# JKAM Paper 2

There is seemingly no right answer when it comes to deciding on what your capital structure should be. There are too many factors such as the credit market, market outlook, and growth rate of the company, so on and so forth making a simple answer absolutely impractical. However, one can outline what the benefits and disadvantages of each capital structure mix, which we will simply break down to all equity, 50/50 debt/equity, and all debt, to get closer to which structure is most suitable. When financing with mostly equity you would be reducing each shares ownership level within the company - something that reduces investor confidence. While this would allow your company to get an interest-free cash payment with no need to pay it back it would reduce the per share value and in some cases may even lower overall market capitalization of the corporation. If you were to split your capital structure into 50/50 debt and equity you would find it to be a healthy amount for most industries and for companies with a decent growth rate. This would allow you to grow at an acceptable rate while allowing you to not have to pay back all of the money (equity-invested) but at the same time keep investors interest levels within the company the same. If you chose to do mostly debt you could leverage yourself too high. That would mean you could find that a small decrease in market value of your holdings could make your company insolvent, as you saw with the housing market crash of the late 2000s. Because of our current D/E ratio we have continued to go with continuing to grow the company with debt.

You have a choice to go with short term or long-term debt, but which is best? If you were to finance all with short-term bank notes you would have to keep a hawk-eye on your cash flow as a small decrease in your A/R collection rate could hurt the ability to pay your obligations on time. If you were to finance with all long-term bank notes you will end up paying more in interest over the long run but you would not necessarily have to worry so much on cash flow. Sometimes it is best to go with long-term or short-term depending what the spread on the interest rates are so you must use your best judgment and understanding of the business accordingly.

What’s best, no dividend, a small, moderate, or high dividend? We have continued to stick to a no dividend policy but if we were to offer a low, moderate, or high dividend policy we could expect the following results. If we were to go with a low dividend policy we would only use a small amount of cash, but we would lose out on that money that could potentially be reinvested in the company on say short-term marketable securities. However offering a dividend would bring in a different type of investor who more than likely will stick for the long term. Just as almost any corporation who has chosen to institute a dividend policy you tend to find it in companies that are confident in their business and are growing at a rate close to inflation. If you were to increase the dividend all the way to a moderate level you would be proving consistent dividends and by doing so producing a better level of confidence for your investors. If you were to go with a high dividend one could expect high volatility within the stock price and that could also be a detriment to cash flow since you may find yourself taking out loans (or the opportunity to pay off the loan early) by providing dividends that represent so much of your cash.