THE RELEVANCE OF GORDON’S DIVIDEND VALUATION MODEL AND EARNINGS MULTIPLIER IN STOCK VALUATION

By

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DEDICATIONS

With love to Allah S.W.T

My parents and family,

for their continuous love and support, and faith in my strengths.
The empirical finding suggested by Mansor and Lim (1992) is that approximately 75% of the analysts used to be speculators. Many investors in Malaysia want capital gain rather than dividends and for some investors focusing solely on dividend is not desirable. Norhayati (2005) found that about three quarter of the firms listed on the Kuala Lumpur Stock Exchange (KLSE) paid stable dividends which indicates the Gordon’s Model is relevant in appraising stock prices. However, due to arguments among analysts the model is considered irrelevant and the focus has been on the Earnings Multiplier Approach. The Earnings Multiplier Approach is more intuitive model which is less sophisticated, less formal, and easy to use. Shamsher, Annuar, and Chotigeat (1998) suggested that about 84% of the analysts prefer to use the Earnings Multiplier Approach in valuing the share prices.

It is interesting to investigate whether the Gordon’s Dividend Valuation Model and the Earnings Multiplier Approach are relevant in appraising the firm’s value on the Kuala
Lumpur Stock Exchange (Bursa Malaysia). Thus, this paper tests the Gordon’s Dividend Valuation Model developed by Gordon (1956) and the Earnings Multiplier approach developed by Basu (1977) to appraise the stock value of selected component stocks of the KLSE.

The objective of this study is to evaluate whether share prices on the main board follow the valuation models of Gordon’s Model or that of Earning Multiplier approach using data stretching from periods before, during and after the financial crisis of 1997. This study also extends the earlier work of Annuar and Shamsher (1993) by incorporating the analysis to include three different economic situations. We believe this is one of the earliest studies employing multi-companies pooled time series panel data approach. In addition, the study also employs the normal traditional cross section analysis for comparison purposes and completion of analysis. This study also conducts appropriate test refinements on risk adjusted market model by employing Dimson-Fowler Rorke (1983) for non-synchronous trading bias. Furthermore, this study consults the analysis on CAPM-DFR and book value (ROE) for the purpose of making comparisons. The findings suggest that the CAPM –DFR is an appropriate tool to measure the discount measured for Gordon’s Model while the Book Value (ROE) is deemed to support the Earnings Multiplier Approach.

Based upon cross sectional analysis, the evidence seems to support both Gordon’s Dividend Valuation Model and Earnings Multiplier Approach depending on the economic conditions. Gordon’s Dividend Valuation Model is applicable only for the period during an economic crisis as documented by Mansor and Lim (1992).
The Earning Multiplier Approach (Value of Stock) is relevant for the period before economic crisis and overall market. Using multi-companies pooled time series panel data approach, the general result suggests that the Gordon’s Dividend Valuation Model is more superior especially during the economic crisis. However, the low and high ranks of dividends and earnings analyses seem to support both Gordon’s Dividend Valuation Model and Earnings Multiplier Approach. Thus, we conclude that both models are practical enough in appraising stock value during the economic crisis though Gordon’s Dividend Valuation Model exhibits more superiority based upon cross sectional results.
Abstrak thesis yang di kemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi sebahagian daripada keperluan untuk Ijazah Master Sains

PENDEKATAN RELEVAN MODEL GORDON PENILAIAN DIVIDEN DAN TEKNIK PENGANDAAN PENDAPATAN UNTUK PENILAIAN SAHAM

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I certify that an Examination Committee met on 28 June 2006 to conduct the final examination of Imbarine Bin Bujang on his Master of Science thesis entitled “The Relevance of Gordon’s Dividend Valuation Model and Earnings Multiplier Approach in Bursa Malaysia” in accordance with the Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulations 1981. The Committee recommends that the candidate be awarded the relevant degree. Members of the Examination Committee are as follows:

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DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or any other institutions.

______________________________

IMBARINE BIN BUJANG

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