In essence, who sets (determines) the cost of capital for a firm?

a. top executives, such as the chief executive officer (CEO) and the chief financial officer (CFO)

b. Congress

c. investment bankers

d. insurance companies

e. investors

The firm’s cost of capital represents the “price” it pays to use funds provided by investors. Investors will not provide funds unless they earn a minimum rate of return—that is, the minimum rate of return they demand. Because the firm must pay the return demanded by investors to attract funds, it is the investors who determine the firm’s cost of capital.

RETURN TO THE SAMPLE QUESTIONS