

Detecting long-run abnormal stock returns:
The empirical power and specification of test
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Detecting long-run abnormal stock returns: The empirical power and specification of test statistics

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Abstract

We analyze the empirical power and specification of test statistics in event studies designed to detect long-run (one- to five-year) abnormal stock returns. We document that test statistics based on abnormal returns calculated using a reference portfolio, such as a market index, are misspecified (empirical rejection rates exceed theoretical rejection rates) and identify three reasons for this misspecification. We correct for the three identified sources of misspecification by matching sample firms to control firms of similar sizes and book-to-market ratios. This control firm approach yields well-specified test statistics in virtually all sampling situations considered.



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Key words

Event studies; Firm size; Book-to-market ratios

JEL classification

G12; G14

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