

AF 120

## AN EMPIRICAL STUDY ON THE STABILITY OF BETA IN THE SRI LANKAN STOCK MARKET

### Abstract

Beta estimation is central to many financial decisions such as those relating to stock selection, capital budgeting, and performance evaluation. It is a vital tool for almost all investment decisions and plays a significant role in the modern portfolio theory as it is the key variable in CAPM model which helps determining minimum required rate of returns for risky assets. In the context of present changing market conditions, it is essential to understand the stability of beta which enhances efficient corporate financial decisions. However, in reviewing the Sri Lankan literature, there is no investigation testing the stability of beta over time and market phases. Thus, the objective of this study is to investigate the stability of beta of stocks in the Colombo Stock Exchange. For this study, monthly return data of 20 stocks that formed a part of Milanka Price Index as at 31<sup>st</sup> December, 2009 are considered for a period of 10 years, from 2000 to 2009. The objective is pursued with the help of two alternative econometric methods namely incorporating time variable in the regression and by the use of dummy variables for the slope coefficient. The tests are carried out by dividing the total sample period into five sub-periods of two years each and into different market phases - Bullish and Bearish. Both the methods give almost consistent results and show that betas are stable over time and market phases. This stability of beta will have favourable effects on corporate financial decisions.

### Keywords:

Stability of Beta, Colombo Stock Exchange Beta