FIRM SIZE AND VALUE

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Abstract

This paper presents an overview of the research on the size effect in equity returns. The size effect in financial literature refers to the tendency for small firms to have higher risk adjusted returns on average than large firms over long horizons. It also suggests that firm size plays a significant role in explaining stock returns. A number of studies focus on the evidence on the validity and consistency of the size effect. Many of the early empirical studies identify a significant size premium in US equity stock returns, but more recent papers suggest that the effect has vanished over time. Nevertheless the international evidence reports that a substantial size premium exists in non-US equity markets. This paper surveys empirical studies on the size premium in stock returns in developed and emerging capital markets. Papers which address the use of different indicators as a proxy for size and the impact of these proxies on stock returns are analyzed as well. This issue is especially important since the chosen indicator may be a proxy not for size but for another unknown factor correlated with size. Another question that has become the subject of a heated debate is the reason why small firms earn on average higher returns than large firms. This paper also provides an overview of the academic debate on the causes of the size effect. Based on various studies, possible explanations for the size effect are summarized. The paper suggests possible directions for further research and methodological improvements, including those for the Russian stock market.

JEL: G12, G15, G32

Keywords: size effect, size premium, stock return, asset valuation, capital markets

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