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# Selling on the News: Does Sound Corporate Governance Mitigate the Negative Contagion Effect?

**Chung-Hua Shen[a], Hsiang-Hsuan Chih[b]**

[a] Department of Finance, National Taiwan University, Taipei, Taiwan
[b] Department of Finance, National Dong Hwa University, Hualien, Taiwan

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**Abstract:** This paper studies when unexpected bad news about firms is released, whether the stock returns of firms in the same industry decline (i.e. *negative contagion effect*), and whether sound corporate governance could influence this decline. Looking at post-2002 data for Taiwan, there have been event firms that announced default, but anecdotal evidence has it that peer stock returns also plunged when the default news was announced, suggesting that this notion appears to hold true-- at least on the surface. This study, however, looks at the issue from a much deeper perspective in that it considers the timing of the bad news announcements and the strength of corporate governance in peer firms. It is found that the *negative contagion effect* only holds true for unexpected events. Equally important, it is determined that not all peer stocks are negatively affected -- only those with weak corporate governance are so affected. The implication of our paper is that, when facing unexpected bad news, peer firms with good governance can avoid being harmed by the ensuing crisis. Our findings encourage firms to improve the quality of corporate governance and protect the rights of stockholders.

JEL Classification: G14, G34
**Keywords**: event study, contagion effect, corporate governance

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Note: This study is the revision of our Chinese paper (*When firms announce financial distress unexpectedly, we believe the peer firms with good governance*, Management Science 管理評論, 2007, vol 26, no 4, pp.77-98) with the permission of the editor.