Weighted average cost of capital

Finance

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The cost of capital is an important phenomenon in determining the overall/weighted average cost of capital. In fact, the financial risk is judged by investors and other stakeholders in line with the cost of capital and nature of the capital structure. The overall cost of capital can be reduced and the value of the firm can be improved by maximizing the debt content in the capital structure. But, as debt content goes on increasing, equity investors' expectations about risk will also change. Investors feel risk in investment with highly levered firms and vice versa. Capital structure theories postulate the various possibilities of capital structure. It does not speak about which approach is most beneficial to companies in various situations. Capital structure is not a static phenomenon. It keeps on changing with every change in the mix of various sources of capital/fund. The profitability of a business proposal/ project can be evaluated in various ways using both discounted and non-discounted project evaluation methods. Discounted methods/Time value adjusted methods are the most popular and widely used ones because of their superiorities over traditional methods. Among the Discounted Methods, Net Present Value and Internal Rate of Return is the commonly used ones. However, all these methods depend upon how successfully the cash flows from projects are estimated or projected.