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Capital Structure Theory: Reconsidered

Abstract

In the mainstream of the academic field of finance, the Modigliani and Miller's (1958) proof of capital structure irrelevance theory, has been praised as the cornerstone of modern scientific finance. However, the capital structure irrelevance theory is based on a set of assumptions, which are both unrealistic and contradictory to the main assumption of the mainstream academic finance. This paper shows that by making more appropriate assumptions, capital structure becomes relevant. The paper, on a foundational ground, argues that since the results of sophisticated mathematical models change as soon as their underlying assumptions are changed, the claim about the scientific nature of the mainstream academic finance becomes questionable.