Q3 ⇒ What do you Understand by capital structure? Also Explain the theories of capital structure in brief.

A ⇒ In financial management, capital structure theory refers to a systematic approach to financing business activities through a combination of equalities and liabilities. There are several competing capital ~~struct~~ structure theories, each of which explores the relationship between dept financing, equity financing, and the market value of the firm slightly differently.

⇒ Net Income Approach to capital structure Theory :-

David Durand first suggested this approach in 1952, and he was a

Proponent of financial leverage. He Postulated that a change in Financial leverge results in a change in capital costs. In other words, If there's an Increase in the dept ratio, capital structure Increase, and the weighted average cost of capital (WACC) decrease, which results in higher firm value.

In this approach to capital structure Theary, The cost of capital is a function of the capital structure. It's Important to remember, however, that this approach assumes an optimal capital structure optimal capital structure Implies that at a certain ratio of dept an equity, the cost of capital is at a minimum, and the value of the firm is at a maximum