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Is economic value added more associated with stock return than accounting earnings? The UK evidence

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Abstract

Purpose

The paper seeks to examine the claim of EVA[®] advocates of its superiority as a financial metric compared with other measures.

Design/methodology/approach

The paper uses a sample of 2,252 firm-year observations from the UK market and applies panel data regressions to test the relative information content of EVA and other accounting measures and the incremental information content of EVA components in explaining stock return.

Findings

It is found that net operating profit after tax and net income outperform EVA and residual income in explaining stock return; it was also found that accruals and operating cash flow have significant incremental information content, while the accounting adjustments of EVA proponents have significantly less contribution in explaining stock return. Yet the paper concludes that other variables must be considered in order to capture the unexplained variation in stock return models.

Research limitations/implications

Future research should include US and UK data in the same sample and examine whether the conclusions are

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For a set of cross-sectional time series data, ordinary least square (OLS) regressions produce biased results and inaccurate estimates of the parameters coefficients; however, this paper applies panel data regressions.

Keywords

Economic value added

Income

Stock returns

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