


An Examination of the Effect of IT Investments on Firm Value: The Case of Y2K-Compliance Costs

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In this study, using the recent Y2-compliance expenditures as an example, we examine whether disclosures relating to investments in information technology (IT) were relevant to investors in assessing the market value of equity. We use a sample of 190 firms that disclosed estimates of total Y2K-compliance costs in their 1997 annual reports to examine the association between Y2K-compliance costs and share prices. We test the joint hypothesis that Y2K-compliance costs were relevant to equity valuation of firms that chose to become Y2K-compliant and that these costs were sufficiently reliable to be reflected in share prices. We find that estimates of Y2K-compliance costs were positively and significantly related to share prices after controlling for earnings, book value of equity, and other factors. We find that the stock market is not shortsighted, and consider investments in Y2K-remediation efforts a significant and value-increasing activity for the average firm.

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