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Do earnings management and institutional ownership affect stock market liquidity?

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Abstract

This study aims to examine the effect of earnings management and institutional ownership on stock market liquidity. Using 963 companies listed in Indonesia Stock Exchange during 2014-2016, this study uses multiple linear regression to test the hypotheses. The results provide empirical evidence that both earnings management and institutional ownership have a negative effect on stock market liquidity. In conclusion, earning management has a significant negative effect on stock market liquidity.

Keywords: Earnings Management, Illiquidity, Institutional Ownership.

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¿La gestión de ganancias y la propiedad institucional afectan la liquidez del mercado de valores?

Resumen

Este estudio tiene como objetivo examinar el efecto de la gestión de ganancias y la propiedad institucional en la liquidez del mercado de valores. Utilizando 963 empresas que cotizan en la Bolsa de Indonesia durante 2014-2016, este estudio utiliza regresión lineal múltiple para probar las hipótesis. Los resultados proporcionan evidencia empírica de que tanto la gestión de ganancias como la propiedad institucional tienen un efecto negativo en la liquidez del mercado de valores. En conclusión, la gestión de ingresos tiene un efecto negativo significativo en la liquidez del mercado de valores.

Palabras clave: gestión de ingresos, iliquidez, propiedad institucional.

1. INTRODUCTION

Stock market liquidity is one of the most important things in a developing country. High stock market liquidity will result in efficient allocations. According to WULLIYATU (2017), allocation efficiency is an important prerequisite for the growth and development of financial markets. High liquidity also contributes to increasing company value and reducing capital costs. Capital market liquidity in stocks listed on the Indonesia Stock Exchange can still be said to be at a low level. Susi Meilina, Chairman of the Association of Indonesian Securities Companies, said that, by the end of 2016, there were 540 shares listed on the IDX, but only 20%, or about 115 stocks, have daily transactions above Rp 10 billion while ideal capital market conditions are 80%, which is somewhat liquid (kontan.co.id). He also said that one of the triggers of low stock market liquidity is the fundamental quality of issuers that sometimes do not fit the actual conditions. This leads to investors' distrust because, when new investors enter, they find it difficult to resell them. Such discrepancies are due to the action of earnings management in an issuer.

AGUSTIA (2013) defines earnings management as the selection of certain accounting policies by management to achieve the expected objectives, both with profit-increasing games and reduction of losses reported in the financial statements. In this case, the result of the position of the financial statements is not presented fairly, and this indicates that the reported income does not show the company's long-term ability to generate profit. Earnings management can negatively affect the quality of financial statements and their usefulness as financial information, which will create information asymmetry and reduce market liquidity.

CHAROENWONG, DING, & SIRAPRAPASIRI, (2011) have examined the effect of governance quality, transparency and accuracy of the information on information asymmetry in the Singapore context. This study found that, among the governance mechanisms studied, information transparency has a significant and negative relationship with the components of information asymmetry. This study concluded that investors are attracted to greater transparency as it allows them to reduce investment costs by reducing the information asymmetry component resulting from lower spreads. According to the researchers, transparency contributes to 60% of the governance index in reducing the cost of information asymmetry.

AL-JAIFI (2017) examined the effect of earnings management on market liquidity. He found that earning management actions undertaken by the company will have an impact on increasing stock market liquidity. This result implies that earnings management may be more informative than opportunistic, and this attracts investors. LIN, LIU, & NORONHA (2016) mention that informative earnings management will benefit outside investors who do not have access to internal managerial information.

Based on the description of the phenomenon and the number of debates about the previous studies, this study aims at determining the influence of earnings management and institutional ownership of stock market liquidity.

2. LITERATURE REVIEW

2.1 EARNINGS MANAGEMENT AND STOCK MARKET LIQUIDITY

AGUSTIA (2013) states that earnings management is the selection of certain accounting policies based on the decision of the management to achieve the expected goals, either by manipulating the increase in profit or reduction of reported losses. Earnings management is an important thing to note because this action has the potential to cause conflicts or losses for the company. Management performs earnings management in order to attract investors and to fulfill personal interests. The high activity of earnings management in a company results in a decrease in the company's profit quality.

According to HEALY & PALEPU (2001), accountant scandals that occurred at the beginning of the decade have explained the important role of transparent financial information in maintaining the smooth operation of financial markets. The concept of market liquidity relies heavily on information transparency, in other words, the presence of asymmetric information in the market can reduce liquidity. ASCIOGLU, HEGDE, KRISHNAN, & MCDERMOTT (2012) argue that the level of earnings management weakens the quality of income statements and disclosures in general, which can result in high information asymmetry. Increased information asymmetry leads to a decrease in stock liquidity. AJINA & HABIB (2017) find that earnings management negatively affects the liquidity of a company's stock market. Companies involved in earnings management actions have higher bid-ask spreads than other companies. Based on the description, the first hypothesis built in this research is:

H1: Earning management has a negative effect on stock market liquidity.

2.2 INSTITUTIONAL OWNERSHIP AND STOCK MARKET LIQUIDITY

Institutional ownership is the ownership of shares by institutional investors, such as banks, investment companies, insurance companies and other institutions (AGUSTIA, 2012). Institutional ownership is the ownership by institutional investors over the company's shares. The existence of institutional shareholders who have high ownership can change the behavior of the company because the institutional shareholders are able to encourage optimal supervision on the performance of management. the measurement of institutional ownership uses the percentage of institutional share ownership of total outstanding shares.

CHUNG, ELDER, & KIM (2008) examined the effect of corporate governance and ownership structure on stock liquidity. The result of their research is that institutional ownership will increase liquidity. YAGHOOBNEZHAD, ROODPOSHTI, & ZABIHI, (2011) state that there is a direct and positive relationship between institutional ownership and stock market liquidity; in other words, an increase in institutional ownership will increase the liquidity of a company's stock. Based on the description, the second hypothesis constructed in this study is:

H2: Institutional ownership positively affects stock market liquidity.

3. RESEARCH METHODS

3.1 RESEARCH APPROACH

The research approach used in this research is the quantitative approach, which is observed from the level of associative explanation.

In a quantitative approach, the study is conducted in a structured manner and quantifies data with statistical analysis. Associative research is a study that aims to determine the relationship between two or more variables.

3.2 TYPES AND DATA SOURCES

The type of data in this study is quantitative data and based on the source, the data in this study are secondary data in the form of financial statements 2014 - 2016 obtained from www.idx.co.id and daily stock price summary obtained from www.yahoofinance.com.

3.3 POPULATION AND SAMPLE

This study was conducted using 963 companies listed on the Indonesia Stock Exchange from 2014 to 2016 in all sectors except finance as a sample and using multiple linear regression analysis techniques.

4. RESULTS

Table 1: Statistical t-test Results

Model	Coefficient	T	Sig
(Constant)	-25,561	-91.391	0.000
DA	2.002	2.228	0.026

INS	3.209	8.066	0.000

Source: SPSS output

The hypothesis will be accepted if the significance level of t-test is <0.05, meaning that the independent variables affect the dependent variable in this study. Based on Table 4.6, it can be seen that the variable of earnings management (DA) has a significant level of 0.026 to stock market liquidity variable (ILLIQ) with regression coefficient 2.002 and t value 2.228. The value shows that the variable of earnings management has a significant influence on stock market liquidity variables. Institutional ownership (INS) has a 0.000 significance level on stock market liquidity (ILLIQ) with a regression coefficient of 3.209 and an 8.066 t value. The value indicates that the institutional ownership variable has a significant influence on stock market liquidity variable.

5. DISCUSSION

5.1 EFFECT OF EARNINGS MANAGEMENT ON STOCK MARKET LIQUIDITY

Based on the results of statistical analysis, earnings management has a significant negative effect on stock market liquidity with a significance value of 0.026. The results of this study indicate that earnings management conducted by companies listed on the Indonesian stock market is more opportunistic than informative. This provides the implication that the higher the earning management actions performed will result in the worsening stock market liquidity. Earning management actions will hurt the quality of financial statements by which it will increase information asymmetry and, ultimately, reduce the liquidity of the stock market.

Earning management actions can undermine the quality of financial statements whereby this will lead to high levels of information asymmetry, which then leads to a decline in stock market liquidity. According to AJINA & HABIB (2017), investors react positively to the quality of disclosure of information on financial statements. This relates to the reliability of financial statement information, which can improve the accuracy of investor decision making.

5.2 THE EFFECT OF INSTITUTIONAL OWNERSHIP ON STOCK MARKET LIQUIDITY

Based on the results of statistical analysis, institutional ownership has a significant negative effect on stock market liquidity with a significance value of 0.000. Institutional investors in Indonesia enter into the company as shareholders by acting in control of the company's shares in large quantities, thereby reducing the number of shares available for sale in the market. The decline in the number of available stocks for sale will lead to an increase in trading cost in the market and, therefore, the liquidity of the company's stock market will decline.

Institutional shareholders in Indonesia have high majority ownership. It allows them to have corporate information that few shareholders know and influence decision-making. This statement is in accordance with the results of KARGAR & ZAREI's (2014) study which states that there is a negative influence on institutional ownership with stock market liquidity.

The role of institutions in accordance with agency theory is to be in the supervisory function of management in order not to act out of personal interest to achieve the undesirable goals of shareholders. Institutions generally have large holdings in a company because they have a large enough source of funds to invest. The community views the existence of institutional ownership as a guarantee of certainty of the survival status of a company because of the large level of supervision, so that the public is interested in placing the funds to invest in the company. However, based on the results of this study, it shows that the existence of institutional ownership tends to increase the asymmetry of information in a stock market so that this results in a decrease in stock market liquidity.

6. CONCLUSION

Based on the results and discussions that have been described the following conclusions can be drawn:

1. Earning management has a significant negative effect on stock market liquidity. Companies that make earnings management

will hurt the quality of financial statements and improve information asymmetry. This will result in a decrease of the stock market liquidity of a company due to the loss of investor interest in companies that make earnings management. Earnings management, in this case, tends to increase the asymmetry of information in the stock market.

2. Institutional ownership has a significant negative effect on stock market liquidity. Institutional shareholders in Indonesia have high majority ownership. This allows them to have company-wide information that few shareholders know and, as such, influence decision-making. The existence of institutional ownership tends to lead to an increase in information asymmetry in a stock market, resulting in a decline in stock market liquidity.

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