



SNS College of Technology

Coimbatore - 35



23BAT611– Financial Management

Unit - III

COST OF CAPITAL & CAPITAL STRUCTURE

Presented by

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1st Indian Institution to Implement Design Thinking Curriculum
Redesigning Common Mind and Business Towards Excellence



Recall



Discussed Problem 4 related to Redeemable Debt



Topic



Equity Share
Capital



Preference Share
Capital



Debts



Retained
Earnings



Cost of Capital





Cost of Irredeemable Preference Capital



Problem : 5

A company issues 20,000 10% shares of Rs. 100 each. The issue expenses were Rs. 2 Per share.

Calculate the cost of preference share capital if the shares are issued

- a) At par
- b) At a premium of 10%
- c) At a discount of 5%



Cost of Irredeemable Preference Capital



Solution:

Cost of Irredeemable Preference Share Capital = Annual Dividend/ Net Proceeds

Annual Dividend

Rs.

Face Value of Preference share capital 100*20,000 = 20,00,000

Annual Dividend at 10% = 2,00,000



Cost of Irredeemable Preference Capital

Solution:

a) Shares Issued at Par

Face Value of Preference share capital	100*20,000	=	20,00,000
Less: Issue Expenses Rs. 2 *	20,000	=	40,000
Net Proceeds (NP)		=	19,60,000



Cost of Irredeemable Preference Capital



Solution:

Cost of Irredeemable Preference Share Capital = Annual Dividend/ Net Proceeds

Cost of Irredeemable Preference Share Capital = 2,00,000/19,60,000

Cost of Irredeemable Preference Share Capital = 0.102 or 10.2%



Cost of Irredeemable Preference Capital

Solution:

b) Shares Issued at a Premium of 10%

Face Value of Preference share capital 100*20,000	= 20,00,000
Add: Premium 10%	= 2,00,000
	= 22,00,000
Less: Issue Expenses Rs. 2 * 20,000	= 40,000
Net Proceeds (NP)	= 21,60,000



Cost of Irredeemable Preference Capital



Solution:

Cost of Irredeemable Preference Share Capital = Annual Dividend/ Net Proceeds

Cost of Irredeemable Preference Share Capital = 2,00,000/21,60,000

Cost of Irredeemable Preference Share Capital = 0.926 or 9.26%



Cost of Irredeemable Preference Capital

Solution:

c) Shares Issued at a Discount of 5%

Face Value of Preference share capital 100*20,000	= 20,00,000
Less: Discount 5%	= 1,00,000
	= 19,00,000
Less: Issue Expenses Rs. 2 * 20,000	= 40,000
Net Proceeds (NP)	= 18,60,000



Cost of Irredeemable Preference Capital



Solution:

Cost of Irredeemable Preference Share Capital = Annual Dividend/ Net Proceeds

Cost of Irredeemable Preference Share Capital = 2,00,000/18,60,000

Cost of Irredeemable Preference Share Capital = 0.1075 or 10.75%



Cost of Irredeemable Preference Capital



Problem : 6

A Ltd issues 10,000 9% preference shares of Rs. 100 each. The shares are redeemable after 10 years at a premium of 5%. Floatation costs are 2%.

Calculate the effective cost of redeemable preference share capital.

Solution:

Cost of Redeemable Preference Capital (RPS)

$$K_p = \text{Annual Cost} / \text{Average Value of Preference Capital}$$



Cost of Irredeemable Preference Capital



Face Value 100* 10,000	= 10,00,000
Preference Dividend 9% on 10,00,000	= 90,000
Add: Floatation Costs 2% on 10,00,000 = 20,000	
Floatation Costs p.a 20,000 / 10 years	= 2,000
Add: Premium on redemption 5% of 10,00,000 = 50,000	
Premium p.a 50,000 / 10 years	= 5,000
Annual Cost =====	97,000



Cost of Irredeemable Preference Capital



Average Value

Issue Price = 10,00,000

Less: Flootation Costs = 20,000

Net Proceeds = 9,80,000

Face Value = 10,00,000

Add: Premium on redemption = 50,000

Redemption value (RV) = 10,50,000



Cost of Irredeemable Preference Capital



Net Proceeds = 9,80,000

Redemption value (RV) = 10,50,000

Average Value = $NP + RV / 2 = 9,80,000 + 10,50,000 / 2 = 20,30,000 / 2 = 10,15,000$

Cost of Redeemable Preference Capital (RPS)

$K_p = \text{Annual Cost} / \text{Average Value of Preference Capital}$

$= 97,000 / 10,50,000 = 9.23\%$



Summarize

Cost of Irredeemable Debt





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