How Should the Value Relevance Research Employ Book Value of Equity?

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Purpose – This study analyses how the mechanical interdependency affects the value relevance inferences by considering the Price Model.

Design/methodology/approach – As the Price Model employs reported earnings together with book value of equity (BVE), it induces a mechanical interdependency since earnings are partially integrated to BVE via the net income available to owners of parent item. We suggest researchers subtract this item from BVE prior to analyses. We perform analyses by employing the Price Model with the unadjusted (or reported) version BVE and the Price Model with the adjusted version of BVE.

Findings – The Price Model with unadjusted BVE figures generates value irrelevant earnings figures which is contrary to expectations. However, as per our suggestion, after adjusting BVE for the net income available to owners of parent item, earnings become value relevant.

Discussion – Although no mechanical interdependency does exist at conventional statistical significance levels, researchers should know data they work in value relevance studies as both independent variables of the Price Model is partially integrated which may yield incorrect value relevance inferences.

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