Study shows that when firms behave badly, whole industry may suffer

June 5 2014, by Victoria Fryer

(Phys.org) —The announcement of a firm's misconduct can have a negative effect on the value of other public firms in the same industry due to decreased investor confidence, according to recent research from Penn State Smeal College of Business faculty members Srikanth Paruchuri and Vilmos Misangyi.

In a recent study appearing in the *Academy of Management Journal*, Paruchuri and Misangyi—both associate professors of management and organization—investigated the contaminating effects of one firm's misconduct on "bystander firms" or firms in the same industry that have not been accused of wrongdoing.

"When one firm reveals financial misconduct, a generalization of culpability ensues such that investors worry that all firms in the same industry category as the misconduct firm are also likely to have engaged in similar misconduct," wrote the researchers.

Further, Paruchuri and Misangyi find that more familiar firms generate a stronger association with bystander firms among investors' perceptions. In other words, bystander firms are more negatively valued based on another firm's misconduct if the offending firm is larger, and therefore more familiar to the investor.

"In the context of investor perceptions of financial misconduct, investors will see those perpetrator firms with which they are familiar as being representative of the industry as a whole, and this familiarity therefore makes the culpability of the perpetrator more potent for generalization," they wrote.

The study, titled "Investor Perceptions of Financial Misconduct: The Heterogenous Contamination of Bystander Firms," is forthcoming in the *Academy of Management Journal*. Paruchuri is an associate professor of management and holds a doctorate in business administration from Columbia University. Misangyi is an associate professor of management and organization and holds a doctorate in strategic management from the University of Florida.

More information: Paruchuri, S. and V. Misangyi (equal contribution) (in press). "Investor perceptions of financial misconduct: The heterogenous contamination of bystander firms." *Academy of Management Journal*

Provided by Pennsylvania State University