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Effect of R&D investments on persistence of abnormal earnings

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Abstract

Purpose

This paper sets out to test the effects of firms' and industry's R&D intensity on persistence of abnormal earnings.

Design/methodology/approach

Ohlson's valuation model is used with pooled regressions along with Fama-Macbeth methodology on yearly regressions and partitioning on Herfindahl index to conduct the tests.

Findings

It was found that firms' and industries' R&D intensities are both positively correlated with persistence of abnormal earnings. The evidence suggests that the positive effect on earnings persistence caused by R&D's effectiveness in mitigating competition dominates the negative effect brought by more risk from R&D projects

Practical implications

The fact that the firm's own R&D investment leads to incremental earnings persistence beyond that of the industry suggests the importance of incorporating both industry and firm's R&D intensity in earnings persistence. While industry R&D investment leads to competition mitigation via creation of entry barriers, a firm's own investment in R&D differentiates its products from those of its competitors, and thereby results in further competition



by reducing the problem of correlated omitted variables.

Keywords

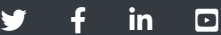
- Research and development
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