Ques:2 What is capital structure? Explain the various theories of capital structure. What is gordon model.

Ans Capital Structure -

The capital structure is the particular combination of debt & equity. used by a company to finance its overall operations and growth. Debt comes in the form of bond issues or loans, while equity may comes in the form of common stock, preferred stock, or retained earnings. Short term debts such as working capital requirements is also considerable to be part of the capital structure.

The following points will highlight the top four theories of capital structure:-

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(1) Net Income Approach (NI) -
(2) Operating Income Approach (NOI)
(3) Traditional Theory Approach.
(4) Modigliani Miller Approach (MM).

- According to (NI) Net Income Approach, a firm may increase the total value of the firm by lowering its cost of capital.

- The overall capitalisation rate of the firm $K_w$ is constant for all the degree of leverages.

- It is accepted by all that the judicious use of debt will increase the value of firm and reduce the cost of capital.

- According to MM Approach, it advocates that the relationship b/w the cost of capital, capital structure and the valuation of the firm should be explained by NOI by ~~bat~~ making an attack on the traditional approach.

* Gordon model -

The dividend discount model (DDM) is a price method of valuing a company's stock is worth the sum of all of its future dividend payments, discounted back to their present value. In other words, it is used to value stocks based on the net present value of the future dividends. The equation most widely used is called the gordon growth model (GGM).