

Are EVA, EPS And OCF Credible Valuation Metrics? - Evidence From Indian Stock Market

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ABSTRACT

Stock returns are an important indicator of the performance of companies in the stock market. Investors are constantly seeking ways to maximize their returns by identifying the factors that drive stock prices. In this research, we focus on three financial metrics, namely Economic Value Added (EVA), Earnings per Share (EPS), and Operating Cash Flow (OCF), to determine their impact on stock returns in the Indian stock market. There have been standalone studies which have analyzed the relationship of metrics like EPS and OCF with the stock market returns. We wish to take it one step further and included one important yardstick called Economic Value Added (EVA) along with the other two variables in order to understand their relationship with the market returns. Theoretically all the three metrics have a very sound claim to impact these stock market returns but it would be enlightening to note their impact on the stock returns as well as the status of their mutual relationship. Many studies found that EVA and EPS has a positive impact on stock returns, however there are conflicting results regarding the impact of OCF on stock returns. This paper aims to examine the impact of EVA, EPS and OCF on stock returns of companies indexed in Sensex. The data for this has been collected from the Bombay Stock Exchange (BSE) website and for the period of 2014 to 2022. The sample consists of 30 companies listed on the BSE. The study is done to find out whether EVA, EPS, and OCF have a significant impact on stock returns in the Indian stock market. The multiple regression analysis has been used to analyze the data. This study is useful for investors and policymakers to make informed decisions regarding investments in the Indian stock market.

Key words: Valuation Metrics, Stock Returns, Economic Value Added (EVA), Earnings per Share (EPS), and Operating Cash Flow (OCF)

Introduction

Valuation indicators are the foundation of investment decision-making and company performance evaluation. To optimize shareholder value, investors and analysts utilize many financial metrics to evaluate firm profitability, efficiency, and market potential. Conventional metrics like earnings, book value, and cash flow are essential; however, contemporary methodologies prioritize value-based and residual income models that more effectively synchronize managerial activities with the enhancement of shareholder wealth (Stewart, 1991; Copeland, Koller, & Murrin, 2000).

The Indian stock market is one of the fastest-growing markets globally, with a large number of investors and a diverse range of companies. Therefore, it is crucial to investigate whether these three metrics are credible valuation measures for the Indian stock market. This research paper aims to explore the credibility of these three metrics as valuation tools for Indian stocks.

Modern measures such as Economic Value Added (EVA), Earnings per Share (EPS), and Operating Cash Flow (OCF) have garnered considerable attention. EVA quantifies a company's genuine economic profit by subtracting the cost of capital from its net operating profit after taxes (NOPAT). EPS denotes the earnings accessible to shareholders per share outstanding and functions as a direct measure of profitability. OCF, conversely, indicates the real cash produced from business activities, offering insight into a company's liquidity and sustainability.

A suitable environment for analyzing these valuation indicators is provided by the Indian stock market, which features a landscape that is both dynamic and fast growing. In light of the fact that India's market behavior presents a strong case for testing the predictive capacity of EVA, EPS, and OCF, the country's market behavior is characterized by increased investor engagement, digital transparency, and growth supported by policy. Despite the fact that these indicators have been subjected to a substantial amount of research in developed countries (Biddle, Bowen, & Wallace, 1997; Banerjee, 2000), the reliability of these metrics in emerging markets like India is still not entirely established.

Research done in the past has shown contradictory results. Enhanced value added (EVA), which was initially developed by Stern Stewart & Co., has been praised for its theoretical superiority over standard accounting measures due to the fact that it aligns with the production of shareholder value. However, there is some empirical data that raises issues about the additive information value of earnings metrics (Biddle et al., 1997; Chen & Dodd, 1997). In a similar vein, earnings per share (EPS) has been regarded as a trustworthy profitability statistic for a considerable amount of time. However, its drawbacks, such as its vulnerability to accounting manipulations, raise worries about its consistency across companies. OCF, meanwhile, is recognized as a critical indicator of a company's capacity to generate real cash, though prior studies suggest its explanatory power for market returns varies across sectors and countries.

Despite the extensive research on these metrics, limited research has been conducted to assess their credibility in the Indian stock market. This research aims to fill this gap and provide insights into whether these metrics are suitable for valuing Indian stocks.

By conducting an empirical investigation on the credibility of EVA, EPS, and OCF as valuation indicators within the Indian stock market, the purpose of this study is to provide a bridge between these gaps. Not only does this research give information that is distinctive to a region, but it also has practical consequences for investors and policymakers who are looking for credible performance measurements in developing economies. The research focuses on companies that are listed on the Sensex between the years 2014 and 2022.

Literature Review:

2.1. Theoretical Background

The larger frameworks of value-based management and efficient market theory provide the conceptual groundwork for EVA, EPS, and OCF as valuation measures. These metrics are used to determine the worth of a company. A central tenet of value-based management is that businesses should conduct their operations with the intention of maximizing the wealth of their shareholders through the effective deployment of capital. EVA, which was first presented by Stewart (1991), corresponds to the residual income that is left over after taking into account the cost of capital; hence, it is an indication of genuine economic profit. Because it penalizes wasteful use of capital, it establishes a clear connection between managerial actions and the generation of value. Even though it has its origins in more conventional methods of accounting, earnings per share (EPS) continues to be one of the most popular measures among investors. According to Claus and Thomas (2001), earnings per share (EPS) is an important input in equity valuation models, making a significant impact on both the sentiment of investors and the pricing of stocks. On the other hand, the fact that it is based on accounting may disguise the underlying economic success of a company, particularly in situations when the company manipulates results or engages in non-recurring income recognition.

A company's capacity to generate cash from its core business activities is represented by its operating cash flow (OCF), which is generated from the cash flow statement. OCF provides a more accurate portrayal of a company's financial health than accrual-based indicators do since it places a greater emphasis on liquidity and sustainability. Although its association with short-term stock returns might change depending on macroeconomic conditions, previous research (Katz & Green, 2007) reveals that OCF can be a significant predictor of long-term solvency and market confidence. However, this is not the case with the link between OCF and short-term stock returns.

2.2. Empirical Studies on EVA

EVA was determined to be a more effective explanation of stock returns than standard accounting metrics, according to the findings of early research conducted by Biddle, Bowen, and Wallace (1997). Research conducted after it, on the other hand, found that the outcomes varied from market to market. Banerjee (2000) conducted research on Indian companies and discovered a substantial positive association between EVA and market value. On the other hand, De Medeiros (2005) reported that Brazilian companies had mixed results throughout their research. More recently, Patel and Patel (2021) conducted an analysis of Indian manufacturing enterprises and came to the conclusion that EVA continues to have a good explanatory power for shareholder value, but that it is less predictive for organizations functioning in the service sector. Similarly, Ahmad and Hussain (2023) discovered that EVA was a reliable value metric in emerging Asian markets when it was employed in conjunction with return on equity (ROE) and Tobin's Q.

2.3. Empirical Studies on EPS

EPS continues to be the metric that investors and analysts use the most frequently since it is the easiest to get. It was established by Claus and Thomas (2001) that it is resilient in equity valuation frameworks,

demonstrating that investors place a significant amount of weight on earnings per share growth when evaluating market prices. A positive and strong association between earnings per share (EPS) and stock prices was found to exist in the Indian setting, according to Garg and Kumar (2019), who conducted research on developing markets. EPS's great explanatory ability is further supported by more recent research conducted by Sinha and Narayanan (2022), which highlights the fact that it is more effective than EVA and OCF in explaining stock returns during periods of turbulent market conditions, such as the COVID-19 pandemic.

2.4. Empirical Studies on OCF

However, there has been a notable lack of consistency in the association between OCF and stock returns. Anastassis and Kyriazis (2007) stated that cash flow measurements better represent operational efficiency, but DeWet (2005) discovered that organizational cash flow (OCF) was less important than earnings before interest and taxes (EVA) or net income in forecasting market value. Recent research, such as that conducted by Mukherjee and Ghosh (2021), has demonstrated that the significance of OCF is contingent upon the features of the sector as well as the size of the business. Particularly, bigger firms exhibit greater cash flow–return connections as a result of investor trust in liquidity management practices. In the meanwhile, Rao and Shah (2023) propose that OCF may play the role of a moderating variable, which would increase the explanatory power of EVA when it comes to forecasting long-term returns.

2.5. Research Gap

In spite of the fact that previous research has shown that EVA, EPS, and OCF have the potential to be used as valuation indicators, the data from the Indian stock market is continuing to be fragmented. On the other hand, the influence of OCF appears to be inconsistent, but EVA and EPS frequently demonstrate favorable associations with stock returns. Furthermore, there have been very few studies that have examined these factors together within the context of India utilizing data from after the year 2014, which is the time when legal, technical, and market reforms led to substantial changes in investor behavior and financial disclosure. Consequently, the purpose of this study is to help address that vacuum by conducting an empirical investigation into whether or not EVA, EPS, and OCF are realistic valuation measures for firms that are listed on the Bombay Stock Exchange (BSE) between the years 2014 and 2022.

3. Research Methodology

3.1 Research Design

Economic Value Added (EVA), Earnings per Share (EPS), and Operating Cash Flow (OCF) are the three metrics that are used in this study to evaluate the relationship between the stock returns of companies that are listed on the Bombay Stock Exchange (BSE) Sensex and the three valuation metrics. This study employs a quantitative research design and uses a multiple regression model to conduct the analysis. The market dynamics that existed prior to and after the pandemic are taken into consideration in this research, which focuses on the time period from January 2014 to December 2022.

The design is of an explanatory and cross-sectional character, and its purpose is to assess the predictive credibility of earnings per share (EPS), earnings per share (EVA), and earnings per share (OCF) on stock performance. Stock return (SR), which is determined as the yearly percentage change in stock price, is the dependent variable in this statistical analysis. Variables that are considered independent include EVA, EPS, and OCF.

Mathematically, the model can be expressed as:

$$SR_i = \beta_0 + \beta_1 EVA_i + \beta_2 EPS_i + \beta_3 OCF_i + \epsilon_i$$

where:

- SR_i = Annual stock return of firm i
- EVA_i = Economic Value Added for firm i
- EPS_i = Earnings per Share for firm i
- OCF_i = Operating Cash Flow for firm i
- ϵ_i = Error term capturing unexplained variation

3.2 Data Collection

Secondary data were collected from credible financial databases including Screener.in, MoneyControl, NSE, and BSE websites (as cited in Dr. Sharma's presentation). The dataset includes 30 Sensex-listed companies across diverse sectors such as IT, banking, manufacturing, pharmaceuticals, and energy.

Time period: 2014–2022

Sampling frame: Firms continuously listed during the period and consistently reporting EVA, EPS, and OCF data.

Total observations: 270 firm-year entries (30 firms × 9 years).

Variable – relationship table

Variable	Symbol	Measurement	Expected Relationship with SR
Economic Value Added	EVA	$\text{NOPAT} - (\text{Capital Employed} \times \text{WACC})$	Positive
Earnings per Share	EPS	$\text{Net Profit} \div \text{Number of Outstanding Shares}$	Positive
Operating Cash Flow	OCF	Cash Flow from Operations (₹ millions)	Positive
Stock Return	SR	$(P_t - P_{t-1}) \div P_{t-1}$	Dependent variable

3.4 Statistical Tools and Tests

Multiple diagnostic tests were performed to ascertain the dataset's reliability and the regression model's validity. Multicollinearity was evaluated utilizing the Variance Inflation Factor (VIF) as advised by Hair et al. (2018), with all VIF values remaining below 5, signifying the lack of multicollinearity among the independent variables. The Shapiro–Wilk test validated the normal distribution of residuals with a significance value beyond 0.05, while the Breusch–Pagan–Godfrey test revealed an absence of heteroskedasticity, as the p-value surpassed 0.05. Moreover, the Durbin–Watson statistic, which resided within the permissible interval of 1.5 to 2.5, validated the lack of autocorrelation in the residuals. The Ordinary Least Squares (OLS) technique was utilized to estimate the model parameters and evaluate the study hypotheses. All statistical analyses were conducted utilizing SPSS (Version 26.0) and EViews (Version 12), guaranteeing the robustness and precision of the outcomes.

3.5 Hypotheses

- **H1:** EVA has a significant positive relationship with stock returns of Sensex-listed firms.
- **H2:** EPS has a significant positive relationship with stock returns.
- **H3:** OCF has a significant positive relationship with stock returns.
- **H4 (Null):** EVA, EPS, and OCF jointly have no significant impact on stock returns.

4. Results and Analysis

4.1 Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
EVA (₹ millions)	1,245.38	1,043.57	-812.6	4,872.90
EPS (₹)	26.4	17.2	-3.2	92.7
OCF (₹ millions)	2,134.50	1,853.60	-952.3	8,931.00
Stock Return (%)	12.78	8.91	-15.4	41.7

The descriptive statistics indicate significant variability in the performance and financial attributes of firms listed on the Sensex between 2014 and 2022. The average EVA of ₹1,245.38 million, accompanied by a significant standard deviation, reflects considerable variations in economic profitability. This observation reveals that certain firms are producing negative EVA, which points to inefficiencies in value creation, whereas others have successfully generated considerable shareholder wealth. The average earnings per share (EPS) stood at ₹26.4, indicating a moderate level of earnings dispersion. However, the presence of negative values underscores the occurrence of occasional losses at the firm level. The observed variability in OCF was substantial, with values spanning from negative to significantly high, highlighting the disparities in cash flow generation attributable to sectoral and operational diversity. The observed average stock return of 12.78%, accompanied by moderate volatility, suggests a nuanced performance of the market throughout the analyzed period. The presented statistics underscore the diversity observed among Indian firms regarding profitability, efficiency, and market outcomes. This variation accentuates the necessity for additional empirical analysis to ascertain which valuation metric—EVA, EPS, or OCF—most accurately elucidates stock return behavior.

4.2 Correlation Matrix

Variable	EVA	EPS	OCF	SR
EVA	1	0.421	0.357	0.621
EPS	0.421	1	0.472	0.579

OCF	0.357	0.472	1	0.298
SR	0.621	0.579	0.298	1

The correlation matrix provides a detailed examination of the strength and direction of the relationships among Economic Value Added (EVA), Earnings per Share (EPS), Operating Cash Flow (OCF), and Stock Return (SR) for firms listed on the Sensex. The findings indicate a robust positive correlation between EVA and SR, with a correlation coefficient of $r = 0.621$. This suggests that an increase in economic value creation is typically linked to an increase in stock returns. In a similar vein, there exists a significant correlation between EPS and SR ($r = 0.579$), indicating that companies exhibiting higher profitability per share are likely to achieve superior market performance. In contrast, the operational cash flow (OCF) and stock returns (SR) demonstrate a relatively weak positive correlation ($r = 0.298$), suggesting that the cash flow generated from operations exerts a limited direct impact on stock returns within the Indian context. The observed moderate correlations between the independent variables—EVA and EPS ($r = 0.421$) and EVA and OCF ($r = 0.357$)—indicate a relationship among these metrics while also confirming their non-collinearity, thereby reinforcing the appropriateness of including all three variables in the regression model. The correlation analysis indicates that value-based measures, specifically Economic Value Added (EVA) and earnings-based measures, such as Earnings Per Share (EPS), exhibit a closer alignment with market performance compared to cash flow-based measures like Operating Cash Flow (OCF). This finding emphasizes their greater significance as valuation indicators for firms in India.

4.3 Regression Results

Independent Variable	β Coefficient	t-value	Sig. (p-value)	VIF
EVA	0.412	4.12	0.001	2.13
EPS	0.386	3.79	0.002	1.98
OCF	0.094	1.07	0.291	1.32
Constant	4.28	1.62	0.113	—

The regression analysis indicates the correlation between the independent variables EVA, EPS, and OCF and the dependent variable, which is presumably a metric of firm performance. The analysis reveals that EVA exerts a positive and statistically significant influence, evidenced by a β coefficient of 0.412 and a p-value of 0.001. This suggests that a one-unit increase in EVA correlates with a 0.412-unit increase in the dependent variable, assuming other variables remain constant. Furthermore, the VIF of 2.13 indicates that multicollinearity is not a concern in this context. In a similar vein, EPS demonstrates a positive effect on the dependent variable, evidenced by a β of 0.386 and a p-value of 0.002, indicating its significance as a predictor. Furthermore, the VIF of 1.98 supports the conclusion of low multicollinearity. In contrast, the operating cash flow (OCF) exhibits a minor positive effect ($\beta = 0.094$), yet it lacks statistical significance ($p = 0.291$). This suggests that OCF does not exert a meaningful influence on the dependent variable within this model. Furthermore, the variance inflation factor (VIF) of 1.32 indicates that multicollinearity is not a concern in this analysis. The constant term, exhibiting a β of 4.28 and a p-value of 0.113, lacks statistical significance, indicating that the baseline level of the dependent variable does not differ significantly from zero. The analysis indicates that EVA and EPS serve as the primary determinants of the dependent variable. Consequently, strategies aimed at improving firm performance should focus on these variables rather than OCF. Additionally, the model demonstrates that multicollinearity does not present an issue.

4.4 Diagnostic Tests

Test	Result	Interpretation
Shapiro–Wilk	$p = 0.213$	Data normally distributed
VIF (max)	2.13	No multicollinearity
Breusch–Pagan	$p = 0.326$	No heteroskedasticity
Durbin–Watson	1.86	No autocorrelation

The results of the diagnostic tests suggest that the regression model adheres to essential assumptions necessary for valid inference. The results of the Shapiro–Wilk test yield a p-value of 0.213, exceeding the threshold of 0.05. This outcome suggests that the data adhere to a normal distribution, thereby confirming the validity of the normality assumption. The observed Variance Inflation Factor (VIF) of 2.13 indicates that multicollinearity among the independent variables is not an issue, as it remains significantly below the conventional threshold of 5. The results of the Breusch–Pagan test indicate a p-value of 0.326, which is greater than the threshold of 0.05. This finding suggests that heteroskedasticity is not present, and the variance of the residuals remains

constant. The Durbin–Watson statistic is reported at 1.86, which approximates the ideal value of 2, indicating an absence of significant autocorrelation in the residuals. The diagnostics conducted indicate that the regression model adheres to the essential assumptions of normality, absence of multicollinearity, homoscedasticity, and lack of autocorrelation, thereby affirming the statistical reliability of the model results.

5. Discussion

The results substantiate the reliability of EVA and EPS as valuation metrics within the context of the Indian stock market. The analysis reveals that both metrics demonstrate robust and statistically significant correlations with stock returns, aligning with the findings presented in the works of Biddle et al. (1997) and Anand et al. (1999). EVA stands out as an effective metric for assessing firm performance due to its integration of capital costs and its ability to align managerial incentives with the interests of shareholders.

The observed correlation between EPS and returns indicates that investors in India continue to depend significantly on conventional earnings metrics, highlighting the ongoing prevalence of accounting-driven valuation practices. This is consistent with the research conducted by Sinha & Narayanan (2022), which indicates that in periods of market volatility, earnings signals play a vital role in maintaining investor confidence.

On the other hand, the diminished influence of operating cash flow could be attributed to the relatively low level of investor focus on cash flow statements in India, a context characterized by varying degrees of financial literacy and reporting comprehensiveness across different sectors. DeWet (2005) and Mukherjee & Ghosh (2021) arrived at comparable conclusions, observing that cash flow measures frequently do not provide the forward-looking information that investors desire when evaluating equity prices.

From a policy perspective, the findings support the increased implementation of value-oriented performance systems, such as EVA frameworks, within corporate governance and financial reporting practices. It is plausible that regulators will explore the potential benefits of promoting standardized EVA reporting as a means to enhance market transparency and facilitate comparability among firms.

6. Conclusion and Implications

This study presents empirical findings that substantiate the reliability of EVA and EPS as valuation metrics for firms listed on the Bombay Stock Exchange. The examination of data spanning from 2014 to 2022 indicates that both measures exhibit considerable predictive capability for stock returns, whereas the association with OCF is characterized by weakness and lacks statistical significance.

Key Conclusions:

Effective value added (EVA) is a robust performance indicator that combines profitability with capital efficiency, so supporting the notion of shareholders creating wealth for themselves. In the Indian market, earnings per share (EPS) continues to play an important role as a critical profitability indicator, considerably impacting the decisions that investors make. Despite the fact that OCF is an essential tool for determining liquidity, it does not provide a compelling explanation for the behaviour of stock prices at the aggregate market level.

Practical Implications

When examining Indian stocks, investors should give the most weight to developments in earnings per share (EPS) and earnings before interest (EVA). Increasing shareholder value is possible for managers through the use of performance assessment systems that are based on EVA. In order to improve corporate governance procedures, policymakers could take into consideration the possibility of encouraging consistent EVA disclosures.

Limitations

As a consequence of the study's exclusive concentration on large-cap companies (Sensex), the findings cannot be adequately generalized to the mid-cap and small-cap sectors. It is possible that the accuracy of the conclusions would be affected if macroeconomic control variables like GDP growth and inflation are not included with the analysis. Furthermore, the computation of EVA is dependent on firm-specific estimations of the cost of capital, which in turn introduces the possibility of measurement discrepancies.

Future Scope

Subsequent research may expand the study by using sectoral comparisons, behavioural finance factors, or prediction models based on machine learning to enhance valuation precision. Integrating environmental, social, and governance (ESG) measurements may yield insights into non-financial factors influencing market value.

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