Andreas Krause

The irrelevance of capital structure decisions

#### Company value

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The irrelevance of capital structure decisions



To assess the impact capital structure decisions have on company value, we can compare the value of companies with different levels of debt

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The irrelevance of capital structure decisions

Companies generate an identical surplus from its investment in the next time period

#### $\blacktriangleright V$

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The irrelevance of capital structure decisions

#### If a company has debt, its equity holders will only obtain the surplus

#### $\blacktriangleright \ E \to V$

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The irrelevance of capital structure decisions

- If a company has debt, its equity holders will only obtain the surplus less the loan repayment
- $\blacktriangleright E \to V L$

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If a company has debt, its equity holders will only obtain the surplus less the loan repayment including interest

 $\blacktriangleright E \to V - (1 + r_L) L$ 

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The irrelevance of capital structure decisions

Suppose an investor makes the same equity investment into the unlevered company as in the levered company

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The irrelevance of capital structure decisions



As both initial investments were identical, the outcome must be identical

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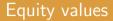
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The irrelevance of capital structure decisions



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The irrelevance of capital structure decisions



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The irrelevance of capital structure decisions

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