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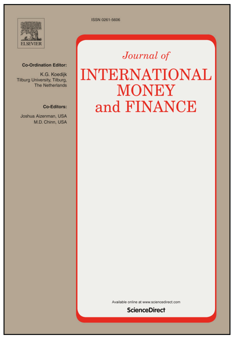

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Christopher Adcock, Xiuping Hua, Khelifa Mazouz, Shuxing Yin

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Does the Stock Market Reward Innovation? European Stock Index Reaction to Negative News during the Global Financial Crisis

by

Christopher Adcock[(1)], Xiuping Hua[(2)], Khelifa Mazouz[(3)] and Shuxing Yin[(1)]

(1) Sheffield University Management School, Sheffield, UK; (2) University of Nottingham, Ningbo, China; (3) Cardiff University, Cardiff, UK

Abstract

This study uses data on 27 European stock indices over the period from January 2007 to December 2012 to investigate the relationship between innovations and the market reaction to negative news during the financial crisis. We use the bivariate BEKK-GARCH approach to estimate time-varying betas and abnormal returns. We show that index prices of countries in the high (low) innovation groups experience significantly positive (negative) abnormal returns on and following the negative news announcement dates. We also find that index beta changes following the arrival of bad news is negatively associated with a country's innovativeness. This finding suggests that innovations promote economic stability and enhance investors' confidence in a country's ability to cope during difficult times. Thus, policy makers who are concerned with sustainable growth should encourage R&D investments by adopting effective policies and avoid unnecessary cuts in R&D expenditures even during times of crisis. A study of the pre-crisis period from January 2001 to December 2006, using the same methods, indicates that investors value innovation more during difficult times.

JEL classification: G1; O2; O3

Keywords: Innovation; R&D investments; Stock price reaction; Time-varying betas.

Corresponding Author:

Shuxing Yin
Sheffield University Management School
Conduit Road
Sheffield, S10 1FL
United Kingdom
Email: shuxin.yin@shef.ac.uk