Ownership concentration, earnings management and stock market liquidity: evidence from Malaysia

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Abstract

Purpose – *This paper aims to examine whether ownership concentration and earnings management affect the stock market liquidity of Malaysian firms.*

Design/methodology/approach – *This study uses a sample of 2,020 yearly firm observations in Bursa Malaysia over the period 2009-2012. The ordinary least square regression is used to examine the relationships. The study undertakes a sensitivity test by regressing the main study variables by using different measurements. Another robustness test is then used, where a regression based on the change in variables and a one-year lag of the independent variables are used. Furthermore, to alleviate the concern of possible endogeneity, the simultaneity and reverse causality are checked using the lag of the dependent variable, fixed effect regression, two-stage least squares using the instrumental variables and the generalized method of moments using instrumental variables analysis.*

Findings – *The study finds that firms with a high level of ownership concentration have discrepancies in information between informed and uninformed traders, which impair the stock market liquidity. In addition, this study finds that firms with high earnings management experience greater liquidity. A possible explanation for this is that firms might manage earnings to convey private information to enhance the information content of the earnings. Overall, the evidence suggests that manipulating earnings signals information informatively, particularly in a country with a higher level of ownership concentration and a higher likelihood of expropriating minority shareholders.*

Originality/value – *This study enriches the limited empirical research devoted to the impact of earnings management and ownership concentration on stock market liquidity especially in the context of emerging economies. The findings of this study are robust to alternative liquidity measurements, to alternative estimation methods, and to endogeneity bias.*

Keywords *Malaysia, Ownership concentration, Earnings management, Stock market liquidity*

Paper type *Research paper*

1. Introduction

It is important for developed and emerging countries to have a liquid market. A highly liquid market results in efficient allocations. Consequently, efficient allocations are a critical pre-condition for financial market growth and development (Wang, 2013). Greater liquidity also contributes to increasing a firm's value and reducing its cost of capital. Prior studies state that stock liquidity differences are derived from legal protection and the nature of the information environment (Bacidore and Sofianos, 2002; Brockman and Chung, 2003; Chung, 2006). Hence, governments introduce corporate governance reforms with an aim to mitigate agency costs, enhance investors' confidence and broaden and deepen the capital market[1] (Chung *et al.*, 2010; Kanagaretnam *et al.*, 2007).

The theory of corporate governance acknowledges the concentration of ownership at the firm level as a central concept (Shleifer and Vishny, 1997). Furthermore, the ownership dispersion is a cornerstone for stock market liquidity. In most countries outside the USA,

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