

RESEARCH ON VALUATION IN ACCOUNTING: FUTURE DIRECTIONS (AND OTHER RAMBLING THOUGHTS)

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Keynote Address

- What is a keynote address? I had no clue
 - Ask someone who has done this before recently
 - So I asked Mark Bradshaw – who shared his slides
- Looks like he had no clue either (but his slides were very funny)
- So – I have decided to wing it
- My presentation will have two portions
 - Accounting Research on Valuation
 - How to shepherd your papers through the publication process – insights from the school of hard knocks

PART I : ACCOUNTING RESEARCH IN VALUATION



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Rotman
a new way to think

How Did I become a Valuation Researcher?

- My thesis was on voluntary disclosure
 - ▣ Never got published – that’s why you’ve never heard of it
- Simple answer – serendipity
 - ▣ 1999 was the days of the “Tech Boom”
 - Eli Bartov and I started working on a paper on Tech IPO valuation (with Chandra Seethamraju). JAR 2002
 - ▣ At NYU, Jim Ohlson was developing a new model on “Implied cost of capital”
 - Wrote a paper with Dan Gode. RAST 2003
 - ▣ NYU asked me to teach Financial Statement Analysis
 - Motivated me to write a paper on applying FSA to growth stocks. RAST 2005
- I have papers on all these three streams of research

Some General Points

- I'll focus on valuation and where I see opportunities for future research
- Forward looking
 - No complaining about “Good old days and how the research these days is crap”
- Many of the areas I identify will be interdisciplinary
- No “Where is the Accounting?”
 - To me it's everywhere
- Unapologetic bias towards areas I have worked in

Looking beyond Equity

- Prior valuation research has strong equity focus – firm level earnings and stock returns
- Now there is much more interest in looking beyond equity
 - Debt markets (e.g. Bhojraj and Swaminathan (2009 RAST) – accrual anomaly in bond markets, Correia (2012 RAST) – value investing in credit markets
 - Options (Lyle (2019 TAR) – How Information Quality is related to returns depends on how “option-like” the firms equity is
 - ETFs (Israeli, Lee, Sridharan(2017 RAST), Glosten et al. (2020 MS), Bhojraj, Mohanram and Zhang (2020 JAE)).
- Important issues related to
 - Sophistication of the market participants
 - Diversification of investors
 - What is systematic and what is idiosyncratic – and does it even matter?

Importance of the Aggregate

- Recent interest in the role of Aggregate Accounting numbers.
- Remarkable differences between firm-level and aggregate
 - e.g Sloan (1995 TAR) and Hirshleifer et. al (2009 JFE)
 - e.g. Bernard and Thomas (1989 JAR) and Kothari et al (2006 JFE)
- Does not necessarily negate the firm-level result
 - Cross-sectional (firm) vs. Time series (aggregate)
 - Positive aggregate accruals a sign of likely economic growth
- Accounting numbers can be very insightful in the aggregate
 - Even if they mean different things
- The rise in interest of ETFs also is a reflection of this

Accounting and the Macroeconomy

- Growing research on the importance of accounting information for macroeconomic forecasting and vice versa
 - Konchitchki and Patatoukas (2014 JAE) – accounting earnings and GDP
 - Konchitchki and Patatoukas (2014 TAR) – using financial statement analysis for macro-forecasting
 - Abdalla and Carabias (TAR 2022) – Aggregate special items
- Can we improve our forecasting models with more macro-level data?
 - Cross-sectional forecasts used in implied cost of capital

Risk vs. Mispricing

- Valuation research - often fundamentally questions market efficiency
 - Should have a high standard of proof - Consistency of returns across time, Timing of bad returns, Rigorous asset pricing tests
- However, the “It has to be risk” guys get a free pass
 - Why? Everything cannot be a “risk” factor (unless both authors names start with F).
- Need to have a more flexible and less dogmatic view
 - Not efficiency vs inefficiency, rather “adaptive efficiency”
- Consider the Accrual Anomaly and the vast literature about whether it is risk or mispricing.
 - When it disappeared
 - Green et al (2010 MS) – “Going, going, gone” – arbitrageurs
 - Mohanram (2014 CAR) – Cash flow forecasts
 - Bhojraj et al (2017 MS) – Improved accounting standards

Asset Pricing – Accounting Perspective

- Latest Fama and French model has five factors
 - CMA (investment factor) and RMW (profitability)
- These are empirical factors that meet the necessary conditions for risk – positive and generally consistent risk premium.
 - Are they sufficient?
 - Will they hold up to greater scrutiny – e.g. the characteristics vs covariance test
- Can one come up with economic rationale for risk story?
 - Penman and Zhu (JAE 2022) - riskiness embedded in earnings growth
 - Much earlier work by Basu (1977 JF) and Ball (1992 JAE) among others
- As accounting academics, we should stop viewing what Finance does as “Manna from heaven”.
 - PIN is priced “information risk” – Lambert et al. (2007 JAR) theoretically and Mohanram and Rajgopal (2009 JAE) empirically question this

Measurement of Cost of Capital

- Many people question ICC models, based on well cited critiques by Easton and Monahan (2005 TAR) and others that
 - Models don't really line up with future returns or other risk factors
 - Underlying models are noisy and/or analyst forecasts provided biased inputs
- Recent research indicates that
 - Forecast bias can be mitigated (Mohanram and Gode 2013 RAST) or avoided with cross-sectional forecasts (Li and Mohanram 2014 RAST)
 - Models perform quite well – unbiased, reflect future returns and other risk factors
- Work very well in the aggregate – Li, Ng and Swaminathan (2013 JFE)
- Can we separate risk from mispricing to improve ICC models?
 - High ICC => High Risk => High Returns
 - High ICC => Mispriced (undervalued) => Market corrects => High Returns

Ignored Areas – Growth Stocks, Banking

- The way we deal with “problem areas” – avoid them. E.g. Fundamental analysis
 - Does not/cannot work in growth firm
 - Does not/cannot be made to work in Banks and FIs
- Problem areas are actually opportunities for research with real and practical implications
 - Mohanram (2005 RAST) GSCORE paper – Fundamental analysis tailored to growth stocks
 - Mohanram, Saiy and Vyas (2018 RAST) – tailoring fundamental analysis for bank stocks
 - Works particularly well during financial crisis
 - Signals based on identifying bank ratios related to profitability, growth and risk
 - Excessive anchoring on ROE – miss out on finer drivers of valuation

Ignored Areas - Tax

- Tax and valuation is another important unexplored area
- Research indicates that even sophisticated users ignore or make naïve assumptions about tax rates
 - How about investors? Do investors consider tax efficiency of the firm's they are investing in?
 - This is especially the case, as the only money one gets ones hand on in most cases is the after-tax dollar
- I think as accountants, we can add to important macroeconomic debates on tax policy
 - E.g. Khan, Nallareddy and Rouen (2019 MS) – high US tax rates impact on GDP growth
 - Edwards et al (2016 CAR) – trapped foreign cash and profitability of cross border M&A

Research in Emerging Markets

- We need to encourage research using data from outside the US
- Often papers are rejected, because the question asked is what are the broader implications
 - Why?
 - Knowing what's happening in India or China will be increasingly important for everyone
- Within valuation/fundamental analysis
 - Emerging markets may give us another look at risk vs mispricing
 - Controlled experiments with different timing of regulatory changes
 - Impact of changing disclosure quality, accounting standards, institutions, governance and enforcement on market efficiency

New Sources of Information

- Research now uses new and emerging sources of information
 - Social Media information (Twitter)
 - Crowd sourced information (Seeking Alpha research, Estimize)

- Research also uses new techniques for analysis
 - Big Data and AI/ML approaches

- Old dogs have to learn new tricks
 - Cannot just spin the old Compustat/CRSP/ IBES tapes
 - My 2018 TAR paper
 - Uses Twitter to measure “Aggregate Opinion”
 - Shows that aggregate opinion on Twitter can predict earnings surprises and announcement period returns

My Valuation WIP

- Chattopadhyay, A., Fang, B. and P. Mohanram (2023). Machine Learning, Earnings Forecasting and Implied Cost of Capital - US and International Evidence. (TAR R&R)
- Ghiringhelli, P., Mohanram, P. and F. Reggiani (2023). The Discount Rate of Normal and Residual Earnings.
- Hugon, A., Faurel, L. and P. Mohanram (2024). Investor Engagement on Corporate Earnings Conference Calls: Evidence from Social Media Investor Comments
- Bhojraj, S., Khizer, A., Mohanram, P. and S. Zhang (2024). Wisdom of the Mob. Is Robinhood Trading Informative to Capital Markets?

Interdisciplinary Work

- We need to encourage and reward inter-disciplinary work – both within accounting and across accounting and other disciplines
 - Broaden the definition of what we consider top tier publications
 - Read papers and worry less about Top 3 vs Top 5 etc.
 - Journals need to be more open towards big picture ideas, different methodologies and approaches
 - Encourage junior people to work on big picture ideas
 - We need to stop being dogmatic about “why is this accounting” kind of questions

Search for the Truth vs. Turf Protection

- At many conferences and presentations, I've noticed people feel the need to protect their turf.
 - Many cases of ABC writing ripostes to XYZ, who write replies and on and on
 - Research on whether something is risk or mispricing
 - Research on ICC
 - Research on whether a model is correct or not
- We should, to the extent possible, be “truth seekers”
- Good research should imply belief revision, including your own beliefs
 - If I am wrong, I would like to know

Advice to Junior Empiricists

- Double check your work – it will be replicated and it better replicate
- Make sure you understand all the tests in your paper, not just the part you did
- Share your code freely and your data as well, whenever possible
- Continue working with data – even as you become a “senior” empiricist
- Pay attention to details – signs of coefficients on control variables matter!
- Don’t hide behind – “the fixed effect takes care of it”.
- Whenever possible, use the simplest possible research design and implementation
 - I always have a sneaking suspicion of something amiss in a “Hidden Markov Latent variable analysis with right censored coarsened exact matching”

PART II : HOW TO SHEPHERD YOUR PAPERS THROUGH THE PUBLICATION PROCESS



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Congrats! You've finished your PhD, what next?

- You need to start publishing
 - ▣ Your thesis hopefully (unlike me)
 - ▣ Other co-authored research
- In this presentation, I will try to focus on
 - ▣ When to send your paper out?
 - ▣ Where to send your paper?
 - ▣ What to do if your paper is rejected?
 - ▣ How to revise a paper?
- Based on my personal experience
 - ▣ Publishing papers in FT50 journals
 - ▣ Zero rejections after 2nd round
 - ▣ Referee
 - ▣ Editor and now Editor-in-chief, CAR

When to send your paper?

- A job market paper is not the same as a publishable paper.
- After the job market, make a detailed list of all comments received.
- Classify comments into categories
 - ▣ Things you : absolutely have to fix, would be nice to fix, could add to paper
 - ▣ Ideas that may lead to future projects
- Fix as many “problems” as you can – some of these people may be referees
- Do not sit on your paper - Nothing gets published sitting on your desk
 - ▣ Don't get bogged down in teaching
 - ▣ Don't get diverted by the excitement of new projects
- For future projects – you don't need to perfect a paper to submit it
 - ▣ Brown bag, conference presentation, 1-2 external presentations
 - ▣ Latter will be tough, especially early

Where to send your paper?

- Figure out what the list of Top/Acceptable journals are at your schools
 - ▣ Top 3
 - ▣ Top 3 + CAR, RAST, AOS
 - ▣ Broader List
- Talk with your advisors and new colleagues
 - ▣ Would your paper's theme and focus suit or not suit a given journal?
 - ▣ Is the journal known to be clubbish or elitist?
 - ▣ Does sending your paper to a journal conference make sense?
 - Quicker turnaround
 - Almost guaranteed acceptance in some journals
 - Can be a very public rejection in others

Dealing with Rejection Letters

- In our profession, it is important to have a thick skin
 - ▣ Rejection rates at top journals exceed 80%
 - ▣ Odds are your papers are going to face rejection
 - ▣ Don't take it personally

- Responses to avoid
 - ▣ The referee is a moron – I've addressed that very issue in Table 7
 - ▣ The editor clearly did not read the paper
 - ▣ The whole system is rigged – it's no point
 - ▣ While each of the above statements might indeed be true, they do not help you achieve your goal

- Decide what you are going to do
 - ▣ In most cases – the right response is make major changes and send to another journal
 - ▣ Sometimes you may decide to shelve a project

Resubmitting Rejected Papers

- Think about why the paper was rejected the last time around
 - ▣ Motivation and Incremental contribution
 - ▣ Weaknesses in theory/hypothesis development
 - ▣ Problems with empirical execution
 - ▣ Writing and communication

- Very important to address all major issues related to prior submissions
 - ▣ Odds of the same referee are quite high
 - ▣ Comments will improve the paper

- Were you aiming too high?
 - ▣ Maybe consider 2nd tier or field journals (especially if they count)

Revising papers

- You've got a "revise and resubmit". Great. Now what?
- Read through the editor's letter and referee reports
 - ▣ I "cut and paste" the points across all letters/reports into a document
 - ▣ This document becomes the early draft of a response memo
- Condense the comments
 - ▣ Some comments can overlap
 - ▣ Some comments can contradict each other
- Set up a plan for a revision
 - ▣ How are you going to address each point
 - ▣ Who is going to address it
 - ▣ Timeline
- Don't take forever – referees and editors forget details
 - ▣ CAR allows 1 year, many journals far less
 - ▣ I try to get revisions back within 3-4 months, 6 months max.

Importance of Response Letters

- Response letters are often more important than your revision
- In this, you lay out
 - ▣ Exactly how your paper is changed
 - ▣ How you addressed each concern that the editor/reviewer had
 - Minimize the number of responses where you do something in the response memo but nothing makes it to the revised paper
 - You are telling the referee – “I don’t think your comment is worthy of real estate in my paper, but because you asked – see, it does not make a difference”.
 - Don’t waste time trying to convince the referee/editor that they are wrong
- If you could not/did not address a concern, be explicit about it
 - ▣ People notice. It will come back next round if there is one.
- Your tone is important. Remember to thank the reviewers and editor
 - ▣ In most cases, they are doing this for free

THANK YOU



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