

## **ALTERNATIVE CONCEPTUAL AND DETERMINATIONS OF THE COST OF CAPITAL**

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**Abstract:** : The cost of capital is the result of two behaviors, one being that of the entrepreneur and the investor second. These behaviors converge in a common point, namely the maximization of enterprise value. Cost accounting reflects cash expenses actually incurred by the enterprise and the economic cost also includes those expenses that do not involve payments to third parties, such as labor consumption of the owner company. In general the cost of capital is highlighted in terms of the entrepreneur (entity) who, at closest" by issuing shares, or the decision to distribute profits to, and reserves. Equity cannot be removed by the cost impact of which is reflected in the development of the company's business. Research aimed at a less discussed issue both theoretically and in practice. Therefore, equity is the part of capital held by the developer on which to exercise their ownership, because it belongs to the shareholders and build upon the outcome of such capital mobilized. He belonged to either a person or an economic entity.

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**Key words:** critical; the cost of capital, land, capital and labor, cost of equity, equity capital

### **1. INTRODUCTION**

Economic and social development has a certain content and role for human society. It supports economic growth processes with the social reflection. Growth process is complex and involves factors and resources. Process in general, the economic process in particular, involves essentially three factors: land, capital and labor. Each of the three factors play a specific role and influence coupled with the aims are involved in the process.

Equity can not be separated from the cost of whose impact is reflected in the degree of development of society, of the company. The research addresses a subject little discussed in the theoretical but also practical plan. In this regard, we proposed orientation of research effort, in a way that we can highlight, sequentially and systematically, the main components that may contribute to elucidate the main impact of IFRS on equity rules.

We have structured research based on the concept of,," capital, structural components, the sources of establishing, to the market as a venue and then turning to look at equity, the main IFRS standards and their impact is reflect the complex process of economic and social development.

### **2. OBJECTIVES**

In everyday language, the notion of cost is,, the cost in money, to be supported for the benefit of a good or service, price to be paid for the purchase of a commodity." In the

scientific sense, the costs consist expression in money, effort and marketing businesses to produce goods and services, the consequences of their economic and environmental imbalances in market failures on the work and life, and waivers generated by choosing a variant of the possible allocation of resources."

Cost is also a very important economic indicator in the behavior of consumers and producers, who, before taking something, it asks how much?

In this respect the cost accounting reflects cash expenses actually incurred by the enterprise, and economic cost also includes those expenses that do not involve payments to third parties, such as labor consumption of the company owner, equity interest due, the appropriate use of building rents own, etc.

The economic cost includes the structure, the cost of explicit and implicit cost. First, indicate the costs incurred by the company and registered in the costs "actually paid" and the second, means expenditure or resource consumption not included in the cost of the developer actually paid by him", here it is: the expense of own labor in his business entity which is not recorded as salary what would be appropriate as part of the costs, the rent which ought to use their own buildings; interest that ought to use equity, etc.

Cost of capital is the result of two behaviors, one being that of the entrepreneur and the investor second. These behaviors converge in a common point, namely the maximization of enterprise value. Entrepreneur or enterprise is the expression of financing costs involved in the optimization of its financial strategy.

Diversity of investment options requires that financial resources should be based on estimating the value created by this conversion involving future flows of income into present value business that can generate these flows.

In the above context, investors and opportunity cost is one user is average, because we can not ignore the existence of financial structure, which leads to cost of equity and debt. Also, we must consider the characteristics of each national financial system as they can change the parameters determining the cost of capital. How the cost of capital in general, is identified by the present value of future flows of income, dividends and interest that are its main elements.

Dividend as a concept is closely linked to economic-profit category. Without profit we can not tackle the issue of dividend. Over time, occurred and have developed several theories about the dividend, which have established policies related to it.

There is a controversy about the financial decisions in the sense whether or not they are neutral on the cost of capital. Thus, from a point of view, that in an epistemological context, we distinguish two types of models.

First, based on a set of assumptions more or less restrictive, try offering a standard distribution of dividends. In this regard, Miller and Modigliani (1961) show that, in a perfect market, a rational investor will be indifferent between dividends and reinvestment of profits collection. Later, Brennan (1970) believe that dividends should not be distributed due to the difference in taxation (taxation of reinvested profits is small compared to the dividend).

Experts' opinion, these theories can be classified into three groups each characterized by a number of supporters, but failed to make any definitive and unquestionable explanation of dividend policy, universally accepted by the research or practitioner community.

The first group mainly prevail theoretical concept of neutrality of dividend policy in perfect market conditions. In the second group we have the necessity of reinvestment of profits .Theories employed in the third group, supporting the necessity of distributing

dividends. Theories on dividend policy allows us to detach a character, dual" of dividend, the,, "while the cost is distributed (allocated) but also, the source of financing "when he is arrested The economic entity. That was not distributed does not mean that it was canceled, it will be a complementary source of shareholder capital and already placed in his account will promise higher dividend in the future, noting the promise CAA does not mean certainty.

Self-financing is a technique which focuses mainly on internal funding, which provides its enterprise development, with its own forces, using for this purpose a portion of profit in the year expired and depreciation fund. The main sources of cash flow are depreciation, provisions and net profit. Shareholders made the process of saving, investment and reinvestment of net income from capital depreciation recovered or protected by provisions.

The amounts of undistributed net income to shareholders as dividends are declared as reserves. When these reserves have come to represent large amounts (the accumulation of previous years) may have incorporated management entity capital reserves and the allocation of free shares (being right about the award-DA) or increase the nominal value of shares held. Company achieves maximum self-financing if it does not distribute dividends.

Alternative retention / distribution is a general policy decision that we find embodied in the financing plan investments that take into account the ownership motivations, motivations which, in turn, are based on opportunity cost.

Therefore, the opportunity cost is the appreciation, the appreciation given to the best of chances slaughtered when making a choice when a decision is taken to produce, buy, to take a particular action in a range as possible.

Lack of resources the needs, coupled with the uncertainty of alternatives that can be used every resource, time and money make choosing one of them is accompanied by killing others. To find the rational choice is taken into account, the gap between desirable and possible. Regardless of how it is the economic operation and who is its subject, the principle of opportunity cost requires either searching utility maximization or minimization of effort.

Generally speaking the cost of capital is highlighted in terms of the entrepreneur (entity) that, at near" by issuing shares, or by the decision to distribute profits to 'reserves". So, the question arises as to cost the business mobilized capital from shareholders? How much was the cost of capital invested by the entrepreneur? In the first case, the literature identifies the cost of equity to the profit distributed as dividend.

In the second case we are dealing with an opportunity cost. These issues highlight the complexity of determining the equity cost of economic entities without which the economic process could not do properly.

### 3. METHODOLOGY

In practice, a constant dividend is unusual in most cases it is variable. Gordon-Shapiro model assumes that dividends will grow at a steady rate over the next years (symbolized by  $g$ ) is lower than the rate of return claimed by the investors ( $r$ ) or a placement rate of return adopted by them.

Analyzing Gordon-Shapiro model, or supernormal growth model, or inconsistent, it appears that it assumes that  $r > g$ , but in practice things are not so, since a company can know for the beginning, corresponding a new activity, a growth rate of abnormally high or supernormal. In conclusion, in an economy with perfectly competitive framework, these growth rates can not be kept updated infinite. Model dividends can be adapted to express

the assessment actions supernormal. Initial period growth of a new activity (or who knows any supernormal growth) is treated separately, and the assumption of a constant increase applies to a stage of maturity of development,

For example, it is assumed that a supernormal growth is expected in early (n-1), in (n) we have a normal dividend, and in (n +1) dividends are expected to grow at an annual rate constant (g). The cost of equity for all regardless of their equity, or external (via equity) or internal (by capitalizing a part of the portfolio remained after tax).

Given that the share price is one of the calculations of cost capital in financial practice are used two relationships, namely:

- Capitalization = Number of shares x current price action;
- Dividend yield = Dividend per share / current price action.

To estimate the costs accumulated profits are circulated several models: the CAPM (Capital Asset Pricing Model) model based on, the yield of the bond plus the risk premium" model-based approach discounted cash flow (DCF approach,, Discounted Cash Flows").

Many times we are faced with the impossibility of predicting the outcome of phenomenon. But where this happens, take two basic categories different. The first includes those processes which consist in using a mechanism known initial conditions variables. Result effect can not be predicted although the mechanism is known. This is the risk.

The second category includes cases where individual effects can not be predicted and the mechanism is not known in general what we can learn entirely here are the result of few observations of last A process had successfully met 10 times and be given failed 2 times is an example of uncertainty. In most cases not even know because the process of interest is very new, so you must rely on past findings of another process. In risk, but not for uncertainty, we can define an effective opportunity.

Analyzing the CAPM model, we find that it is based on the same assumptions as modern portfolio theory (whose foundation was developed by Harry Markowitz based on the observation that portfolios consisting of risky actions can be attached, so that the resulting portfolio as whole have a lower risk than its individual components separately), unless additional assumptions, namely the existence of risk-free asset, so an asset for which future cash flows are known with certainty.

Hypothesis relates directly to ability to lend and investors take out loans,, unlimited amounts of interest rate risk-free." In fact, it can hardly be identified as risk-free asset any asset in the market has attached a degree of risk. Quality model, according to some opinions, comes from the ease with which can be applied in practice. "Thinks a company a new capital investment needs of a standard from which to profit report.

Analyzing capital actions brought by similar companies, the company can estimate how much income can be sensitive to movements in advance market. This observation helps to turn to estimate the expected return on market overall. Risk the cost because we are interested in Gordon-Shapiro model capital. If ignores risk CAPM model gives a risk phenomenon important. The original approach of risk is due to the fact that it takes into account the existence of an efficient market conditions and without risk of an asset, so an asset for which future cash flows are known with certainty.

Analyzing the approach, the bond yield plus risk premium", considered as a subjective procedure, we find that analysts often estimate the cost of equity of a company by adding a risk premium of 2% to 4% interest rate payable by the firm for its debts long.

So term,  $r = \text{interest rate} + \text{risk premium}$ . For this date interest rate (which actually presents fluctuations especially since it refers to long-term company debt) investors to determine the  $r$  plus a risk premium of between 2-4%.

#### 4. ANALYSES

Analyzing the basic approach of discounted cash flows, notes that there are a number of techniques used to estimate the retention rate and rate of return of projects would be financed from profits accumulated. Any technique used, she planned to reflect the latest expectations of investors regarding the variables. This approach is useful especially if past experience, about the evolution of dividends and profits showed instability.

Securities analysts made forecasts of earnings growth and dividends by analyzing factors such as forecast sales figures, profit margins and factors competitiveness. We can off a series of dividend policy: policy stability (prudential) ensuring investors a dividend is constant or more annual growth rate, regardless of size variations in net profit.

Although a certain amount of profit falls, constant dividend policy based on a slight increase causes the shareholder to sell shares not held. Success this policy depends on maintaining a rising trend of net profit per share and flexibility when investment needs can be financed from additional sources, policy constant amount, the entity assuming the obligation to pay dividends as a fixed amount for each share held by shareholders.

Sol, ensure steady income to shareholders, even if failure by the firm profits in the previous years. As such, fluctuations in net income per share are moderate and there is a pronounced upward trend of this indicator, steady rate policy, in which case you will have to pay dividends, year after year, a fixed proportion of net profit.

Establishing a constant proportion of dividends to shareholders creates a certainty of remuneration, regardless of self-financing policy pursued by society residual policy, dividend paying the amount that remains available after covering the financing needs of the company.

The models presented on the cost of capital, respectively: dividend discounted model cases (zero growth dividend, their supernormal or inconsistent, the capitalization of profits and Bats' model) are designed to help the investor and the entrepreneur in the selection of projects investment.

This must be done in conjunction with the phenomenon analyzed and presented by the model risk CAPM. In our economy these models find utility in conditions that are known. The cost of equity interest in the assessment of any investment project, in full in equity financing and in financing the venture (equity and loan). Overall cost of equity and borrowed, viewed as a hope for the remuneration of capital investment (shareholders and creditors), which expresses the market value of the company.

Net cash flows (CF) released the company serves, in fact, remuneration, providers of capital". Shareholders will be paid, according, to, rule the rest" of the difference remaining positive cash flows and interest paid, net profit respectively (PN):  $PN = CF - \text{Dob}$ . This leads to greater variability in the spreads on certain conditions and the overall enterprise value. If cash flows are equal to or less than the interest to be paid, the equity value is zero (for all limited liability companies).

Equity value increases with increasing net profit. We appreciate that the study of the concept of capital cannot be made without surprise, "linkages with other economic categories, significant and complex, respectively, the property" and, "owner. So there can

be something without,, sooner or later know the owner and the nature of the property and the owner will surely establish ownership."

In this context, the classical conception (Marxist) indicate, the initial transformation of money into capital is made, then, in perfect conformity with the economic laws of commodity production and property rights arising from them.

#### **4.1 Critical**

Equity capital is that part of the business owned on which exercises ownership, because it belongs to the shareholders and is the result of such capital fructification belongs mobilized. Equity represents the profit entity, a factor underlying the economic process parameters. Capital in general is a production factor, a factor in the economic effort that he valued. Equity cannot be effortlessly up without a creed.

Property owners are directly interested in such lor.Ca their subscription for any economic entity is one, and fuel needed maintenance and development", and as a result of this effort identify dividends and / or increasing firm value. In other words, if,, after seeding" identify, the fruits" profits enjoyed by the owners (shareholders). For them the cost of resources is a waiver from consumption (economy) and / or interest on a loan and cost of equity due to the fact that the entity has benefited from resources shareholders or owners (as defined cost data), is a,, cost of economic literature" that identify with dividends.

Therefore the location of interest on capital, to determine the cost, because this notion (of cost) makes its presence in both, the camp' 'shareholders, as well as the individuals and / or legal entities within the economic process, being entrepreneurs. Capital is a factor of production and its cost is not easy to estimate. If the enterprise market purchase factors of production, the cost is simply the purchase price and if the company is also the owner of a factor, it cost us appears by default.

In this case the result is taken into account," opportunity cost of that factor, defined cost is the biggest factor income that would occur in an alternative use. Generally speaking the cost of capital is highlighted in terms of the entrepreneur (the entity) who, at the nearby issuing",," action or decision to distribute the profits, reserves".

So, the question arises as to cost the business mobilized capital from shareholders? How much was the cost of capital that the entrepreneur invested? In the first case literature identifies the cost of equity to the profit distributed as dividend. In the second case we are dealing with an opportunity cost. These issues highlight the complexity of determining the equity cost of economic entities without which the economic process could not do properly.

Analyzing the dividend, we find that is an element of the capital cost of ownership. Presentation of the concept of a dividend is a necessity of nature gnoseology.

The dividend date is considered the traditional cost of equity assessment, based on dividend update risk. We note that the update means,, the operation in which an expense or income in a year of progress in monetary units .Recalculate a base year zero. According to this model, price or current course of action equals the present value of future cash flows that it generates cumulative dividends and resale price.

At the same time, we ask,-what is the dividend? For entrepreneurs, it is a promise, made, becomes a,, cost of business"(company) and its profit for the investor a form, the overall effect of its placement opportunity. If the investor and shareholder dividend is the same person, to some extent, is an implicit cost (pockets theory).

The dividend data involve several cases treated in the literature, namely: zero dividend growth model, supernormal growth model or inconsistent, and earnings capitalization model Bates model. Analyzing the zero growth model indicates that there is no increase in dividends but they will remain constant.

## 5. CONCLUSIONS

The conclusion we reach is that we are at the beginning of market economy whose subject is the capital with its multiple forms and minimize the cost impact is to maximize value to minimize the cost company.

For, entrepreneurs and investors (qualities to them and central and local authorities) must apply research results embodied by the models and techniques for estimating the cost of capital, based on concrete conditions of our country.

The complexity cost of capital derived from that knowledge uncertainty accurately financial results, results that can be determined only after the financial year and approved by the General Assembly of Sshareholders.

Just therefore the cost elements of capital, dividend and interest were and are still topics of research and implementation of its results aimed possible estimates near certainty.

Investors will always estimate the income (profit) that can achieve it by placing short-term capital, long and medium entrepreneurs, according to the cost capital" in budget. Elements of cost, dividend and interest can not be analyzed only in close correlation because size financial expenses (including interest) can influence the size and hence net profit will distribute dividends to shareholders.

Therefore, a total allocation of net profit as dividends may expose more than ever on external financing company, making it dependent on it. Alternatives to more funding (including domestic ones) gives the company a certain independence. Internal and external funding should give him some opportunities and entrepreneur, according to them, to estimate the cost of the main elements of funding small. One internal self-financing is the difference between cash flow and dividends distributed capacity, where important role the profit is reinvested.

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