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Research on the Impact Mechanism and Optimization Path of Capital Structure on Enterprise Value

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Abstract: Capital structure, as the core issue of corporate financial decision-making, has a crucial impact on the enhancement of corporate value through its rationality in three key dimensions: financing costs, governance efficiency, and risk management. In the current process of China's economic transformation and upgrading, as well as the improvement of the capital market, some enterprises have problems with imbalanced capital structures, such as excessive reliance on debt financing to increase financial risks, concentration of equity leading to inefficient governance, and restricting the release of enterprise value. This article is based on the MM theory and the trade-off theory, using the normative research method to analyze the impact mechanism of capital structure on enterprise value through three paths: financing costs, corporate governance, and financial risks. Combined with the practical characteristics and constraints of China's enterprise capital structure, an optimization path is proposed. Research has shown that there is a non-linear correlation between capital structure and corporate value, and a reasonable structure requires achieving dynamic balance between debt and equity financing; Enterprises should combine their lifecycle, industry characteristics, and market environment to improve capital allocation efficiency by optimizing financing structure, improving governance, and expanding channels. The research provides practical reference for corporate capital structure decision-making and theoretical support for the improvement of capital market systems.

Keywords: Capital structure, enterprise value, influencing mechanism, optimization path, financing decisions.

1. Introduction

In a market economy, the enhancement of enterprise value is the core goal of business management, and capital structure is the key link between financing and operation. Its allocation efficiency directly affects the quality of enterprise survival and development. After China's economy shifted towards high-quality development, competition among enterprises has intensified and the financing environment has become diversified. Capital structure selection and optimization have become important means for enterprises to cope with risks and enhance competitiveness. Currently, there are structural problems with the capital structure of Chinese enterprises: small and medium-sized enterprises often face difficulties and high financing costs, and excessive reliance on short-term debt leads to insufficient financial flexibility; The concentration of equity in large enterprises is too high, the debt maturity is unreasonable, and some state-owned enterprises have low debt efficiency, which erodes the value of the enterprise.

In theoretical research, the impact of capital structure on corporate value is a core issue in the field of finance. The MM theory lays the foundation for research and balances theory, agency theory, and priority financing theory to improve the framework. However, there are differences in existing research: some believe that the debt financing tax shield effect enhances corporate value, while others emphasize that excessive debt risk suppresses value growth [1]. At the same time, existing research mostly focuses on single industries or large-scale enterprises, and there is insufficient exploration of the differential impact mechanism of capital structure on different types of enterprises, and the optimization path lacks operability.

Based on this, this article focuses on the correlation between capital structure and enterprise value, analyzes the influencing mechanism, sorts out problems, identifies constraint factors, and proposes an optimization path with theoretical and practical value. Research Approach: Define core concepts and theoretical foundations, analyze the transmission mechanism of capital structure on enterprise value, elaborate on the current situation and impact of capital structure in Chinese enterprises, identify optimization constraints, and propose optimization strategies. The innovation of this article is to combine the actual situation of China's capital market and construct the above complete analysis framework, providing guidance for optimizing the capital structure of enterprises.

2. The Core Concepts and Theoretical Basis of Capital Structure and Enterprise Value

Capital structure refers to the composition and proportional relationship of various types of capital in an enterprise, with the core being the allocation ratio of debt capital and equity capital, as well as extended dimensions such as debt maturity structure, equity concentration, and financing method selection. Debt capital is raised through bank loans, corporate bonds, commercial credit, etc., with fixed interest payment obligations and maturity repayment characteristics; Equity capital is formed through the issuance of stocks, retained earnings, and other means, and investors have the right to distribute surplus income and make business decisions. Enterprise value is the present value of a company's future cash flows, covering dimensions such as market value, intrinsic value, and book value. The core measurement criteria are maximizing shareholder wealth and the company's sustainable development capability.

The study of capital structure and enterprise value is supported by classical theories and forms a complete system. The MM theory is the starting point of research. In 1958, Modigliani and Miller proposed that capital structure is

independent of firm value under the tax-free assumption. In 1963, after revision, income tax was introduced, indicating that the tax shield effect of debt financing can reduce the weighted average cost of capital and enhance firm value. The trade-off theory, based on the MM theory, introduces financial distress costs and agency costs, and believes that when a company has an optimal capital structure - the debt tax shield effect - and balances financial distress costs and agency costs, the company's value is maximized.

Agency theory starts from the principal-agent relationship and analyzes the impact of capital structure on governance efficiency: under equity financing, agency conflicts between shareholders and management may lead to overinvestment by management, while fixed repayment obligations in debt financing can constrain management and reduce agency costs; However, excessive debt can lead to conflicts between shareholders and creditors, resulting in issues such as asset substitution and insufficient investment [2]. The theory of prioritized financing is based on the theory of information asymmetry, which clarifies the financing preference order of enterprises: internal financing is preferred, followed by debt financing, and finally equity financing is considered. This order can reduce financing costs under information asymmetry and indirectly enhance corporate value. These theories provide a solid basis for analyzing the impact mechanism of capital structure on enterprise value and optimizing capital structure.

3. Analysis of the Transmission Mechanism of Capital Structure on Enterprise Value

The impact of capital structure on enterprise value is indirectly transmitted through multiple pathways, with the core mechanisms being financing costs, corporate governance, and financial risk mechanisms, which are interrelated and jointly determine the direction and degree of influence.

The financing cost mechanism is the fundamental path. Enterprise value is the present value of future cash flows, and financing costs, as a discount rate, directly affect the magnitude of present value. The cost of equity financing is influenced by the expected return rate of shareholders: excessive concentration of equity can harm the interests of small and medium-sized shareholders and push up costs, while excessive dispersion can easily lead to excessive control by management and increase agency costs. The main cost of debt financing is interest expenses, and a reasonable debt size can reduce the weighted average cost of capital through the tax shield effect; But when the debt ratio is too high, creditors will demand a higher risk premium, pushing up the cost of debt. When the capital structure is optimal, the weighted average cost of capital is the lowest and the enterprise value is the highest. Imbalance pushes up costs and inhibits value enhancement.

The corporate governance mechanism is the core path. Capital structure shapes corporate governance and decision-making mechanisms by defining the ratio of stocks to bonds. In terms of equity structure, moderate concentration can avoid "insider control" and improve decision-making efficiency, while excessive concentration can easily lead to major shareholders encroaching on the interests of small and medium-sized shareholders and triggering governance conflicts; Introducing institutional investors can improve equity balance and enhance the level of governance specialization. In terms of debt financing, creditors will constrain corporate decisions through debt contracts, such as restricting high-risk investments and requiring regular disclosure of information, which can promote standardized management and reduce agency costs. A reasonable capital structure can create a synergistic effect between equity and debt governance, improve governance efficiency, and ultimately drive the growth of enterprise value.

Financial risk is an important constraint. The rigid repayment obligation of debt financing can easily lead to risks, and the inability to repay debts during business downturns may result in financial difficulties or even bankruptcy, directly damaging the value of the enterprise [3].A high proportion of short-term debt can exacerbate the pressure on capital turnover, and may trigger a crisis when market liquidity tightens; Excessive long-term debt weakens financial resilience and restricts a company's ability to respond to market changes. Although equity financing does not have rigid repayment pressure, excessive financing can dilute equity, lower shareholder returns, and trigger negative market expectations. The key to optimizing capital structure is to balance risk and return, and avoid the imbalance between the two affecting enterprise value.

4. The Current Situation of Capital Structure in Chinese Enterprises and Its Practical Impact on Enterprise Value

At present, the capital structure of Chinese enterprises presents obvious structural characteristics, with prominent differences between enterprises of different sizes, industries, and ownerships, and widespread imbalances, which have a complex impact on the value of enterprises.

In terms of financing structure, it is common for debt financing to account for a high proportion. According to financial statistics from the People's Bank of China, credit accounts for over 60% of corporate financing in the long term, bonds account for about 20%, and equity accounts for less than 20%. Excessive reliance on debt has led to high asset liability ratios for some companies, with traditional manufacturing and real estate industries generally having debt ratios exceeding 60%, and some exceeding 80% [4]. High debt increases interest expenses, squeezes profits, and concentrates financial risks. During economic downturns, it is easy to trigger debt defaults. In recent years, some real estate companies have fallen into operational difficulties due to excessive debt, resulting in a significant decline in corporate value.

The equity structure is polarized: state-owned enterprises and family owned enterprises have high concentration of equity, with major shareholders holding over 50% of the shares and some holding absolute control. Although this improves decision-making efficiency, it can easily lead to major shareholders encroaching on the interests of small and medium-sized shareholders (such as transferring assets through related party transactions), reducing market recognition of enterprise value; Some listed companies have scattered equity and insufficient constraints from shareholders on management, resulting in "insider control". Management overinvests and blindly expands for their own interests, wasting resources and inhibiting value enhancement.

Unreasonable debt maturity structure is prominent: the proportion of short-term debt in enterprises is generally high,

with short-term loans and accounts payable accounting for over 70%, and long-term debt being low. The rigid repayment pressure of short-term debt can easily lead to tight cash flow, frequent refinancing pushes up costs and exacerbates liquidity risks; The insufficient long-term debt restricts the long-term project investment of enterprises, affects long-term value creation such as technology research and equipment updates, and weakens the sustainability of development.

Industry differences are obvious: capital intensive (manufacturing, infrastructure) enterprises have high debt ratio and rely on debt to support fixed assets investment; The proportion of equity in technology intensive (high-tech industries) is relatively high, but some small and medium-sized enterprises still face difficulties in equity financing due to narrow financing channels; Due to asset lightweighting, the service industry has a relatively balanced proportion of stocks and bonds, but some have been affected by external shocks and increased debt pressure. The inadequate adaptability of the capital structure industry hinders the release of enterprise value.

5. Analysis of Constraints on Capital Structure Optimization

The optimization of capital structure in Chinese enterprises faces multiple internal and external constraints, with intertwined factors that make it increasingly difficult to achieve synergy between capital structure and value enhancement [5].

The core issue in external constraints is the imperfect capital market system. China's capital market is still dominated by the main board, and multi-level markets such as the Growth Enterprise Market, Science and Technology Innovation Board, and New Third Board are not yet mature. The threshold for equity financing is high, and it is difficult for small and medium-sized enterprises to obtain funds through equity financing; The bond market has a single variety of products, high issuance thresholds, and insufficient liquidity. The credit bond market has a low tolerance for small and medium-sized enterprises, resulting in limited channels for corporate debt financing and an excessive reliance on bank credit. In addition, the market-oriented reform of interest rates has not been fully implemented, and the financing costs of enterprises are greatly affected by policy interest rates. The market-oriented pricing mechanism is not sound, making it difficult to accurately reflect credit risk and capital costs, which in turn affects the rational allocation of capital structure.

The policy and institutional environment constitute another important external constraint. The guidance of tax policies still needs to be strengthened, and the tax shield support of corporate income tax for debt financing is limited. The coverage of tax incentives for small and medium-sized enterprises is relatively narrow, which has failed to effectively stimulate the optimization of financing structure; Further improvement is needed in capital market regulation, as information disclosure standards are relatively loose and some companies engage in financial fraud and illegal operations, which undermine investor confidence and limit the activity of equity financing. At the same time, the development of the credit system lags behind, and the credit rating of small and medium-sized enterprises is not sound enough, making it difficult to reduce debt costs through credit financing and exacerbating the imbalance of financing structure.

In internal constraints, insufficient profitability of enterprises is a key bottleneck. Optimizing capital structure requires stable cash flow and profitability to support debt repayment and equity returns. Currently, some enterprises, especially small and medium-sized enterprises, are affected by intensified competition and rising costs, resulting in weak profits, low net profits, and a lack of internal financing capabilities. They have to rely on high cost external debt financing, forming a cycle of "weak profitability - excessive debt - high financial risk - value decline".

The insufficient level of financial decision-making and governance in enterprises also hinders optimization. Some enterprises lack a scientific capital cost calculation system, make blind financing decisions, focus only on short-term needs, and ignore long-term structural balance; Weak awareness of financial risk management, incomplete risk warning, and difficulty in responding to the impact of interest rate and market changes. At the same time, some enterprises have imperfect governance structures, insufficient functions of shareholder meetings, board of directors, and supervisory boards, and a lack of motivation and ability for management to optimize capital structure, resulting in long-term imbalances in capital structure.

6. Capital Structure Optimization Path Based on Enterprise Value Enhancement

Based on the current situation, constraints, and impact mechanism of capital structure on enterprise value in China, a targeted optimization path is constructed from five dimensions:

One is to dynamically adjust the financing structure and balance the allocation of bonds and stocks. Enterprises need to develop strategies based on their lifecycle and industry characteristics: during the growth phase, they should focus on equity financing and introduce venture capital and private equity to supplement funds and reduce risks; Moderately increasing the debt ratio in the mature stage and reducing costs through the tax shield effect; Reduce debt and optimize assets during the recession period, and activate capital through equity restructuring. At the same time, establish a dynamic adjustment mechanism to adjust the proportion of bond stocks based on market interest rates and operating performance, ensuring a reasonable weighted average cost of capital [6].

The second is to improve the governance mechanism and strengthen the governance effect of capital structure. In terms of equity structure, reduce the proportion of single shareholder shareholding, introduce institutional and strategic investors to form a balance, and improve the protection mechanism for small and medium-sized shareholders; In terms of debt governance, it is necessary to design debt contracts reasonably, clarify their purpose and binding terms, and strengthen cooperation between banks and enterprises; Simultaneously linking capital structure optimization with management performance to stimulate their enthusiasm.

The third is to broaden financing channels and enrich configuration options. Enterprises can utilize multi-level capital markets, and small and medium-sized enterprises can participate in the bond market by issuing debt instruments with optimized maturity through equity financing on the Growth Enterprise Market, Science and Technology Innovation Board, and other platforms; Innovative financing

methods, small and medium-sized enterprises rely on supply chain finance to obtain funding, while technology intensive enterprises reduce their dependence on traditional credit by pledging intellectual property and leasing financing; We also need to strengthen internal financing, increase retained earnings, and reduce external dependence.

The fourth is to strengthen financial control and improve the efficiency of capital allocation. Establish a scientific capital cost estimation system to avoid blind financing; Strengthen risk management, establish warning models to monitor key indicators, and balance the liquidity risk of bond maturity reduction; Improve capital efficiency, conduct investment justification, and ensure that funds flow towards high return projects.

The fifth is to leverage policy support and optimize the external environment. Enterprises can enjoy pre tax deduction of debt interest through tax incentives, while small and medium-sized enterprises can apply for inclusive financial support to reduce costs; Participate in the feedback of the capital market system and promote the improvement of the financing system; Relying on government and industry funds to obtain long-term funding and provide guarantees for optimization.

7. Conclusion

As the core of corporate financial decision-making, the rationality of capital structure is directly related to financing costs, governance efficiency, and risk control effectiveness, ultimately affecting the quality of enterprise value enhancement. The structural characteristics and imbalance of the capital structure of Chinese enterprises are essentially the result of the combined effects of internal and external constraints and decision-making deviations of the enterprises themselves - problems such as a high proportion of debt financing, polarization of equity structure, and unreasonable allocation of debt maturity, which are not only constrained by external environmental factors such as imperfect capital market system and insufficient policy and institutional guidance, but also related to internal factors such as weak profitability and inadequate financial governance level of enterprises.

The dynamic balance of debt and stock financing is the key to solving the imbalance of capital structure. This requires enterprises to adopt precise strategies based on their lifecycle and industry characteristics: focusing on equity financing to solidify the foundation during the growth period, moderately increasing the debt ratio to leverage the tax shield effect during the maturity period, optimizing the asset liability structure to activate capital during the decline period, and establishing a dynamic mechanism that adjusts with market interest rates and business performance. Expanding financing channels, improving governance mechanisms, and strengthening financial control are essentially providing institutional and capacity support for dynamic balance.

Optimizing capital structure is never a unilateral action of enterprises, but also requires the promotion of multi-level construction of the capital market, precise guidance of policies and systems, and continuous improvement of the credit system. Only through the joint efforts of enterprises, markets, and governments can financing constraints be overcome, and capital structures truly adapt to the development needs of enterprises. This not only improves efficiency through coordinated governance of stocks and bonds, but also builds a solid foundation for sustainable development through the balance of risk and return, ultimately achieving sustained growth in enterprise value.

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