

The Cost of Equity in Emerging Markets

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Several of the methods used to value firms in Emerging Markets (EMs) tend to yield either lower or higher expected rates of return than others do. I studied a set of 227 companies from six countries in Latin America to assess the impact the discount rates for firms' valuation, obtained by different methods in EMs. By using historical information from the stock markets of Argentina, Brazil, Chile, Colombia, Mexico and Peru, I applied eight methods to calculate the discount rate for firms' valuation. There are two main approaches to value firms in EMs. The first one focuses on analysis and inclusion of risk factors into cash flow. The second one focuses on the use of appropriate discount rates. This specific research uses the later approach. The methods implemented in this research modify the discount rate obtained with the Capital Asset-Pricing Model (CAPM). Each of the used methods contemplated country risk premiums in a different way.

This research allows for a better understanding of the way in which country risk is integrated into the various firm valuation models currently in use. Additionally, this paper assesses the impact of the methods used for equity valuation in Emerging Markets, particularly in Latin America.