What is a Company Really Worth? Intangible Capital and the Market to Book Value Puzzle

What is a Company Really Worth? Intangible Capital and the "Market to Book Value" Puzzle

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NBER Working Paper No. 14548
Issued in December 2008
NBER Program(s): Productivity, Innovation, and Entrepreneurship

"What is a company really worth?" is a question asked repeatedly during the recent financial crisis. Attention has been focused on short-term valuation issues, like the "mark-to-market" controversy. Sorting out these issues is complicated by the fact that the market puts a value on shareholder equity that is consistently more than twice the reported book value of a company. Numerous observers have pointed to the absence of most intangible assets from financial statements as an important source of this puzzle. We use Compustat financial data for 617 R&D intensive firms to test this possibility. We find that conventional book value alone explains only 31 percent of the market capitalization of these firms in 2006, and that this increases to 75 percent when our estimates of intangible capital are included. The debt-equity ratio also falls from 1.46 to 0.61. These findings suggest that financial reports tend to substantially understate the long-run intrinsic value of corporate America.

(119 K)

Acknowledgments

Machine-readable bibliographic record - MARC, RIS, BibTeX

Document Object Identifier (DOI): 10.3386/w14548

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