

and regulators should recognize that no model can be refined to the extent that the cost of common equity for any firm can be reduced to a simple formulistic exercise and be exactly measured. Investor expectations differ and it is apparent that all investors do not rely upon the same information and models in making investment decisions. Consequently, no single model and model variant can be demonstrated to capture all investor expectations.

Furthermore, no single model is so inherently precise that it can be relied on solely to the exclusion of other theoretically sound models. Each model requires the exercise of judgment as to the reasonableness of the underlying assumptions of the methodology and on the reasonableness of the proxies used to validate the theory. Each model has its own way of examining investor behavior, its own premises, and its own set of simplifications of reality. Each method proceeds from different fundamental premises, most of which cannot be validated empirically. Investors clearly do not subscribe to any singular method, nor does the stock price reflect the application of any one single method by investors. Therefore, it is essential that estimates of investors' required rate of return produced by one method be compared with those produced by other methods, and that all cost of equity estimates be required to pass fundamental tests of reasonableness and economic logic. "The concept of a fair rate of return, therefore, represents a range or a zone of reasonableness" (Phillips, 1988, 357-358).

Two texts have evaluated the various cost of equity models (Kolbe, Read and Hall, 1986; Thompson, 1991). These texts, while informative to the process of evaluating alternative methods, do not establish a single model as superior to the others. In addition, the texts do not evaluate the alternative methodologies available for implementing each model. Nevertheless, they do provide informative insights to the interested reader.

Classification of Models

There are numerous ways that the various cost of equity models can be classified. One way is to classify models according to their underlying financial theory. The capital asset pricing model (CAPM) is based upon portfolio theory; the comparable earnings method is based upon the economic concept of opportunity cost; the discounted cash flow (DCF) model is based on the