

**Financial Management:**  
Optimum Capital Structure and Dividend Policy

E-Content prepared by  
Dr. Mohammad Anees  
Department of Business Administration,  
University of Lucknow, Lucknow  
Contact:  
Email [drmohdanees@gmail.com](mailto:drmohdanees@gmail.com)  
whatsApp no. 9415179375

**Optimum Capital Structure**

Meaning of an Optimum Capital Structure:

The capital structure which is the most suitable for a given business organization is known as the optimum capital structure.

**Important Factors/Considerations for an optimum capital Structure**

Following factors contribute to make the capital structure optimum for a given concern:

1. Profitability
2. Solvency
3. Flexibility
4. Conservatism
5. control

Profitability consideration is achieved when the components' and overall cost of capital (WACC) is reasonable in the capital structure. It leads to enhancement of profitability in the organization.

Solvency means that the company should be able to pay its long term debts easily out of its available assets. In order to ensure this the company should ensure that excess debt capital should be avoided to use in its capital structure so that it does not become difficult to pay them.

Flexibility means that the finance manager should always be in a position to alter or change the debt equity ratio its capital structure any time it feel necessary. It is done in order to avoid risk and optimize the profitability. Flexibility in the capital structure can be ensured by employing redeemable capital in the capital structure.

Conservatism here means to under utilize the fund raising capacity of the organization. This adds to optimacy in the capital structure by way of maintaining a positive image in capital market and for ensuring that some fund raising capital is still available for the business at the time of financial emergency.

Control means the decision making or voting right of shareholders in the company. This control of owners/shareholders should not be unnecessary diluted by way of adding more and more equity capital in the capital structure.

### Optimum Dividend Policy

Meaning of an optimum dividend policy:

Optimum dividend policy means that the company should formulate a dividend distribution and profit retention policy which fulfills the underlying objectives of the company as well as the objectives of shareholders of the company.

### Optimum Dividend Policy Considerations

Following consideration contribute in the optimum dividend policy of the organization:

1. Fulfilling Internal capital requirement of business
2. Meeting the dividend expectations of shareholders
3. Liquidity of business
4. Fulfilling legal rules/covenants
5. Availing profitable projects
6. Capital market conditions for raising fresh capital
7. Dividend policy of other competitors
8. Prevailing Inflation
9. Past dividend distribution behavior of the company
10. Control of shareholders