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Asset Valuation : A Synthesis of Existing Literature and New Insights

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Abstract

Studies on asset valuation or pricing have long been a mainstay in research on finance. Valuation are important investment analysis, but also include decisions on merger and acquisition, capital budgeting, financial reporting, determination of tax liability, in litigation, and due diligence among others. Researchers have worked on various genres of valuation models; however, despite over five decades of extensive research in this area, research findings remain inconclusive. This paper argues that one of the plausible reasons behind these ambiguous findings is market efficiency, which has not been explored or addressed adequately. Most importantly existing research has decoupled the two areas as independent and mutually exclusive. The paper opines that integrating the above areas can help explain the inconsistencies in existing findings and simultaneously throw open new insights in this field of study.

I. Introduction

A VALUATION MODEL is a mechanism that uses a series of historical values or forecasts to determine the intrinsic value of a financial asset (*most often a stock*). The intrinsic value is basically an estimate of the value of the stock, what it should be, based on its fundamentals. The market value though may be different in the short term; it is an indication in which direction the market value is likely to move in the medium to long term. It is important, because they are a fundamental source of excess returns for investors and fund managers worldwide. Valuation of stocks is done using various types of models. The first generation models include "absolute value" models which attempts to determine the present value of a stock using expected

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considered far from being efficient by any developed country standards, despite substantial progress in economic liberalization. Going by existing literature, most valuation studies assume efficient markets. It is therefore but logical that valuation models holds good in most efficient markets in the West and also plays a key role in investment decision making. However, our own tests to study the robustness of Whitbeck Kisor Model and CAPM in India fail to generate conclusive evidence. The issue may not be of the validity of the models *per se* or its customization, but that of market efficiency. Till such market efficiency is enhanced, valuation studies will be a futile exercise in most emerging markets, including India.

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