







Q

Home ▶ All Journals ▶ Economics, Finance & Business ▶ Financial Analysts Journal ▶ List of Issues ▶ Volume 36, Issue 6 ▶ The Magic in Earnings: Economic Earnings

Financial Analysts Journal >

Volume 36, 1980 - Issue 6

50 | 68 0 Views CrossRef citations to date Altmetric

Research Articles

The Magic in Earnings: Economic Earnings versus Accounting Earnings

Fischer Black

Pages 19-24 | Published online: 31 Dec 2018

 https://doi.org/10.2469/faj.v36.n6.19 **66** Cite this article

CFA Institute members: sign in to access the Financial Analysts Journal.

Sample our **Mathematics & Statistics Journals** >> Sign in here to start your access to the latest two volumes for 14 days

66 Citations

Metrics

➡ Reprints & Permissions

Read this article

Share

by Fischer Black

The Magic in Earnings: **Economic Earnings versus Accounting Earnings**

Users of financial statements-analysts, stockholders, creditors, managers, tax authorities and even economists-really want an earnings figure that measures value, not change in value. Analysts, for example, want an earnings number they can multiply by a standard price-earnings ratio to arrive at an estimate of the firm's value. Accordingly, the ideal set of accounting rules is one that makes the priceearnings ratio as constant as possible. The main thing lacking in present accounting practice is the recognition that this has been the goal all along.

Ideally, the earnings figure will take account of everything observable about the firm, including past earnings growth and past earnings volatility. Because everything that bears on the future will be incorporated in the current earnings figure, estimates of future cash flow, or future earnings, will be of no help in estimating the firm's value

To be sure, the accountant's earnings figure will often yield variable priceearnings ratios. In arriving at his earnings figure, the accountant can use much information about the firm that analysts and the public will never know. But he cannot use information external to the firm, accounting rules that have not yet been agreed upon or even information about the firm that came in after the financial statement cutoff date.

The surprising thing is that, even though accountants have not formally recognized the goal of having an earnings figure that measures value, they have done a remarkably good job of achieving this goal. In particular, the variability of book value to price ratios exceeds the variability of earnings to price ratios, both across the universe of stocks and over time, suggesting that the earnings figure is a better measure of value than the book value figure. That's the magic in earnings.

HO are the users of financial state- I claim that all these users want the same kind of ments, and what do they want comings include financial analysts, stockholders, cred- value. itors, managers, tax authorities and even economists concerned with national income. economists concerned with national income. (Earnings figures, somewhat modified, are used as the corporate component of national income.)

Fischer Black is Professor of Finance at the Sloan School of Management, Massachusetts Institute of Technology, and an associate editor of this journal.

ments, and what do they want earnings arnings figure. They all want earnings to be a to measure? The users of financial statements measure of value, not a measure of change in

FINANCIAL ANALYSTS JOURNAL | NOVEMBER-DECEMBER 1980 | 19



Log in via your institution

Access through your institution

Log in to Taylor & Francis Online

Log in

Restore content access

Restore content access for purchases made as guest

Purchase options *

Save for later

PDF download + Online access

- 48 hours access to article PDF & online version
- Article PDF can be downloaded
- · Article PDF can be printed

EUR 48.00



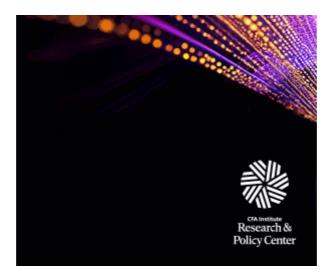
Issue Purchase

- 30 days online access to complete issue
- · Article PDFs can be downloaded
- · Article PDFs can be printed

EUR 175.00



* Local tax will be added as applicable



Related Research 1



Information for

Authors

R&D professionals

Editors

Librarians

Societies

Opportunities

Reprints and e-prints

Advertising solutions

Accelerated publication

Corporate access solutions

Open access

Overview

Open journals

Open Select

Dove Medical Press

F1000Research

Help and information

Help and contact

Newsroom

All journals

Books

Keep up to date

Register to receive personalised research and resources by email



Sign me up











Accessibility



Copyright © 2025 Informa UK Limited Privacy policy Cookies Terms & conditions



Registered in England & Wales No. 01072954 5 Howick Place | London | SW1P 1WG