

Book-to-Market, Size, and Industry Effect

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Abstract

Recent research by Hou and Robinson (2006) tests the link between stock prices and market structure. The authors found that firms in highly concentrated industries earn lower return than those in highly competitive industries. They argued that "If barriers to entry in product markets insulate some firms from aggregate demand shocks, while exposing others, then we would expect distress risk to vary with market structure. This predicts that industries with high barriers to entry are associated with lower equilibrium stock returns. Thus, distress is another way that market structure can impact stock returns". Therefore, Hou and Robinson (2006) relied on the structure-conduct-performance approach in industrial organization to suggest that there are barriers to entry that restrict new firms from entering highly concentrated industries, thus, firms operate in these industries are able to exercise their power and earn abnormal returns which in turn lowers distress risk and returns.

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This paper seeks to investigate how industry structure (concentration) contributes in explaining the variation in stock returns for Amman Stock Exchange. The paper finds that firms operate in highly concentrated industries earn lower returns than those operate in highly competitive industries for the individual portfolios, however, for the hedge portfolios, the paper concludes that industry concentration (structure) does not contribute in explaining the variation in stock returns, thus, an investment strategy based on industry structure is not plausible for investors in Amman Stock Exchange to make abnormal returns.

JEL classification: G15

Keywords: book-to-market effect, Size-effect, Industry Effect, , and Three-factor model.