

The impact of Investability on Asset Valuation

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This study builds a new international asset pricing model (IAPM) that explicitly investigates the impact of ownership constraints on asset pricing in emerging markets. More specifically, it analyzes the impact of openness of these markets on the equity cost of capital and provides some metric to assess the effect on expected returns and the benefits of market liberalization. Main results include the fact that with increased investability, a firm is able to reduce the cost of equity capital by about 44% giving more credence to market liberalization policies.

Some views

- I suppose there are both implicit barriers along with explicit barriers like restriction on ownership (quota), tax regulations (tariff). In such a case, will concentrating on ownership constraints alone lead to an identification problem? Empirically, will the two imply the same result, though on a different scale?
- Is the theoretical model constructed on the assumption that the international market is not integrated? On the other hand the empirical part tests this as the null and is rejected strongly. In the literature, Wheatly (1988, J. Financial Economics) for example assumed that markets are strongly integrated and tested jointly for the pricing process and the risk generation process. In other words, how can one reconcile this model with other IAPM with other factors?

- The study finds some percentages like 44% reduction in the cost of capital. While such findings are very interesting, such percentages themselves could be time varying. So, ideally we need to develop a bound for such figures.
- How does one evaluate such models? Normally a tool to check the usefulness of any volatility model, say the GARCH models, is its ability to forecast (out of sample) or its predictive content.
- As a minor point, personally I would like to see the a table consisting of coefficient estimates, where one can check just for pedagogic reasons and check if the stationarity conditions and other conditions are met.

References

Wheatly, S. (1988) Some tests for international equity integration, *Journal of Financial Economics*, 21, pp. 177-212

Zhang, X. (2003) Specification testing of international asset pricing models, Working Paper, Cornell University.