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The Economic Versus Accounting Impacts of R&D on U.S. Market-to-Book Ratios

32 Pages

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Abstract

This paper examines the extent to which the rise in U.S. market-to-book ratios over the period 1980-2000 is due to expenditures on R&D becoming more profitable versus simply becoming more prevalent. More profitable R&D increases the numerator of the market-to-book ratio, while the biased nature of U.S. GAAP means that more prevalent spending on R&D depresses the denominator. I seek to disentangle these effects by measuring annually the NPV of R&D expenditures and the revenue intensity of R&D spending, and then testing to see which better explains variation in annual market-to-book ratios. I find that the profitability of R&D tripled in the 1990s relative to the 1980s, and the revenue intensity of R&D spending doubled. Although the simple correlations between market-to-book ratios and the NPV of R&D and the intensity of spending on R&D are both strongly positive, multivariate tests indicate that the influence of increased spending on R&D entirely dominates that of higher R&D profitability. For R&D, the impact of biased accounting swamps that of improved economic profitability.

Keywords: R&D; Market-to-book ratio; Profitability; Conservative accounting

JEL Classification: G12, G31, M21, M41, O32

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