

- i) AS the amount of debt increases, the cost of capital decreases - True or False - Give reasons.

False

AS the amount of debt increases, the cost of capital decreases is saying.

~~Cost of Capital~~

\* when a company takes on a Moderate level of debt, the cost of debt (interest rate) is typically lower than the cost of equity because debt holders take on less risk than equity holders (debt is senior in the capital structure). Thus, adding a reasonable amount of debt can reduce the weighted average cost of capital (WACC) as debt is cheaper than equity.

\* When a debt provides a tax shield since interest payments are tax deductible. AS debt increases, the overall cost of capital might decrease.

\* There is an optimal level of debt that minimizes the WACC. Beyond this point, as the firm takes on more debt.

\* The moderate level of debt can reduce the cost of capital due to cheaper debt and tax benefits, beyond a certain threshold, increased debt raises the overall cost of capital due to higher financial risk and rising costs of both debt and equity.