Finance essay

Business, Company

Weighted Marginal Cost of Capital

Weighted Marginal Cost of Capital is the cost of the last new dollar of capital raised by the firm. As a firm raises more and more capital, the costs of different sources of financing will increase. For instance, if a firm raises additional debt, the cost of debt will rise because of additional financial risk associated with debt financing. WMCC is calculated as follows:

WMCC: Weight of Debt* Cost of Debt(1- Tax Rate) + Weight of Equity* Cost of Equity

For instance, if the company has already issued a bond and existing bond covenants prohibits the company from issuing new series of bond with same senority as existing debt. Therefore, the company will have to issue more expensive subordinate bonds at higher interest rates. This will increase the cost of capital for the company. Similarly, after a certain level of debt financing, company is required to issue equity capital which again will be more expensive than retained earnings due to floataion cost associated with equity financing. In simple words, WMCC represents cost of additional source of financing while WMCC always increases as firm raises additional capital.

The schedule related with marginal cost of capital i. e Marginal Cost of Capital Schedule shows that WMCC for different amount of financing. Since additional sources of financing becomes more expensive, the WMCC schedule typically has an upward slope. Below is an example of WMCC Schedule:

Yes, the WMCC schedule will be always accurate because every additional source of capital will increase the marginal cost of capital of the firm.

Works Cited

Robinson, Thomas. " Cost of Capital." Institute, CFA. Corporate Finance.

Boston: Custm, 2011. 45-50.