Estimating the Cost of Equity in the Restaurant Industry: The Influence of Index and Variable Selection

<table>
<thead>
<tr>
<th>Item Type</th>
<th>symposium;article</th>
</tr>
</thead>
<tbody>
<tr>
<td>Authors</td>
<td>Madanoglu, Melih; Karadag, Ersem</td>
</tr>
<tr>
<td>Download date</td>
<td>2024-06-22 01:38:16</td>
</tr>
<tr>
<td>Link to Item</td>
<td><a href="https://hdl.handle.net/20.500.14394/30847">https://hdl.handle.net/20.500.14394/30847</a></td>
</tr>
</tbody>
</table>
ESTIMATING COST OF EQUITY IN THE RESTAURANT INDUSTRY: THE
INFLUENCE OF INDEX AND VARIABLE SELECTION

Melih Madanoglu
And
Ersem Karadag

ABSTRACT

Estimating the required rate of return for a project is a challenging issue that is on
the agenda of almost any hospitality manager (Olsen, West, and Tse, 1998). The
motivation of this paper is to assess the performance of the various cost of equity
variables and the influence of market index selection on the cost of equity estimates in
the restaurant industry. The observation period of this study is between 2000 and 2004
and the sample entailed 81 restaurant firms. Three market indices Equal Weight Return
Index of CRSP (EWCRSP), Value Weight Return Index of CRSP (VWCRSP), and
Standard & Poor’s (S&P) 500 and five cost of equity variables Fama-French (three
variables) momentum (UMD), and liquidity were used in this study. In all instances, the
Fama-French (FF) model resulted in a significant $R^2$ change over the CAPM which
showed that the two Fama-French variables (SMB and HML) explained some extra
variance over and above the CAPM. The full five-variable model performed worse than
the FF model for all market indices. As a result, it is recommended that restaurant
executives/entrepreneurs use the FF model by averaging the cost of equity estimates of
the three market indices.