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“Stock Return Dependence and Product Market Linkages”

Abstract
We study the implications of inter-firm product market linkages for dependence among the stock returns of US publicly traded firms using a spatial econometric approach. Firms’ stock returns are affected by those of their rivals, major customers (i.e. those that represent 10% of the firms’ revenue), potential customers and potential suppliers. The effects are the strongest contemporaneously and die out within one week. Furthermore, the effects of rivals and major customers vary with various characteristics of the product market network. We document the co-existence of contagion effect and competitive effect among rival firms. Positive (negative) dependence on the returns of rivals imply that contagion (competitive) effect dominates. Competitive effect is found to dominate contagion effect in highly concentrated industries, while contagion effect becomes stronger in industries with higher product fluidity. The effect of major customers is larger for firms that depend on their major customer(s) for a larger portion of sales and whose products are similar to the products of other firms. This suggests that concentrated customer base and weak product uniqueness may lower firms’ bargaining power and increase the sensitivity of their stock returns to large customers. Furthermore, we show that a firm’s stock return is more sensitive to the negative return shocks than to the positive return shocks of linked firms.