accounts

Up to now you've been learning what the OUTSIDE world sees about a company — audited financial statements. But what does the CEO see every Monday morning? The reason is fascinating.



Two Different Audiences, Two Different Accounts

Every company — from a village grocer to Ryanair — keeps essentially two sets of books. Not dishonest: legally required and logically necessary.



FINANCIAL ACCOUNTS

Audience	Shareholders, CfR, lenders, MFSA, public
Frequency	Annual (+ half-year for listed co's)
Governed	IFRS · Companies Act · EU directives
Format	Strictly prescribed — cannot be changed
Audited	YES — by independent auditor
Public	Yes — filed at Malta Business Registry
Focus	Historical — 'what happened'



MANAGEMENT ACCOUNTS

Audience	CEO, Finance Director, dept heads, board
Frequency	Monthly (or weekly / daily / real-time)
Governed	NOTHING STATUTORY — design your own
Format	Whatever helps — dashboards, tables, KPIs
Audited	NO
Public	Absolutely NOT — highly confidential
Focus	Past + Present + FUTURE — decisions

The core distinction

Financial Accounts answer: 'How did the company perform last year, for people OUTSIDE the company?'

Management Accounts answer: 'What decisions should I make right now, as a manager INSIDE the company?'

Side-by-Side Comparison

Dimension	Financial Accounts (Statutory)	Management Accounts (Internal)
Primary audience	External — shareholders, regulators, public	Internal — managers and directors
Frequency	Annual (+ half-yearly for listed)	Monthly, weekly, or real-time
Legal requirement	Yes — Companies Act & IFRS	No — fully voluntary in form
Standards	IFRS / IFRS for SMEs	None — tailored to the business
Level of detail	Aggregated (whole company)	Granular (by product, branch, person)
Time horizon	Backward (historical)	Mix of past, present, and future
Formats used	Balance Sheet, P&L, Cash Flow Statement	Variance reports, budgets, KPIs, forecasts
Audit	Required (by independent auditor)	Not audited
Confidentiality	Public document	Strictly confidential
Includes non-financial data?	Rarely	Very often — staff hours, customer numbers, waste %
Main purpose	Accountability & comparison	Decision-making & control

Example of same business, two views



Tools & Techniques Unique to Management Accounting

Budgeting

Targets BEFORE the period begins.

Variance Analysis

Actual vs budget — why the gap?

Costing

Marginal, absorption, ABC methods.

Break-even Analysis

How many units to cover fixed costs?

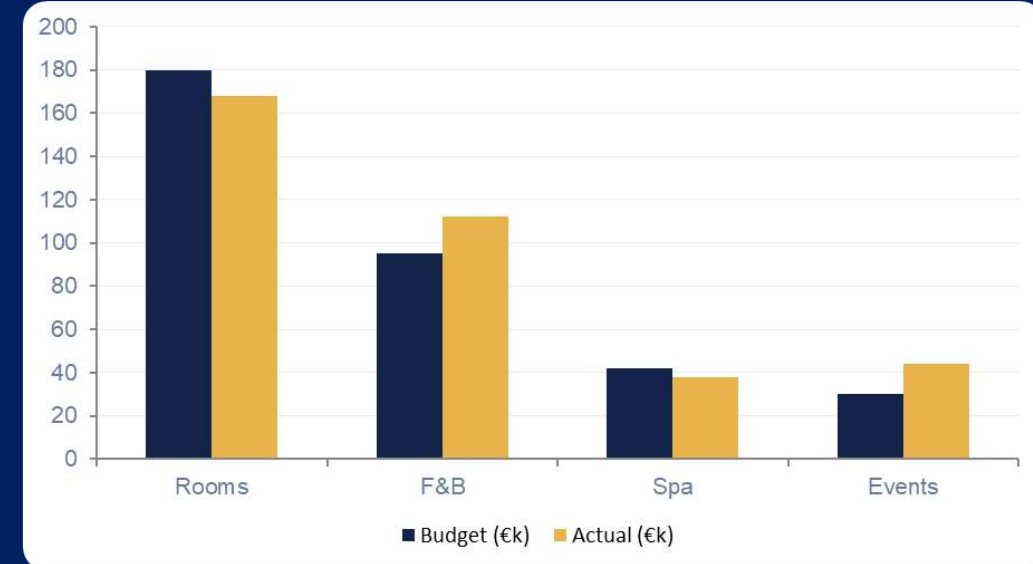
KPIs

Non-financial drivers of the business.

Forecasting

Predict the rest of the year or project.

Example: A Malta Hotel's June Variance Report



-€12k

ROOMS

Fewer bookings

+€17k

F & B

Banquets up

+€14k

EVENTS

Weddings

The MA lined to the Balance sheet

The answer is simple: everything on the Balance Sheet — the assets, the liabilities, the equity — was the end result of thousands of management decisions during the year. Management accounts are how those decisions get MADE; financial accounts are how the consequences get REPORTED.



Example one transaction, two views

A Gozo boutique hotel issued €500,000 of corporate bonds to buy a new annex.

In MANAGEMENT ACCOUNTING (before the decision):

- Forecasts of extra occupancy from the new annex
- Break-even analysis on the annex
- Sensitivity analysis on interest rate and occupancy assumptions
- Cash flow forecast showing when each coupon payment falls due



Example one transaction, two views

In FINANCIAL ACCOUNTING (after the year-end):

- Bonds payable €500,000 sits in non-current liabilities on the Balance Sheet
- Interest expense shown in the Income Statement
- Full disclosure in the notes — coupon, maturity, security
- **Both are true, both are necessary — and both describe the same transaction from different angles.**



What we covered

1

WHERE THE MONEY COMES FROM

Businesses raise money from INSIDE (retained earnings, asset sales, working capital) or OUTSIDE (loans, bonds, shares, grants, leasing) — for SHORT (< 1 yr) or LONG (> 1 yr) periods. Match the source to the need.

2

BONDS vs SHARES vs CAPITAL STRUCTURE

BONDS create liability, require interest, are tax-deductible. SHARES create ownership, pay discretionary dividends, are permanent. The mix between them is your CAPITAL STRUCTURE, measured by GEARING.

3

TWO SETS OF BOOKS

FINANCIAL accounts tell the outside world what happened (audited, public, yearly, IFRS). MANAGEMENT accounts help insiders decide what to do next (monthly, confidential, no rules). Both are vital.



Final Quiz



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