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 and Irredeemable Preference Share

Topic

Equity Share Capital

Preference Share Capital

Debts

Retained Earnings

Cost of Capital

Cost of Equity Share

Problem : 7

A company issues one crore equity shares of Rs.100 each at a premium of 10%. The company has been consistently paying a dividend of 18% for the past five years. Its expected to maintain the dividend in future also.

a. **Compute the cost of equity capital.**
b. **What will be the cost of equity capital if the market price of the share is Rs.200?**

Cost of Equity Share

Solution

Compute the cost of equity capital ke = D1/NP

D1 = Expected dividend per share = 18% on Rs. 100

= 100*18/100

= 18

Solution

Compute the cost of equity capital ke = D1/NP

NP = Net proceeds per share = Rs. 100 + Premium 10%

Premium 10% = 100*10/100

Premium 10% = 10

NP = Net proceeds per share = Rs. 100 + Premium 10

NP = Net proceeds per share = 110

Cost of Equity Share

Solution

Compute the cost of equity capital ke = D1/NP

Compute the cost of equity capital ke = 18 / 110 = 16.36%

Solution

If the market price is Rs. 200

Cost of equity capital ke = D1 / MP

D1 = Expected dividend = Rs.18

MP = Market Price = Rs. 200

Cost of equity capital ke = 18 / 200 = 9%

Cost of Equity Share

Problem : 8 Anand Ltd. Offers for public subscription equity shares of Rs. 10 each at a premium of 10%. The company pays an underwriting commission of 5% on the issue price. The equity shareholders expect a dividend of 15%.

a. **Compute the cost of equity capital.**

b. **What will be the cost of equity capital if the market price of the share is Rs.20?**

Cost of Equity Share

Solution

Compute the cost of equity capital ke = D1/NP

D1 = Expected dividend per share = 15% on Rs. 10

= 10*15/100

= 1.50

Cost of Equity Share

Solution

Compute the cost of equity capital ke = D1/NP

NP = Net proceeds per share = Rs. 10 + Premium 10%

Premium 10% = 10*10/100

Premium 10% = 1

NP = Net proceeds per share = Rs. 10 + Premium 1

NP = Net proceeds per share = 11

Cost of Equity Share

Solution

Less: Underwriting commission 5% = 11*5/100

= 0.55

NP = Net proceeds per share = Rs. 10 + Premium 1 = 11.00

Less: Underwriting commission 5% = 0.55

Net Proceeds Per Share = 10.45

Compute the cost of equity capital ke = D1/NP = 1.5/10.45 = 14.35%

Cost of Equity Share

Solution

If the market price is Rs. 20

Cost of equity capital ke = D1 / MP

D1 = Expected dividend = Rs.1.50

MP = Market Price = Rs. 20

Cost of equity capital ke = 1.50 / 20 = 7.5%

Problem : 9

The market price of an equity share of G Ltd. Is Rs. 80. The dividend expected a year hence is Rs. 1.60 per share. The shareholders anticipate a growth of 7% in dividends.

Compute the cost of equity capital.

Cost of Equity Share

Solution

Compute the cost of equity capital ke = D1/MP+G

D1 = Expected dividend per share = Rs. 1.60

MP = Market Price = Rs. 80

G = Growth rate in dividend = 7%

Compute the cost of equity capital ke = 1.60 / 80 + 7%

= 0.02 + 0.07 = 0.09 or 9%

Summarize

Cost of Irredeemable Debt

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