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The Practice and Strategy of Capital Structure Optimization under the Background of the Financial Crisis

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Abstract: In recent years, financial crises have occurred frequently worldwide, exerting a severe impact on the capital structure of enterprises. Affected by the financial environment, enterprises are confronted with problems such as narrowed financing channels, rising capital expenses and heavier debt repayment pressure. This paper, in combination with the changing patterns of enterprise capital structure under the financial crisis, summarizes how to optimize the enterprise capital structure of the company during the economic downturn to improve stability and enhance the ability to resist risks. It puts forward suggestions such as appropriately adjusting the ratio of liabilities to equity, broadening financing channels, improving cash flow management and constructing a flexible adjustment mechanism. It is hoped that this can provide certain assistance for improving the company's financial health and enhancing its ability to resist risks.

Keywords: optimization of capital structure; financial crisis; financing strategy

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1. Introduction

The capital structure of an enterprise is the core of its financial strategy and plays an important role in the survival and development of the company. During the financial crisis, enterprises may encounter problems such as difficulties in raising funds, high debt interest and capital costs, and an imperfect capital structure of the enterprise. Corresponding methods should be adopted to solve these problems. By accurately grasping and responding to the financial situation, and by adjusting the capital structure of the enterprise to enhance its risk resistance capacity and competitiveness in the market, in the face of the dynamic financial environment, adjusting the capital structure of the enterprise has become the main method to improve the stable operation level of the enterprise, which has profound theoretical and practical value.

2. Overview of the Background of the Financial Crisis

2.1. The Evolution Process of the Financial Crisis

Financial instability is mainly manifested as financial crises. The evolution of crises is not isolated, not a linear development in a single dimension, but a multi-dimensional development and also has circularity. After the Great Depression at the beginning of the 20th century, it was successively hit by the subprime mortgage crisis in 2008 and the financial "storm" following the impact of the COVID-19 pandemic in 2020. All these reflect the crisis in the financial market: Such as the explosion of the banking business chain caused by the bursting of the real estate bubble due to aggressive high-risk loans and financial innovation, which affected the international financial market, first the prices of financial assets dropped, then the credit market froze, investment and consumption decreased, and eventually led to an overall economic recession. Governments and central banks of various countries have attempted to prevent the spread and expansion of the crisis by taking rescue measures and monetary easing policies [1]. However, the more they alleviate the situation, the slower and more expensive it becomes. The development of the financial crisis has exposed the increasingly prominent characteristics of the global financial system being tight and vulnerable to shocks, and new problems in capital structure management have also emerged accordingly [1].

2.2. Macroeconomic Changes

The impact of the financial crisis is comprehensive, namely, economic growth slows down, the unemployment rate remains high, investment decreases and consumer confidence declines [2]. When a financial crisis occurs, both enterprises and individuals will encounter a situation of increased financial burden, and at this time, the phenomenon of credit crunch aggravates the impact of the above-mentioned adverse consequences. At this time, the government often eases the downward trend of the economy through fiscal policy tightening and monetary policy relaxation, which will lead to an increase in the burden of public debt and subsequently give rise to a new round of financial risks. However, the scale of trade and investment activities among countries has decreased, and the process of international trade integration has been impacted. The financial crisis has prompted countries to gradually realize the need to enhance the intensity of financial supervision and intensify the control over the capital adequacy ratio and liquidity risks of the banking industry. Under the new circumstances, the macroeconomic environment has become more complex and unpredictable. In this situation, when enterprises choose their capital structure, there exists a coexistence of risks and returns. Therefore, when optimizing the capital structure, a decision that weighs the pros and cons is required [3].

3. Analysis of the Impact of the Financial Crisis on Capital Structure

3.1. Contraction of Financing Channels

After the outbreak of the financial crisis, the liquid funds of global financial institutions shrank significantly, resulting in a sudden tightening of financing channels. The loan measures of traditional banks have become more stringent, and the loan application conditions have suddenly risen. Small and micro enterprises are even facing the predicament of difficult financing. It is precisely because investors in the market prefer risk-averse strategies that they have imposed certain restrictions on the means of raising stocks, resulting in a sharp decline in the number of bonds issued. Private equity and high-risk start-up projects have both shrunk significantly [4]. The deterioration of the financing environment has greatly affected the normal operation and development plans of enterprises. This not only deals a blow to the financing business of enterprises, but also traps them in the predicament of internal financing or reducing investment expenditure (see Table 1).

Table 1. Comparison Table before and after the Financial Crisis.

Financing channel	Availability before the crisis	Availability after the crisis
Bank loan	high	low
Equity financing	middle	low
Bond financing	middle	low
Private equity investment	middle	Extremely low

The contraction of financing channels not only aggravates the financial predicament of enterprises, but also leads to the premature release of the demand for capital structure adjustment, forming a vicious circle.

3.2. The Financing Cost Has Risen

In the context of the financial crisis, the overall risk premium of the market has risen significantly, leading to a simultaneous increase in the financing costs of enterprises. To control credit risks, banks have raised loan interest rates and additional conditions. As a result, the spread faced by enterprises when issuing bonds has widened, while equity financing has seen an increase in the cost of equity due to the sluggish market. Theoretically, the formula for Cost of Capital (WACC) is:

$$WACC = (\frac{E}{V} \times Re) + (\frac{D}{V} \times Rd \times (1 - Tc) \quad (1)$$

Among them, Re represents the cost of equity, Rd represents the cost of debt, Tc represents the income tax rate, and V is the total value of the enterprise. When Re and Rd are generally raised due to the increase in market risks, the overall $WACC$ rises, and the threshold for the return on enterprise investment also increases accordingly. The rising financing costs have led enterprises to be cautious about financing, resulting in a sharp decline in project investment. This ultimately affects the overall capital structure planning, making enterprises more inclined to reduce liabilities or adopt short-term self-raising funds to get through the crisis period.

3.3. Imbalance in Capital Structure

After the financial crisis occurred, the imbalance of the company's capital structure intensified. Especially for those enterprises that financed through debt borrowing, they will face severe capital pressure. Due to the financial crisis, the value of the company's assets has been continuously declining, and the amount of net assets has shrunk. However, in the short term, it is impossible to reduce the amount of liabilities. The asset-liability ratio keeps increasing, and the imbalance of the capital structure is mainly reflected in the relatively high proportion of liabilities and the lack of sufficient share capital. This will cause problems in both the company's debt-paying ability and credit capacity.

Enterprises with high debt and low credit ratings are more likely to be punished by the imbalance of capital structure. As a punishment for the imbalance of the capital structure, the decline in credit rating may lead to the obstruction of financing channels for highly indebted companies, the decline in financing capacity, and an increased possibility of insufficient liquidity [5]. This has reduced the financial quality of the company, made banks lose confidence in the company, and increased the probability of stock price decline and bond default. In the capital-intensive manufacturing and real estate industries, the deterioration of capital structure has become one of the main reasons for the bankruptcy and reorganization of a large number of companies. To withstand the crisis, after being punished, enterprises must promptly correct the debt structure of the company to increase the proportion of equity and improve the resilience and adaptability of the capital structure.

3.4. The Debt Repayment Pressure on Enterprises Has Increased

During a financial crisis, usually, the maturity of corporate debts, difficulties in refinancing and the rise in interest rates will all amplify the repayment pressure, making problems such as the pressure of working capital more prominent.

The common way to measure the debt-paying ability of an enterprise is to take the enterprise debt-paying ratio (DSCR) as the benchmark, and its calculation formula is as follows:

$$DSCR = \frac{\text{Net operating income}}{\text{The total principal and interest of debts payable}} \quad (2)$$

When DSCR < 1, it indicates that the enterprise's cash flow is insufficient to cover the maturing debts. Against the backdrop of the financial crisis, the DSCR of a large number of enterprises dropped rapidly, triggering a wave of debt defaults and bankruptcies (see Table 2).

Table 2. Changes in Solvency (DSCR) of Different Industries before and after the Financial Crisis.

Industry	Pre-crisis DSCR	Post-crisis DSCR
Manufacturing industry	1.8	0.9
Real estate industry	2.0	0.7
Energy industry	1.6	1.0

Due to the increased pressure of debt repayment, enterprises are forced to divest assets, reduce scale and borrow new loans to repay old ones, which has a relatively large negative impact on the capital structure and long-term development of enterprises.

4. Practices and Strategies for Optimizing Capital Institutions under the Background of the Financial Crisis

4.1. Optimize the Debt-To-Equity Ratio

Facing the impact of the financial storm, reducing the company's debt ratio and ownership ratio and adjusting the order of the company's asset composition are the first-stage tasks of the company's reorganization. The company needs to reduce the high risks and high costs brought about by high debts, lower the overall leverage of the company, and enhance the security and protection of capital. Relieve the pressure of concentrated debt repayment by means of repaying short-term loans in advance, adjusting the loan structure, and delaying the repayment cycle, while maintaining the liquidity of the repayment model. Expanding the company's own capital is also an important solution. By increasing the share capital, introducing strategic investors, and introducing convertible bonds, the capital strength of the enterprise itself can be enhanced. Maintaining profits, reducing cash dividends and enhancing the ability to raise internal funds are also important measures to increase the proportion of shareholders' equity (see Figure 1).

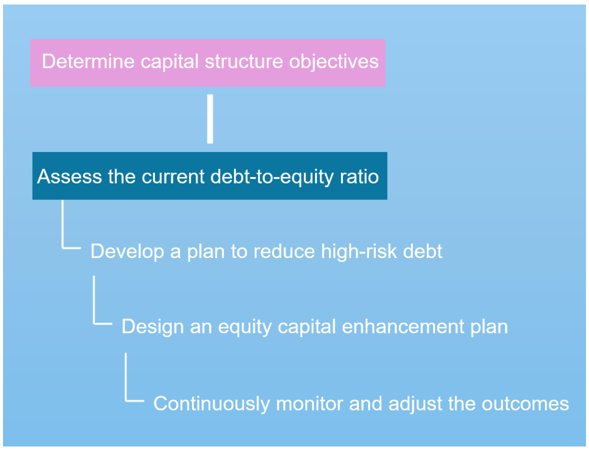

Figure 1. Flowchart of Capital Structure Optimization and Adjustment.

In actual operation, some enterprises effectively enhance their ability to resist financial risks by increasing share capital and expanding shares to achieve an increase in their own net value scale and a decrease in the debt ratio. Large enterprises adopt the form of quantitative additional share issuance to attract industrial investors. While enhancing their own strength, they also obtain opportunities for industrial resource cooperation, achieving a dual-purpose operational protection effect.

4.2. Expand Diversified Financing Channels

Broadening diverse financing channels is an important way to enhance the stability of an enterprise's financial structure. During the financial crisis, single-channel financing tools demonstrated a high degree of vulnerability. Therefore, enterprises should consciously reduce their excessive reliance on major commercial banks and proactively explore new financing channels, such as debt issuance, equity additional issuance, and convertible bond financing, in order to expand the coverage and depth of financing resources. Financing through the capital market can increase the borrowing amount, adjust the borrowing structure, reduce the overall borrowing cost and thereby enhance the resilience. By rationally choosing short-term and long-term, fixed-rate and floating-rate borrowings through different types of financing tools, a balance between liquidity and cost risk can be achieved. Supply chain finance has become a means of replenishment for small enterprises in times of crisis. Through innovations in financial tools such as accounts payable mortgage, order financing, and advance payment financing, enterprises can quickly realize the existing operating assets and improve the turnover of working capital.

4.3. Strengthen the Cash Flow Management System

Broadening diverse financing channels is an important way to enhance the stability of an enterprise's financial structure. During the financial crisis, single-channel financing tools demonstrated a high degree of vulnerability. Therefore, enterprises should consciously reduce their excessive reliance on major commercial banks and proactively explore new financing channels, such as debt issuance, equity additional issuance, and convertible bond financing, in order to expand the coverage and depth of financing resources. Financing through the capital market can increase the borrowing amount, adjust the borrowing structure, reduce the overall borrowing cost and thereby enhance the resilience. By rationally choosing short-term and long-term, fixed-rate and floating-rate borrowings through different types of financing tools, a balance between liquidity and cost risk can be achieved. Supply chain finance has become a means of replenishment for small enterprises in times of crisis. Through innovations in financial tools such as accounts payable mortgage, order financing, and advance payment financing, enterprises can quickly realize the existing operating assets and improve the turnover of working capital. To carry out supply chain finance, it is necessary to select reputable upstream and downstream related enterprises and build an efficient transaction model in order to reduce financing risks and borrowing interest. Large or medium-sized enterprises can also play a core role, helping suppliers obtain better financing conditions and promoting the improvement of the capital efficiency of enterprises throughout the supply chain.

The diversified strategic choices are inseparable from the support of new financing methods. Innovative financial tools such as new types of online financial services, asset securitization (ABS), lease loans, and equity crowdfunding provide a variety of financing channels for enterprises at different stages of development. Converting asset securitization into future cash flows can optimize the existing assets of enterprises, thereby enabling more funds to be invested in the main business. For companies with environmental protection or technological characteristics, such as green bonds and science and technology innovation bonds, specialized financial products can provide professional assistance to such enterprises, thereby increasing the financial support for their development prospects.

During the financial crisis period, the most effective policy for maintaining the stability of the capital structure and avoiding liquidity risks is to enhance the management of cash flow. In the actual operation process, an enterprise financial decision-making system is established with cash flow as the core, and cash flow is taken as the basic criterion for evaluating the enterprise's investment decisions, financing decisions and business decisions.

For the refined management of commercial cash flows, capital expenditure cash flows and debt financing cash flows, it is necessary to supervise each of the three respectively in specific work. For commercial cash flow, optimize the management of accounts receivable, accelerate the collection period, extend the payment period, and maximize sales revenue and minimize costs. Optimize the cash flow model by means of modifying credit policies, assessing customers' credit ratings, and coordinating supply and demand chains.

4.4. Establish a Dynamic Adjustment Mechanism

During the period of economic crisis, the external environment has changed rapidly. Enterprises should establish a sensitive and efficient dynamic adaptation and regulation mechanism, continuously improve the capital structure and enhance the resilience. The core lies in the dynamic analysis of financial indicators and the timely identification of potential risks, as well as the immediate implementation of capital structure change plans in response to environmental changes. Enterprises should establish a comprehensive capital structure management system, including key capital structure indicators such as the asset-liability ratio, asset-liability ratio, interest coverage ratio, current ratio and other financial indicators. They should periodically analyze data changes, determine the appropriateness and safety threshold of the capital structure, and formulate countermeasures in a timely manner after adverse conditions occur. Such as increasing the rapid reduction of short-term borrowing amounts, raising the proportion of long-term funds, or changing the fixed ratio and floating ratio in loan group cooperation. Flexible utilization of the financing structure is also an important means. In different cycles, equity financing, debt financing and retained earnings accumulation are utilized in a balanced manner to ensure the low cost of long-term borrowing when interest rates decline. Conversely, equity capital is moderately increased when the capital market is prosperous to maintain the balance between the cost of capital and the capital structure.

Enterprises should have certain financial emergency preparations, including emergency loan quotas for enterprises, emergency plans for issuing corporate bonds, and temporary emergency channels for private equity financing. These can inject liquidity into enterprises when there are significant changes in the financial situation, preventing further expansion of problems due to issues with the enterprise's capital chain.

5. Conclusion

In the face of a severe economic situation and financial pressure, enterprises must appropriately optimize their capital structure to maintain stable development. This mainly includes appropriately controlling the amount of debt and the proportion of ownership, expanding financing channels, strengthening the control of cash flow, and establishing a mobilizable system to effectively enhance the enterprise's ability to resist risks and the efficiency of capital operation. To achieve this goal, enterprises must have a good sensitivity to the health of their own financial situation and be able to continuously improve their adaptability to changing environments and self-recovery capabilities, so as to ensure the competitiveness of the enterprise and maintain healthy and sustainable development in various financial environments.

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