

An International Investigation of Market Efficiency With Regard to Cash Flow and Accrual Information

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Abstract

This paper investigates the efficiency of the major stock exchanges of Germany, Japan, the United Kingdom, and the United States, with regard to earnings expectations based on past earnings, and the relative persistence of the cash flow and accrual components of earnings. This study is an international extension and update of Sloan (1996). Data from the Global Vantage database for 1985 through 1994 were analyzed using a two equation framework developed by Mishkin (1982).

These current results using Mishkin's framework provide support for Sloan (1996)'s findings of market inefficiency with regard to the use of cash flow and accrual information to forecast earnings. Despite the increased availability of cash flow data in the United States since the late 1980s and in the United Kingdom since the early 1990s, the evidence indicates that although market pricing on the International Exchange in London and on the New York Exchanges is conform with earnings expectations based on past earnings, it still does not take account of the relative earnings persistence of cash flows and accruals. These results are consistent with Sloan (1996) which used data from 1960 through the mid 1980s.

The results for the Tokyo Exchange and the Frankfurt Exchange indicate that these stock markets are less efficiency than their Anglo-Saxon counterparts. Unlike the major exchanges in London and New York, earnings expectations embedded in stock prices on the Tokyo Exchange do not fully account for past earnings. The failure to account for the relative earnings persistence of cash flows or accruals is consistent with the results for the United Kingdom and the United States. Finally, there is no evidence that stock prices on the Frankfurt Exchange are even related to past earnings, not to mention the relative earnings persistence of cash flows or accruals.