# Chapter 15
# Promoting Entrepreneurship Education Through Valuation of Cost of Equity

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## ABSTRACT

*This chapter provided an extensive discussion on promoting entrepreneurship education using capital asset pricing model (CAPM) and Gordon dividend discount Model in the valuation of cost of equity. Researchers have debated on the valid model for valuation cost of equity capital. There are two main models that can be used in the valuation of cost of equity capital; these are CAPM and the Gordon dividend discount model. The Gordon dividend discount model proposed by Myron Gordon is grounded on conventional assumptions. Gordon dividend discount model is built around the future value of dividends expected by the company's shareholders in line with the anticipated growth rate provided. However, CAPM sets its estimation of determining the expected return of a single asset on beta coefficient ($\beta$), which is difficult to predict. Predicting of $\beta$ is based on a company's historical returns and the model asserts that historical returns of a company's stock can help in determining the future return of that stock. Practically, this is undoubtedly difficult to ascertain.*

## INTRODUCTION AND BACKGROUND

Capital is an indispensable component for a company and cognitively an imperative tool in the financial sector. Companies or firms that undertake new capital or investment projects, have to ascertain whether these developments add value to the firm and ultimately to the shareholder (Chivaura, 2013). Olweny (2011: p.127) mentions that "investment is a commitment of funds for a certain period of time in order to come up with a rate of return to compensate for the time funds invested, the expected rate of inflation during that time, the liquidity premium, and the risk involved". For companies operating under a regulated exchange like the Johannesburg Stock Exchange (JSE), equity capital is a critical constituent under a company's capital structure. The capital structure relates to the source of finance a company uses to fund its operations and mostly comprises of debt capital and equity capital. Most entrepreneurs and finance practitioners, separate equity capital into two; namely, common stock (ordinary share capital) and preference share capital. This means common stock forms a large component of a company's capital. According to Olweny (2011) common equity, therefore, needs a more lucid analysis as compared to preferred stock and debt.

The cost of equity reflects the required returns to common equity holders (Moore, 2016). In the case of Gordon's model, prior research has shown that common stock valuation is one of the most challenging tasks in financial analysis due to complications of the uncertainty of cashflows to the investor (Lee & Lee, 2010). On the dimension of CAPM, Laghi and Marcantonio (2016) assert that, the applicability of CAPM requires the estimation of a sequence of variables and parameters, and this has caused a considerable debate on the best form of equity valuation. The cost in this aspect is attributed to the time value of money connotation, which mentions the importance of money and time (a dollar today is much superior to a dollar expected tomorrow). Nhleko (2015) further subscribes to the view that, due to complexities of risk and return, an investor might encounter a loss when undertaking an investment. Accordingly, it is vital then that an appropriate analysis of ordinary stock is conducted. The proper analysis can provide a close or realistic estimate for the cost of equity.

In addition to the above discussion, there has been an on-going debate on the accuracy of promoting entrepreneurship education using different valuation models in the field of corporate finance and this represents a major challenge for entrepreneurship researchers and finance practitioners (Karlsson & Josefsson, 2011; Laghi & Marcantonio, 2016). The debate centres on the efficiency of these models in predicting the future value of shares. This chapter focused on promoting entrepreneurship education through an analysis on two cost of equity valuation methods; namely, CAPM and the Gordon Dividend Discount Model.

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