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EMPIRICAL INVESTIGATION OF THE CAPM VS. FAMA-FRENCH MODEL: EVIDENCE FROM THE LODGING INDUSTRY

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Proper estimation of the cost of equity continues be a challenge for business executives in their capital investment decisions. This is evidenced by the heated scholarly debate in the last two decades over the issue of what model should be used in estimating cost of equity capital. The present study empirically investigates two of the main cost of equity models in their capacity to explain the variability in the lodging stock returns. The results reveal that Fama-French model consistently outperforms the Capital Asset Pricing Model in its explanatory power of cross-sectional lodging industry portfolio returns for the examination periods of 1993-2002 and 1998-2002. In addition, the Fama-French model provides a more realistic cost of equity estimate by adjusting for size and financial distress of the lodging portfolio.