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# Stock Liquidity and Corporate Diversification: Evidence from China's Split Share Structure Reform[*]

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**Abstract**

We establish that stock liquidity is conducive to less corporate diversification. Two potential channels are identified: the financial constraint channel and the corporate governance channel. Specifically, the negative effect of liquidity on diversification is stronger among financially-constrained firms, since higher liquidity helps firms improve external capital markets and thus reduces the need to broaden the internal capital markets through diversification. Moreover, the effect of liquidity on diversification is strengthened among firms with severe information asymmetry, since enhanced price informativeness caused by increased liquidity promotes market monitoring and deters managers' opportunistic diversification decisions. Meanwhile, we rule out the alternative explanation that liquidity discourages diversification by facilitating blockholders' monitoring on managers' decisions. Our results suggest that stock liquidity plays a positive role in corporate decision making.

*JEL Classifications*: G14, L25, G30.

*Keywords*: Stock liquidity, Corporate diversification, Financial constraint, Agency problem, Corporate governance, Split share structure reform, China.

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