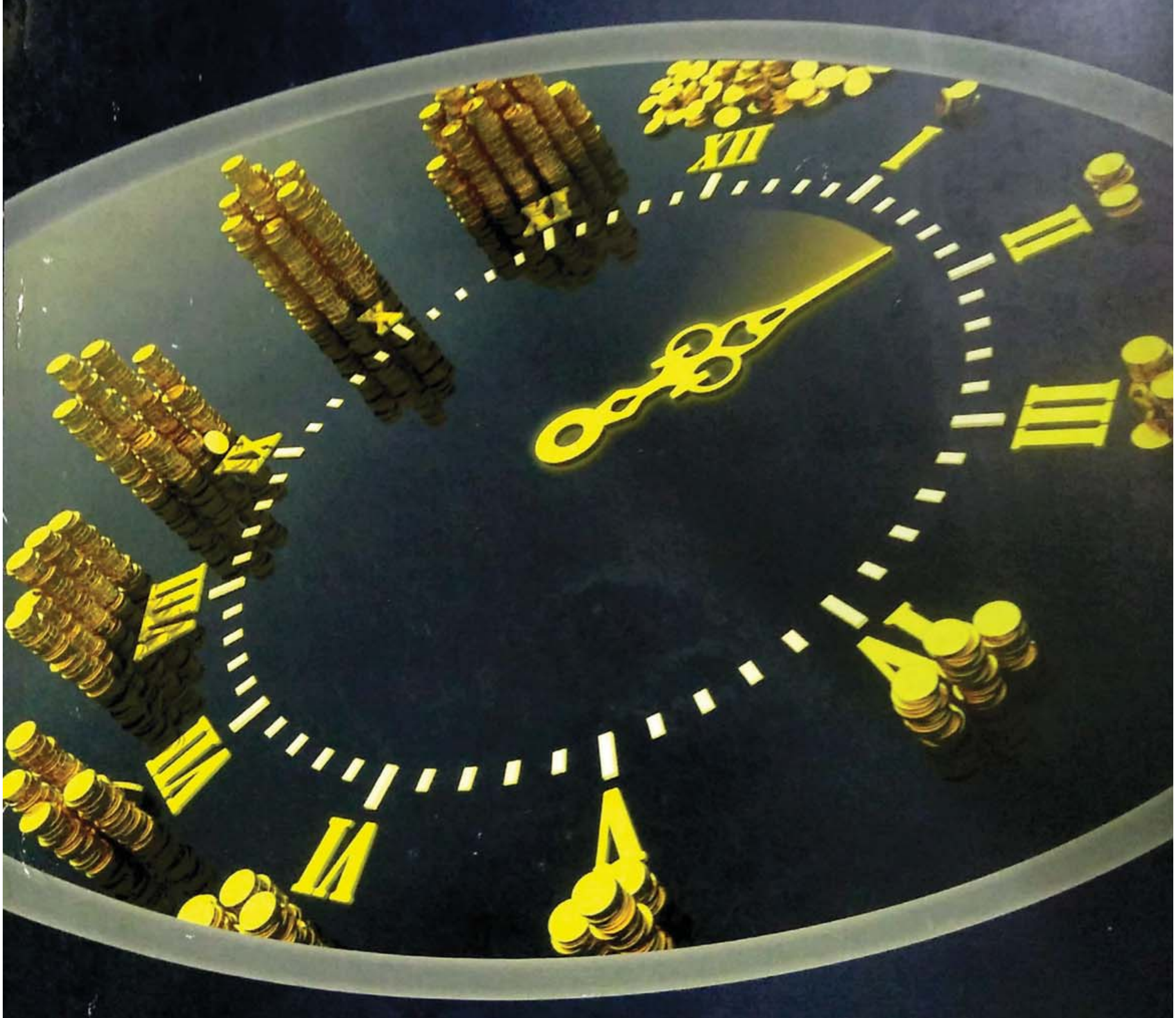
COMPETITIVE STRATEGIES IN GLOBALIZED ECONOMY



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A Study on the Applicability of CAPM Model to the Indian Banking Industry

S. Dileep and Dr. G.V. Kesava Rao

Abstract--- CAPM one of the most popular methods used for estimating the required returns, which states that only beta, the systematic risk has the power to explain the returns. But recent empirical studies have suggested apart from beta others factors like skew ness, variance, co skew ness etc also have a significant power to explain the returns and not alone the beta as suggested by traditional CAPM. In light of this, here in this paper we address the question whether the CAPM offers a better explanation of stock returns in the Indian Banking sector

Keywords--- CAPM, Banking Industry, William Sharpe, Beta

I. Introduction of CAPM

THE capital asset pricing model (CAPM) of William Sharpe (1964) and John Linter (1965) marks the birth of asset pricing theory (resulting in a Nobel Prize for Sharpe in 1990). Four decades later, the CAPM is still widely used in applications, such as estimating the cost of capital for firms and evaluating the performance of managed portfolios.

The motivation behind the paper is coming from the long standing debate on one of the influential theory of capital markets; that is CAPM. The CAPM has been in use for very long period and is still the standard in most real-world analyses. It which attempts to explain the relationship between risk and return on a financial security, and this relationship can then be used to determine the appropriate price for the security.

II. Review of Literature

Lakshman Alles & Louis Murray(2003) studied to explore alternative explanations of the risk /reward relationship, in the developing capital markets .It is likely that these markets will be characterized by various inefficiencies, which will impact on the relationship that is implied by the capital pricing asset model. They confirm the importance of beta, as coefficients of beta are significant in most cases. It is interesting to note that Sri Lanka, the smallest market, provides the only exception. Beta values do not offer a significant explanation of average daily returns.

III. Methodology

The methodology applied in this paper is as follows:

They have applied test for structural stability to two leading conditional factors models: conditional CAPM, conditional factors models on a set of sized portfolio for each country. These models have been estimated via the

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