1- Definition WACC

The weighted average cost of capital (WACC) measures the average costs companies pay to finance capital assets. Capital costs can include long-term liabilities and debts like preferred and common stocks and bonds that companies pay to shareholders and capital investors. Unlike measuring the costs of capital, the WACC takes the weighted average for each source of capital for which a company is liable. You can calculate WACC by applying the formula:

WACC = [(E/V) x Re] + [(D/V) x Rd x (1 - Tc)], where:

- E = equity market value
- Re = equity cost
- D = debt market value
- V = the sum of the equity and debt market values
- Rd = debt cost
- Tc = the current tax rate for corporations

2- Variables that affect WACC

1- Market values of debt and equity

Both equity and debt affect the weighted average costs of a company's capital. When looking at the WACC, though, the market value of debts and equity become more important than the actual or book value.

2- Costs of debt and equity

Similar to market values, the actual costs companies pay on capital debt and equity can cause changes to the WACC. While equity represents assets from which companies generate gains, it also requires payouts when shareholders collect dividends. The obligation to distribute payments to capital investors means equity companies build can vary as profits vary. Fluctuations in the cost of equity can affect the WACC, as can change in the costs of each capital debt for which a company is liable.

3- Corporate tax rates

Typically, corporate tax rates represent consistent values that companies must pay each accounting period.