Abstract

The thesis aims to address the issue of using improper weights of equity and debt in Weighted Average Cost of Capital in the Discounted Cash Flow to Firm valuation technique. In theoretical part I present the textbook derivations of the discussed method and algebraically show the necessity of using target market value of equity in Weighted Average Cost of Capital for this method to lead to unbiased results. Furthermore, I argue that in practice current market value of equity is more than often used instead of target value. In practical part I then try to quantify the biases which may stem from using improper weights for equity. I model resulting biases based on variables such as Return on Invested Capital and growth profiles. I find that in my modeling the level of relative bias gets ceteris paribus larger with lower Return on Invested Capital and larger relative difference between target value of equity and value of equity used in Weighted Average Cost of Capital.