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MCI Communications Corp Case Study

Definition of the problem and analysis

The problem with the MCI Corporation is the poor performance of its stocks in the stock market. This is portrayed by the stock prices which are performing poorly and their prices are going down. This shows that the value of the company is also going down. This has led to loss of investors' confidence in the company shares. When the investors' loses confidence in the shares of a company the demand of its stocks in market goes down. Due to the law of demand and supply in any perfect market this low demand of MCI stocks has forced the share price to go down.

This problem is making the shareholders feel uncomfortable with their investment as they feel as if they are losing part of their investment. The poor performance has also led to reduced returns of the shareholders investment. This is because the company has resulted to paying low dividends as compared to other competing companies in the same business. The problem of share holders losing confidence in the future returns of the MCI Company may cause them to off-load the shares the company hold in the market to avoid any further risk. Incase such a scenario happens in market the company stocks are likely to go down further which will have further negative impact to the companies market performance.

Looking at this case we realize that in the company the earning are reducing and most of the problems are being attributed to the capital

structure and its capitalization. First we realize that MCI is the second largest long distance carrier in the country, due to its nature of business and competition it requires a large capital base. Considering the aspect of market capitalization and the nature of business I am of the opinion that MCI is suffering from market undercapitalization. This is the problem that has led to the sluggish performance of the MCI stocks in the market.

Recommendation

There are proposed two options to the company which she can use to redeem its market value. One is to repurchase it shares from the open market the other one is to implement a debt financing strategy. These two actions will have different implication to the performance of this company; let's have a look at each.

When a company wants to repurchase its shares from the open market it aims at reducing the amount of its shares in the market. The reduction of shares in market creates a low supply of its shares in market; a low supply is likely to raise the share prices in market. This action is likely to impact on the market share value and not on the earning of share in the market. This strategy can work best when the company is already well capitalized and wants to appreciate the value of the company stocks in the market.

The other option is the debt financing, this option will increase the dept -equity ratio. The action of raising the companies leverage results to increased shareholders income from their investment. When a company

is highly levered the earning per share of the company stocks raises.

Analyzing the both options the company has I would recommend the dept financing strategy option. Debt financing will create the investors confidence on the future prospects of the companies stocks earning. The share holders are likely to hold their stocks because they expect better future earning. This action will reduce the supply of stocks in market forcing the stocks prices to go up. This will work for the company because in comparison with the other market competitors the increased leverage will not have much of the negative impact in the company operations. 3) An analysis to back up both of them including financial/numerical analysis.

The MCI has a market capitalization of $18,398 million which is further below the two competitors in the same business, the Ameritech, and AT&T. This shows that it has a weak financial base which is affecting the investors' confidence in market. This is contributed by the fact that the capital base of a company has great effects on its operations and also in its stock market. The annual dividend the company is expected to pay of $0.005 is too low as compared to the other stocks in the market; this is together with the payout percent which is also low. These two outcomes are contributed by the poor performance of the company.

The MCI has a long term debt of $3,444 million and a total capitalization of $18,398 million this shows that the debt to equity ratio is still low as compared to other players in the market who are highly levered. This demonstrate that if this company increases its capital leverage it will still be within the market average. This is evidence that the company debt

financing will be able to push the future earning per share of the company stocks.