Spurious Correlation due to Scaling

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Abstract: Scaling is common in empirical accounting research. It is often done to mitigate heteroskedasticity or the influence of firm size on parameter estimates. However, using analytic results and Monte Carlo simulations we show that common forms of scaling induce substantial spurious correlation via biased parameter estimates. Researchers are typically better off dealing with both heteroskedasticity and the influence of larger firms using techniques other than scaling.

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