Cost of Capital Changes in Lithuanian Manufacturing Industry

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Abstract

Purpose of the article Purpose of this article is to identify the most appropriate way for capital cost assessment in manufacturing industry, apply the method on Lithuanian manufacturing industry and revel the main changes of capital cost during 2001-2016.

Methodology/methods Analysis of scientific literature indicated that Weighted Average Cost of Capital (WACC) measure was the most widely used and accepted method for capital cost evaluation. The problematic aspect of the measure is that the method is tailored for companies, which are listed in the stock exchange. If country does not have a liquid stock exchange or a company is not listed, there is a lack of data to use WACC method for evaluation of capital cost. For this reason, methodology for WACC evaluation should be adjusted in order to be suitable for companies, operating in countries with developing financial markets. For evaluation of cost of capital in this research Capital Asset Pricing Model (CAPM) was used. Methodology of CAPM evaluation was modified in accordance with academic literature to adopt the model for companies operating in less liquid financial markets.

Scientific aim In most of the empirical studies, analyzing capital cost, research is performed on countries with large financial markets, where a lot of companies are listed on stock exchange. This research tries to fill the gap, adapting standard capital cost evaluation methods for countries with less liquid financial markets, where not a lot of companies are publicly listed in stock exchange.

Findings Analysis of WACC measure shows that in the period of 2001-2016 cost of debt in Lithuanian manufacturing industry was steadily declining, while cost of equity between 2014 and 2016 increased. Despite cheaper borrowing price, share of debt in structure of capital decreased.

Conclusions. Results of the research suggest that in order to reduce capital cost, companies in Lithuanian manufacturing sector should increase the share of debt in total capital structure. This could be performed by paying out a portion of retained earnings as dividends and financing future growth by debt.

Keywords: Cost of Capital, Manufacturing Industry, Weighted Average Capital Cost, Cost of Debt, Cost of Equity.

JEL Classification: G32, L60.

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