Smaller companies hit hardest during emerging market crises

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A study of the reaction by the United States stock market to international financial crises shows that small companies are often hit hardest, and the impact is above and beyond what would be expected given their exposure to global market factors.

This unexpected result suggests the significant impact that investors' actions can have during emerging market crises. During these crises, investors flee to the perceived safety of big companies and shed stocks of smaller companies, despite comparable levels of international exposure during normal periods.

"The take-away is, just because you invest locally doesn't mean you are protected from the global market," said David Berger, an assistant professor of finance at Oregon State University.

Looking at almost 20 years of data that covered about eight large emerging market crashes, Berger and H.J. Turtle of Washington State University uncovered this flight-from-risk trend on the part of investors that flee from small stocks. The results are published in the current issue of the *Global Finance Journal*.

"We would expect that stock markets in two different, but related economies would crash at the same time," Berger said. "But we found that during big market crashes, investors adjust their holdings towards bigger corporate stocks that they perceive as being safer, even after controlling for economic exposures."

Berger said the results of his study are unexpected because past research has focused on the aggregate U.S. market as a whole and found little impact during emerging market crises.

"Investors see these big blue chip stocks as the safer ones, and small, R&D intensive stocks for example, as riskier," Berger said. "So the stock of a smaller domestic company could take a hit because of an international shock."

Berger studies U.S. equity markets and international stocks, and said the findings from this study have important implications for investors, even those who tend to invest mainly in the domestic market.

"Interestingly, larger stocks often benefited from emerging market crises and exhibited positive returns," Berger added. "Because investors started dumping smaller stocks in favor of safer, larger ones, the irony is that larger multinational corporations potentially see positive benefits during international crises."

Provided by Oregon State University

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