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Investor protection and stock crash risk

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Abstract

This paper examines the empirical relationship between investor protection and the risk of stock crash. We develop a firm-level index to measure how well a firm's investors are protected. Using a sample of listed Chinese companies from 2010 to 2012, we find that the stock of those firms whose investors received the best protection were less prone to crashes. We used an instrument approach to check the robustness of our findings. We also conduct a subsample analysis and decompose an investor protection score. We find consistent evidence of the adverse impact of poor investor protection on the risk of stock crash.

Keywords: Investor protection; Crash risk; China; Financial accounting; Corporate governance

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