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# Liquidity, ownership concentration, corporate governance, and firm value: Evidence from Thailand☆

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We examine the interactions among ownership structure, liquidity, and corporate governance in an important emerging market. The results suggest that firms with more concentrated ownership experience significantly lower stock liquidity. Large shareholders are assumed to possess private information, leading to information asymmetry and thus a higher adverse selection cost. As a result, higher ownership concentration is associated with less liquidity. Nevertheless, there is no evidence that corporate governance plays a significant role in the relationship between ownership and liquidity in Thailand.
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## 1. Introduction

Several theoretical arguments exist that suggest that ownership concentration has a significant impact on stock market liquidity. For instance, concentrated ownership is potentially costly, because large shareholders may possess private information about firm value. Liquidity providers are reluctant to trade against informed traders, leading to lower stock liquidity (Glosten & Milgrom, 1985). In addition, concentrated ownership

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implies a lower number of shareholders, leading to lower trading frequency and hence lower stock liquidity. In spite of these theoretical arguments, the empirical evidence is far from conclusive. A number of studies examine this issue using U.S. stocks (Dennis & Weston, 2001; Heflin & Shaw, 2000; Kini & Mian, 1995; Rubin, 2007; Sarin, Shastri, & Shastri, 1999). The U.S. is characterized by sophisticated stock markets and relatively strong corporate governance.

Particularly absent in the literature is a study that examines the relationship between ownership concentration and liquidity in emerging economies. Developing economies possess several distinctive characteristics. For instance, the stock markets are less developed and equity is much less liquid because most firms rely on bank loans. Moreover, corporate governance tends to be weaker in developing countries. For all these reasons, it is not possible to extend the findings based on developed countries to emerging markets. Besides, even the evidence from the developed countries is mixed and remains inconclusive.

The purpose of this study is to contribute to the debate on the effect of ownership concentration on equity liquidity. The empirical evidence documented thus far in the literature is far from conclusive. Therefore, the debate should benefit from additional evidence based on a different setting. We extend the literature to an emerging market with distinctive characteristics. Thailand possesses a number of features that make it an interesting venue for examining this issue. First, ownership structure in Thailand is much more stable over time, relative to the U.S. Many large shareholders are family members that remain with the company permanently. Thus, ownership in Thailand can be regarded as largely pre-determined and is thus less likely to be endogenous. Second, unlike the U.S., ownership structure in Thailand is highly concentrated, about two to six times more concentrated than is typically the case in American firms. Third, high liquidity lowers the cost of equity. Thus, liquidity is critically important in the U.S. as well as in many developed countries, where firms rely on capital market financing. Thai firms, on the contrary, derive a substantial part of their capital from bank loans, possibly rendering the equity market much less liquid. The lower level of liquidity is also the case in most emerging economies, where capital markets are relatively less sophisticated. Moreover, the awareness of corporate governance has intensified in Thailand only in the past decade. In contrast to the U.S., corporate governance in Thailand is relatively less stringent. Thailand offers several unique characteristics and hence should serve as an interesting setting.

Following the literature, we measure ownership concentration by looking at the combined ownership of the five largest shareholders. The average ownership concentration is 62.5%, highly concentrated when compared to the typical ownership structure in the U.S.[1]Our empirical results, based on large firms in Thailand over the period 2006–2009, reveal that higher ownership concentration is associated with poorer liquidity. For robustness, we employ three alternative measures of liquidity, namely Amihud's (2002) measure, turnover, and the liquidity ratio. The results are consistent across all measures of liquidity. The economic magnitude of the ownership effect is large. For instance, an increase in ownership concentration by one standard deviation lowers liquidity by 50.34%, when liquidity is measured by Amihud's (2002) method. The effect of ownership survives even after controlling for the various factors identified in the literature as related to liquidity. In particular, we control for firm size, corporate governance, leverage, return volatility, asset tangibility, share price, firm age, as well as time variation and industry effects.

To alleviate concerns for endogeneity due to unobservable firm characteristics, we exploit the insight from Altonji, Elder, and Taber (2005). Their study suggests that selection on observables can be used to estimate the potential bias generated by unobservables, i.e. how much stronger selection on unobservables, relative to selection on observables, would have to be to explain away the full estimated effect. Our tests indicate that the effect of unobservables would have to be 2.66 times stronger than selection on observables. It appears unlikely that the estimated effect of ownership concentration on liquidity is mainly driven by unobservables. Furthermore, we estimate a two-stage least squares (2SLS) regression analysis to mitigate concerns for endogeneity due to reverse causality. We employ instrumental variables based on ownership concentration in the earliest period as well as based on industry. Sargan's (1958) statistic suggests that our instruments are acceptable. Our 2SLS results are similar to the OLS results. Therefore, our conclusion does not appear to be vulnerable to endogeneity.

A number of prior studies find that the impact of ownership on firm outcomes may not be linear. Concentrated ownership is helpful up to a certain point as the incentive effect gets stronger. At higher levels of

[1] To put in perspective this level of ownership concentration, on average, Dennis and Weston (2001) report that insiders own merely 9.79% of equity in American firms, while institutional shareholders hold a total of 31.06%.

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