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Foreign institutional ownership and liquidity commonality around the world

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ABSTRACT

In this study, we identify the relation between foreign institutional ownership and stock liquidity commonality in 39 countries from 2000 to 2014. Our results show a negative and robust linkage between foreign institutional ownership and global stock liquidity commonality. Corporate transparency is a key mechanism through which foreign institutional investors can reduce stock liquidity commonality. Independent and U.S.-based foreign institutional investors have a greater effect on reducing stock liquidity commonality. Additionally, there is a U-shaped relation between foreign institutional ownership and stock liquidity commonality. Next, we provide evidence that foreign institutional investors mitigate the effects of local culture, exaggerate the impacts of economic policy uncertainty, and substitute the role of a country's corporate governance level. Finally, it is evident that stock liquidity commonality mediates the relation between foreign institutional ownership and firm valuation. Foreign institutional investors can enhance firm valuation through stock liquidity commonality and stock illiquidity.

Keywords: Foreign institutional ownership; liquidity commonality; international finance

JEL classification: G14; G15; G18; G23; G32; N2

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