Public Utility Beta Adjustment and the Cost of Capital

Richard A. Michelfelder  
Rutgers University  
School of Business – Camden  
227 Penn Street  
Camden, NJ, USA 08102  
richmich@rutgers.edu

Panayiotis Theodossiou  
Rutgers University  
School of Business – Camden  
227 Penn Street  
Camden, NJ, USA 08102  
theodoss@rutgers.edu

Abstract

We provide empirical support to show that the commonly-used Blume (1971) capital asset pricing model beta adjustment applied to public utility betas are not appropriate since these betas do not converge to 1.0. Short-term betas follow a cyclical pattern with structural breaks since the mid 1990’s and long-term betas trend downward. The implications of our findings are that Blume-adjusted utility betas distributed by the major vendors of beta should not be used for estimating the cost of common equity capital in public utility rate proceedings. The Blume model is a poor predictor of future public utility betas and lead to a misstatement in the cost of common equity capital.

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