

Information Composition and R&D Mispricing

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Prior studies provide evidence on future benefits associated with R&D expenditures and there are future positive excess returns to R&D firms. One explanation for the future excess returns is that investors fail to incorporate future operating performance implications of R&D expenditures fully into stock prices, hence R&D is mispriced. On the other hand, Chambers, Jennings and Thompson (2002) provide evidence that suggest excess returns are compensation for additional risk associated with R&D activities.

This paper builds on first explanation and examine whether future excess returns of R&D firms are similar for firms with different levels of proportion of public information precision out of total information precision. The main evidence presented in this study is that the average one- to three-year ahead risk-adjusted future excess return to R&D intensive firms is negatively associated with the relative precision of public information to total information. These findings indicate that when there is higher relative public information precision for firms, the future excess returns are less pronounced and investors seem to incorporate reported R&D numbers into stock prices fully for these firms. The results imply that mispricing of R&D intensive firms is due to lack of public information and better public disclosure will enable all investors to assess and evaluate the future performance of R&D activity of firms and hence alleviate the R&D mispricing phenomenon.
