

PROBLEM 1: THE EFFECT OF A CHANGE IN THE COST OF CAPITAL



PROBLEM 2: THE EFFECT OF A CHANGE IN THE COST OF CAPITAL



PROBLEM 3: THE EFFECT OF A CHANGE IN THE COST OF CAPITAL

QUESTION: Suppose that the cost of capital for a firm increases. How does this affect the firm's value? How does this affect the firm's investment decisions?

ANSWER: An increase in the cost of capital will decrease the firm's value. This is because the firm's value is determined by the present value of its future cash flows, which are discounted at the cost of capital. A higher cost of capital means that the cash flows are discounted more heavily, resulting in a lower present value. This decrease in value will also affect the firm's investment decisions, as the firm will be less likely to invest in projects that have a lower net present value.

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