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A General Formula for the Wacc

Andre Farber (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=15634)
Université Libre de Bruxelles (ULB) - Solvay Brussels School of Economics and Management

Roland L. Gillet (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=456546)
Université Paris I Panthéon-Sorbonne

Ariane Szafarz (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=392200)
Université Libre de Bruxelles (ULB), Solvay Brussels School of Economics and Management, Centre Emile Bernheim (CEB) & CERMi

Abstract

Recent controversies testify that the tax shield valuation remains a hot topic in the financial literature. Basically, two methods have been proposed to incorporate the tax benefit of debt in the present value computation: The adjusted present value (APV), and the classical weighted average cost of capital (WACC). This note clarifies the relationship between these two apparently different approaches by offering a general formula for the WACC. This formula encompasses earlier results obtained by Modigliani and Miller (1963) and Harris and Pringle (1985).

Keywords: WACC, Adjusted present value, Tax shield, Return on equity

JEL Classification: G30, G32, E22

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