

Assignment 3 / Solution

Table 1: Earnings quality measures for the whole sample (n= 5 156)

	(1) Earnings_ predictability	(2) Cash_flow_ predictability	(3) ERC
eps_2018	0.996*** (0.004)	1.751*** (0.006)	
eps_2019			19.011*** (0.128)
_cons	-0.148 (0.185)	0.074 (0.303)	21.216*** (6.907)
Obs.	5156	5156	5156
R-squared	0.940	0.947	0.811

Standard errors are in parenthesis

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 2. Separate analysis of Non-US ('0') and US ('1') sub samples

Panel A. eps_2019 as the dependent variable

	(1) 0	(2) 1
eps_2018	1.037*** (0.002)	0.114*** (0.013)
_cons	-0.290** (0.132)	2.447*** (0.276)
Obs.	3739	1417
R-squared	0.984	0.052

Standard errors are in parenthesis

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Panel B. cfs_2019 as the dependent variable

	(1) 0	(2) 1
eps_2018	1.827*** (0.003)	0.131*** (0.017)
_cons	-0.148 (0.178)	4.741*** (0.363)
Obs.	3739	1417
R-squared	0.990	0.040

Standard errors are in parenthesis

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Panel C. price_2019 as the dependent variable

	(1)	(2)
	0	1
eps_2019	19.067*** (0.150)	13.826*** (0.229)
_cons	19.494** (9.461)	39.696*** (2.499)
Obs.	3739	1417
R-squared	0.812	0.721

Standard errors are in parenthesis

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Interpretation of the results.

The results in Table 1 show that for all large listed companies the regression coefficients of earnings predictability, cash flow predictability and ERC are positive and highly significant. A unit increase in 2018 earnings per share results in an increase of 1 (0.996) in 2019 earnings per share. A unit increase in 2018 earnings per share results in an increase of 1.8 (1.751) in 2019 cash flow per share. A unit increase in 2019 earnings per share results in an increase of 19 (19.011) in 2019 cash flow per share.

We can observe from panels A-C of Table 2 that the absolute values of the regression coefficients in US subsample are lower, suggesting that the quality of earnings is lower in the US compared to other countries. Also, the explanatory power (r^2) is lower for the US companies compared to companies from other countries. These differences may be an outcome of different accepted accounting principles in the US compared to the rest of the world (IFRS). One explanation to differences in Panel C is that the capital market in the US uses other inputs than elsewhere. It is also possible that outliers in the sample or other reasons relating to the distributions of subsets explain the differences (at least partly). Outlier analysis was not done for the sample.