34 Lecture - MGT201

Important Subjective

1. **What is the Millar Modigliani theory, and how can it be applied to a company's capital structure decision?**
   Answer: The Millar Modigliani theory states that the value of a firm is independent of its capital structure. Companies can use this theory to determine the optimal mix of debt and equity financing to minimize their cost of capital and maximize their value.

2. **How do taxes affect a company's capital structure decision, and what is the trade-off theory of capital structure?**
   Answer: Taxes can make debt financing more attractive because interest payments are tax-deductible. The trade-off theory of capital structure suggests that there is an optimal level of debt financing that balances the benefits of tax shields with the costs of financial distress.

3. **What is the pecking order theory of capital structure, and how can it be used to explain a company's financing decisions?**
   Answer: The pecking order theory suggests that companies prefer to finance investments with internal funds first, then with debt, and finally with equity. This theory can be used to explain why companies may be hesitant to issue new equity, which can be perceived as a signal of poor investment opportunities.

4. **How does the agency cost theory of capital structure explain the potential conflicts of interest between a company's shareholders and debt holders?**
   Answer: The agency cost theory suggests that conflicts can arise when managers prioritize their own interests over those of shareholders or debt holders. Debt holders may be concerned that managers will take excessive risks that could harm the company's ability to repay debt.

5. **What is the signaling theory of capital structure, and how can it be used to explain a company's decision to issue new equity?**
   Answer: The signaling theory suggests that companies may issue new equity to signal their confidence in their future prospects. By raising new equity, companies are effectively putting their money where their mouth is and signaling to investors that they believe they have good investment opportunities.

6. **How does the market timing theory of capital structure explain a company's decision to issue new debt or equity?**
   Answer: The market timing theory suggests that companies may issue new debt or equity when market conditions are favorable, such as when interest rates are low or when there is high demand for new issuances.

7. How does the cost of capital affect a company's capital structure decision, and how can it be minimized?
   Answer: The cost of capital is the minimum return that investors require to invest in a company. Companies can minimize their cost of capital by finding the optimal mix of debt and equity financing that maximizes their value and minimizes their risk.

8. **What is the trade-off between debt and equity financing, and how can it be managed by companies?**
   Answer: The trade-off between debt and equity financing involves balancing the benefits of debt financing, such as tax shields, against the costs of financial distress, which can result from high levels of debt. Companies can manage this trade-off by finding the optimal level of debt financing that minimizes their cost of capital and maximizes their value.

9. **How can a company's growth prospects affect its capital structure decision?**
   Answer: Companies with high growth prospects may prefer to use more equity financing to avoid the risk of financial distress associated with high levels of debt. On the other hand, companies with stable cash flows may be more comfortable using debt financing to take advantage of the tax benefits.

10. **What is the relationship between a company's capital structure and its risk profile?**
    Answer: A company's capital structure can affect its risk profile by influencing the amount of financial leverage it uses. Companies with high levels of debt may be more susceptible to financial distress and bankruptcy, while companies with lower levels of debt may be more stable but have a higher cost of capital.