

Example of report on capital structure case study

[Business](#), [Company](#)



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Brief Background to the Case

The current case about Medical Temps Inc. revolves around the issue of capital structure. Basically, the owners and the financial advisors are having an argument about the future capital restructuring plans for the Medical Temps Inc. Tiffany Radcliff, the owner of the company, believes that the company will experience not zero, but slowed growth in the upcoming years, due to external factors, such as a significant decrease in demand for temporary nursing workers which is what the firm is all about; a significant increase in firms offering similar services at competitive price ranges; and other indirect factors leading to two factors we mentioned. Paul Duncan, the financial manager advises Tiffany to consider using debt financing options, a move that would most likely be against the owner's will considering she has been a firm believer of equity financing since the business began.

Discussion and Analysis

In a nutshell, the two personas, Tiffany and Paul, are having dilemmas in figuring out the right mixture of capital structure that will be used to fund Medical Temps Inc.'s maintenance and expansion costs. Tiffany strongly advocates the use of equity financing while Paul suggests the use of debt

financing, up to a certain extent—depending on the results of his analysis, to balance out the pros and cons of being a largely equitized firm. According to Pearl et al. (2009), although calculations could indeed help decrease the likelihood of bankruptcy or shrinkage as a result of wrong financial decision making—specifically in the aspect of capital restructuring, capital structure inputs are more of guesstimates than exact numbers. The right mixture of capital structure should be based on the company's goals. Does it want to focus more on the stock price or does it aim to expand its product lines and services. In the case, it was not clearly established what the firm's goal was because it seemed that it was in a relatively stable position. However, for the sake of discussion let us assume that the company is indeed towards expansion.

As Paul's assistant, I would ask him and Tiffany to review the situation using different models of capital structuring. There are various models out there. However, the most important thing is to determine how to arrive at the optimal capital structure. There are two general ways in doing so: first, by maximizing WACC or the Weighted Average Cost of Capital and second, by maximizing the stock price. Approaching the present problem by focusing on either of these two methods would only lead to the same results. But in this case, it seemed that the firm has been more concerned in the stock prices. What Paul and Tiffany have to remember is that the type of financing schemes they employ would have direct impacts on the firm's stock price, and possibly its future.

According to the Trade-off theory, issuing more debt (Paul Duncan's way), can result to a significant increase in EPS or Estimated Profit per share. The

increase in EPS is generally perceived by investors as a measure of a company's profitability. Higher EPS means more profits—a scenario which would most likely attract investors. Attract more investors and the company could issue more stocks, a situation which goes according to Tiffany's pro-equity plan. However, the problem with relying too much on debt is the fact that too large amounts of debts would lead to increased leverage values, meaning, the investors would perceive the act of investing in the firm as too risky. Also having too much debt could lead to significantly lower stock prices. This is why according to the trade-off theory of capital structure, the firm must know the sweet spot where the balance between debt and equity financing costs and benefits exist. The decision may also be based on quantities. Ideally, the cost of capital should be as low as possible. In the analysis of the data, it appears that the cost of debt—25% is lower than the cost of equity—31%, for a 12, 500, 000 borrowed amount. The administrators can consider this in choosing the right mixture of capital structure for their assets. Either way, there indeed has to be a perfect balance if they want to maximize the firm's potential.

The best thing for the company as of now is to know what their goals are. If their goal is to expand their services in order to counter the projected slow growth in the upcoming years, then the best way they could start would be by continuing the capital structure strategy they used in the previous years, and then should they be able to agree on what Paul Duncan says, they could try and make some new changes—debt finances, in small increments. This would expose the company to fewer risks and would do minimal damage to

the stock prices and to the image of the company as an investment haven, should financial miscalculations occur.

References

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