The application of the capital asset pricing model (capm) essay sample

Business, Management

With the current levels of competition in the business world, every investor dreams of minimizing any form of risk to enable them record higher returns (Fama & French, 2004). Realistically, the success of any investment is defined by the level of returns as well as the competitive advantage over the risks and threats in the market. Therefore, for an investor to predict the future returns of the investment, an effective description and analysis of the relationship between the expected returns and possible risk is necessary. The capital asset pricing model (CAPM) is the best technique to use for such analysis and descriptions (Fama & French, 2004).

Specifically, CAPM is used in various applications, especially when it comes to risks management. For instance, with the best application of CAPM, an investor can make the best choice for a pioneer project whose value is expected to exceed the costs. Such decisions are then capitalized and bolstered by proper and professional investment management (Fama & French, 2004). The management plan should always stick to the main objectives and strategies to maintain a favourable risk-free rate, which is attained through effective cost and time management.

Additionally, the capital asset pricing model is used to determine the best risk securities and calculate the most effective and practical premiums. Ideally, such securities should be in a position to protect the investment from any forms of risks and at the same time avoid losses (Fama & French, 2004). In that case, investors can balance the size of the investment, the level of risks, and the costs of security. For instance, the investor chooses the most effective insurance policies, and other stakeholders, such as suppliers and labour force, as an effort to minimize the cost of risk management and increase its overall productivity.

In most cases, the best application of capital asset pricing model is to calculate the chances that an investment has to increase its expected returns and minimize the possible risks. Such information can be used to determine whether an investor should carry on with the investment or not.

References

Fama, E. F., & French, K. R. (2004). The capital asset pricing model: Theory and evidence.