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Research Article

THE IMPACT OF INSTITUTIONAL OWNERSHIP ON STOCK LIQUIDITY

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ABSTRACT
Based on theory of productivity market, one of the main features in effective & ideal market is lack of trading costs and highest liquidity. Increasing liquidity will decrease trading cost, increasingly. Liquidity plays the role of detection in price. With regards to importance of liquidity, recognition of effective factors could improve them. The aim of this study is reviewing of relationship between Institutional ownership and liquidity

Keywords: *Stock Liquidity, Institutional Ownership, Company Governance*

INTRODUCTION
One of the key issues in investment is the amount of assets liquidity. The role of liquidity factor in asset valuation is crucial, because investors concern to this issue, if they want to sell their property, is there a good market for them or not? The liquidity of a stock sheet means the fast sell. If we could sell stocks faster and with less cost, it can be said that stock has greater stock liquidity. There are securities which are traded daily and repeatedly than securities which are traded limited and low numbers and they have more liquidity and less risk (Yahya *et al.,* 2010).
In Iran, on the relation between ownership structure and concepts such as corporate governance, corporate performance, profit and its quality and company value, there are researches. But in empirical research, there is an issue which is obsolete in the ownership structure but also in relation to other areas, and it is the concept of stock liquidity. This study will address the institutional ownership on stock liquidity. But what is the significance of liquidity and why we study it? One of the characteristics of an ideal and efficient market is the absence trading cost and thus high liquidity. Trading cost include the wide range of cost as obvious cost such as taxes and brokerages and other unobvious costs of information inefficiency. Accounting is one of the information sources and by providing relate and reliable information, and it reduces inefficient market information. And it can influence to the improvement of stock liquidity of company, so the stock liquidity could be used as a measure of market performance, particularly in terms of information and it can widely used in investigating the effect factors to provide useful information (Rezapour, 2010).

Research Expression
Capital markets are created to allocate resources efficiently and thus it improves the community welfare and the main characteristics of financial market in order to achieve this goal, include:
1) the presence of institutions that have the power to prevent fraud and abuse.
2) the presence of many financial instruments that completes the market and risk distribution.
3) the markets that can trade the assets in less time and cost. So, one of the main uses of capital market is supplying the liquidity (Agarwal, 2008). One of the main subjects is the assets liquidity. The liquidity of the asset includes: "the ability to buy and sell the assets at the lowest possible cost and time." Therefore, the definition of liquidity is created on the absence of trading costs. The role of liquidity factor in asset valuation is so crucial, Because investors concern to this issue that if they want to sell their assets, is there an appropriate market for them or not? If the liquidity potential of a stock will be less, that stock will be less attractive for investment unless the holder gains more efficiency. Liquidity is a function of ability of a quick transaction according to the high volume of securities and low cost. This means that asset price should not have large change between ordering and purchasing. The liquidity degree of an investment is

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low when its fair price is not obtained, quickly. The stock liquidity effects on investment decisions and creating the investment portfolio. In other word, rationale investment has high risk for stocks which have lower liquidity and its expected return will be more (Zade *et al.,* 2010).
According to the theory of efficient market, one of the characteristics of ideal and efficient market is lack of trading cost and high liquidity. By increasing the cost liquidity, the trading cost will be reducing, dramatically. Also, liquidity plays an important role in price discovery process. Many of researches address the liquidity effects on expected return. According to the importance of liquidity, understanding the effective factor can help to its improvement (Rezapour, 2010).

Literature

1-Koueto conducted a study in 2009 about the market liquidity and ownership structure that its result is the presence of institutional owners in ownership structure that reduces the information asymmetry and it has a positive effect on stock liquidity.
2-Agarwal conducted a research in 2008 about the institutional ownership and stock liquidity and its overall result is that there is a nonlinear relation between institutional ownership and stock liquidity.
3-Rahmani and Rezapour in the 1389 investigated the institutional ownership and stock liquidity and they show that there is a direct relation between the level of institutional ownership and stock liquidity and there is an inverse relation between the institutional ownership and stock liquidity.

Institutional Ownership

Institutional ownership equals to the percentage of held stock by public and private companies of all public capital stock. These companies include insurance, financial institutions, banks, public companies and other components (Setayesh and Nezhad, 2010).

Liquidity

The assets liquidity is the ability to quickly transaction of high volume from securities with low cost and the low price effect (Islamic, 2008).

Stock Liquidity

One of the criteria for determining the company value is the stock liquidity. The securities liquidity includes the ability to quickly high volume transactions with low cost and low price effect. The effect of low price means that the asset price has little change in the interface between ordering and purchasing. For many years, liquidity is one of the most important areas of financial innovation. So far, a lot of research has been done in the context of effective factors to assets return. And in some of these studies, the stock liquidity is selected as one of the factors (Bidgoli and Sarenj, 2008).

Corporate Governance

Systematic description of the roles and relations between major shareholders, minority shareholders, institutional investors, the CEO and board are done in order to improve relations between them, and obtain the interests of all interest group, enterprise of performance monitoring, manager's control and conduct through clear rules and procedures for decision making. (Ahmadvabd, 2006, 10).

Ownership and Management of Business Units

Stakeholder theory was introduced in 1984 (Ferry man) and in this theory, it is expressed that companies are become bigger. And its effect on community is so deep that we should considered the various stakeholders and various sections of community and companies should be responsible to all these sectors (Karami *et al.,* 2009, 48). Companies have been established to carry out economic activities. One of these companies which are so prevalent is capital corporations. According to Article 1, the act reform law of Iran Trade act, the capital corporations are (Mansour, 2003): there are companies whose capital is divided into capital and the responsibility of shareholders is limited to the nominal amount. In these companies, a micro finance is equipped to do great things. Due to the lack of sufficient time and in some cases the owners to manage their company and they were peoples named managers. As representatives of the owners, they took corporate governance. This representation relation become known, Jensen and Meklink, 1976 know it as a contractual relation. And based on it, the owner delegated the authority. So managers does not have owned a lot of stock, so there is a problem that managers do not make decision necessarily in the interest of the shareholders.

Corporate Governance Mechanisms for the Protection of Shareholders:
Corporate governance use mechanism in order to protect the rights of shareholders that include:
1-Borad of Directors
2-Institutional Investors:
3-Affiliate of micro-organization:
4-the requirement to submit the stock micro to buy the control blocks:
According to the dependence of the investee company, the shareholders are divided into two groups (Namazi and Kermain, 2008).
1-the private shareholders include: shareholders refer to the board members or their family members that they have a percentage of the company capital.
2-External stakeholders: it refers to the foreign citizenship that is responsible of a percentage of company capital.
3-Institutional investors**:** Institutional investors refer to large institutions such as banks, insurance companies, pension funds and such institutions.

Institutional Investors
Booshi (1998) defines the institutional investors as large investors such as banks, insurance companies and investment companies and such institutes. In developed countries like America and Britain, there are four main types of institutional investors (Pourheydari *et al.,* 2009).
1-pension funds, 2-investment companies, 3- insurance companies and 4-banks. In the recent years, the institutional investors are the biggest institutional investors of companies and they have a large amount of market stock and company stock. Hayashi (2003) stated that the institutional investors control about 60% or available stock in the market of United States of America. However, Taylor (1990) argues that these amounts were about 8.33 and 45% in the year of 1980, 1950 and 1990 and by increasing the percentage of institutional ownership, their role was gradually changing. And from the simple shareholders, they become the shareholders with the monitoring power to manager's functions. And after than that, institutional investors were not involved to the decision making process and they were easily under the management order. In the past, institutional investors sell their stock when they were facing with the dissatisfactions of managers performance or stock performance (Batala *et al.*, 1990).
Gradually by managing the stock with institutional investors, the ownership distribution changed in the companies. With respect to the ownership of a large part of company's stock, institutional investors gained a considerable influence in investment firms (Chen *et al.*, 2007).
It can be seen that there are some organizations in Iran as institutional investors in the combined ownership of some companies. From these type of organizations and institutions, we can point to the insurance companies such as agency business organization, social security and pension funds, Martyr foundation and veterans affairs, Foundation of june fifteen, the organizations of expansion and renovation industry and Red Crescent. As such, it can be seen that companies are facing with some changes in texture and shareholders in their ownership structure (Rahman and Mazlomi 2005).
And it is assumed that these shareholders have the ability to influence the decisions and policies of Investee Company.

Hypothesis about the Monitoring Role of Institutional Shareholders:
In this regard and about the monitoring role, two efficient monitoring hypothesis and interest convergence is provided:
1-Effective monitoring hypothesis: this hypothesis states that by higher investing of institutional investors, more efficient monitoring exercised by them. And disputes and reprehensive differences most likely disappear (Hassas *et al.,*2008).
According to this hypothesis, Barreto *et al.,* (2000) argue that institutional owners are the professional investors who have long-term concentration. Thus, according to the investment volume, professional shareholders cause the management monitoring and maximizing the company value in long-term.
2-the interest convergence hypothesis: this hypothesis stated that institutional investors have large and strategic alliances with management (Yegane *et al.,* 2008).

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According to this hypothesis, Porter (1992) argues that frequent transactions and focusing on short-term goals of the institutions create incentives for management to avoid of failure in interest, because it may lead to the investment sale by institutional investors and reduction of company's stock price. So the institutional investors mainly focus on current profits and in this way, managers are also associated with them. Pound (1988) argues that institutions are not effectively monitoring the company because they have not enough experience. And they may be disappointed or unpleased with the presence of free-riders or they may compromise with management-oriented policy.

Sensitive and Insensitive Institutional Investors to Pressure

Researchers such as Alyasiani and Jia (2010) Batachraya and Graham (2009) and Kerant *et al.*, (2007), divided the institutional investors into sensitive and insensitive group to pressure. Accordingly, sensitive institutional investors (non-supervisor) are who less likely to challenge with management. So it can be seen that this group of institutional investors are more in line with the interest convergence theory. But on the other hand, institutional investor which are insensitive to pressure (monitor) and they have a greater incentive to monitor and management control. These group of institutional investors are more in line with the efficient supervision theory (Elyasani, 2010).

Agency theory: one of the raised issues regarding the composition of company's ownership of agency theory. This theory deals with the conflict issue of interest between owners and managers, and there is a duality and conflict between management objectives and shareholder's goals. While the main objective of shareholders is to maximize the shareholder's wealth by maximizing the company value, usually following this goal is neglected by managers and as a result, shareholders are hesitant to the optimum use of capital and wealth by managers (Shleifer and Vishney, 1997). According to Jensen and Mac ling definition we have: "agency relation is a contract that based on it, the owner appointed a representative or factor and delegate the decision authority to him." In the agency relation, the goals of owners is to maximizing wealth and to reach this goal he monitor on representative work and they evaluate his performance. Based on the agency theory, owners or shareholders invest with the aim of achieving the maximum efficiency against the unreasonable risks of a company. By selecting person or persons as the manager or mangers, companies follow their goals, but in many cases, due to the separation of ownership from management, it is possible that the goals of two groups are not in line. As a result, the managers effort are not use to achieving the shareholder's goals and thus a type of conflict is created between them. In a general category, the agency costs can be divided into three main groups:

1-the costs and expenses related to monitoring such as auditing costs;

2-the costs related to the organizational structure and the restriction process for managers, such as the appointment the outsiders on the board;

3-the cost of lost opportunity arise by limiting the manager's authority for company (Shariat, 2003).

Now the composition of investing and managers ownership in company is one of the most important issues that can create costs or opportunities in different situation for company and we have to see an appropriate ownership structure. On the one hand, management efforts are in line to supply the shareholder's goal and on the other hand, the agency cost is decreases to the possible minimum cost. In this regard, there are many investigations and experiments but only a part of them investigate the effect of ownership combined and they also have considered the manager's ownership (Suk-Kwon, 2002).

Liquidity

Capital markets are created to allocate resources efficiently and thus to increase the society welfare. The main characteristics of financial markets to meet this goal includes 1- presence the institutions that don't have the power to fraud and abuse, 2)presence of various financial instruments that completes the market and risk distribution and it is a market than we can trade assets in shortest time and cost. So one of the most important function of capital market is liquidity. New theories predict that both liquidity and risk liquidity are priced in market (Agrawal, 2008).

In recent years, the liquidity issue has attracted much attention in academic studies and in important publications. Liquidity of an asset is defined as "ability to buy and sell the assets at the lowest possible cost and time." According to definition, liquidity implement in the absence of trading costs. Trading cost

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can be divided two group of explicit and implicit. The explicit costs include the wages of workers and tax and in general, can be measured, simply. But implicit costs include the cost of simple access to accurate and complete information, search cost, technological inefficiency, the difference between supply and demand, incomplete competition and other factors. According to the efficient market, one of the ideal and efficient characteristics of market is the absence of trading cost and high liquidity. Accounting is one of the information resources that can effect on the improvement of stock liquidity by providing related and liable information; it can decrease the information inefficiency of market. So the stock liquidity can be designed as a measure for the market efficiency in particular from the information perspective and it can be used widely in investigating the effective factors for providing useful information. And we know that the information content will be investigated by the market reaction. In general, in markets we see two types of reaction to information. The first reaction, the price effect is considered on securities that the majority of accounting research conducted to investigating this reaction to the accounting information. But market reacts to the information as a volume effect. This reaction is observed as an increasing or decreasing in demand or supply and the stock sell and purchase and it can be observed that this issue can occur with or without change in stock price. This effect is shown in liquidity indicators and so far, it is used less by accounting researchers. And liquidity plays an important role in the process of price discovery and it is a measure for market performance, especially in terms of information (Amihud *et al.*, 2005). By increasing the liquidity, the trading costs will decrease significantly. Liquidity also plays an important role in the process of price discovery. A number of studies have investigated the liquidity effect on the expected return (eg the latest research, we can point to Ahimud *et al.*, (2005) and Easley & Ohara (2005). By considering the liquidity importance, understanding about the effective factors can be helpful in improving it.

First, liquidity was introduced as one of the determinants of asset returns by Keyns (1930). He stated that when an asset has more liquidity than other assets that we can converted it, in the shortest possible time and without incurring losses. Fernandez (1999) stated that liquidity is not measurable by an absolute standard. But it must be assessed on a basis that includes key elements of liquidity such as size, time and trading costs. However, choosing an appropriate benchmark for measuring the liquidity is one of the challenging issues in the finance literature. So, liquidity is remembered as a complex context in researches. Usually, it is seen from these dimensions to the liquidity:

1-Speed: the ability to perform rabid trading.

2-Integration: the ability to buy or sell an asset at a sinlar price at a time

3-depth: the ability to sell and buy some amount of assets without having a significant effect on price

According to these dimensions, the liquidity levels are shown in the following picture (Weiss, 2004).

Liquidity Measures

Liquidity is not an obvious and clear variable, by considering this issue, for studying and investigating the liquidity effect on the stock market price, the liquidity should be stated in the frame of quantities statement. In the first part of this section, five measures are provided to measuring the market liquidity. It should be noted that the whole population of measurement criteria for market liquidity are significantly more than other measures which are handled by the articles that investigate the relation between price and market liquidity. Akiten & Winn state than there are about 68 measures for market liquidity which has been used in different context. These issues indicate the lack of consensus about the best criteria for use (Ben, 2005). Finally, in the second part, three criteria are used for liquidity management. In a general classification, we can places the measurement of market liquidity in a variety metrics from order-based measure to trade-based measures.

The Dimensions of Market Liquidity

In general, the market liquidity depends to depth, width and flexibility and market transactions:

1-marketv depth: the trading effect with high volume on price

2- the market width: it is a ratio of the whole market which participate in upward or downward price movement. In other words, this measure depends to the market strength and so it represents the repositioning cost in the market. The common indicators of the market width are the gap between the

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suggested buy or sell prices. In other words, in a cash market, in order to avoid drastic changes in price, the desired distance should be low enough.

-market flexibility- it is so far that after the extreme price volatility, market should reaches to the equilibrium. Usually, these volatilities occurred by the news releasing (usually negative news) or large volume transactions. The flexible market us a market that prices return in a short time to average or their reasonable amount.

4-time: the speed at which transaction can be absorbed by the market. In a cash market, transactions are executed with little interruption (Masjed, 2010).

Institutional Ownership and Stock Liquidity

The relation between institutional ownership and stock liquidity are one of the unresolved and controversial areas in the capital market. In general, the theoretical principles can be investigated in the field of the influence of institutional ownership on stock liquidity, from four different perspectives. Two perspectives theorize on behalf of institutional owners and two others against them.

Legal Theories of Institutional Owners

Monitoring hypothesis: the first hypothesis defends from the presence of institutional owners the institution monitoring hypothesis is based on the management and this hypothesis is usually known as the "monitoring hypothesis" of institutional ownership and usually it is stated related to the corporate governance and ownership on reduction the agency costs. Holmestrom and Tirol (1993) provided a theoretical model about the monitors of performance management in stock markets. They believe that institutional owner can improve the governance situation and corporate governance is a tool that can direct market to liquidity, according to the directing management to the goals of shareholders.

Information Efficiency Hypothesis: the next hypothesis is related to positive role of institutional investors in stock liquidity. It is called "information efficiency hypothesis" or "trading theory". Trading theory states that institutional investors reflects their information to market and so the trading cost reduced and cost liquidity increase.

Opposite Theories of Institutional Owners

Adverse selection hypothesis: first theories in the effect field of institutional ownership on liquidity can be search in the presence of institutional owners in information field. Adverse selection hypothesis believe that when a group of stakeholders have advantage of information than the other groups, the information asymmetry occurs and reduces the liquidity. While the level of institutional ownership represents the trading behaviors of institutional owners, owner concentration indicates information asymmetry. However, because with the presence of ownership concentration, few informed shareholders can get a deal on their information advantage (Rubin, 2007).

The hypothesis of fluent stock reduction: free fluent stock is a percentage of the total capital and it is available in the market for transactions in market and it is tradable without any restriction. This percentage is obtained from the difference between total stocks and non-tradable stocks. To calculate the fluent stock, the shareholders composition should be considered to determine the strategic shareholders. If the institution enters into corporation as a strategic shareholder, a large percentage of company stock will be blocked. However, presence of shareholders long-terms can have monitoring benefits but as these shareholders have a large part of the company stock, they can reduce the amount of fluent stock in the market. Reducing the fluent stock in market led to an increase in trading costs in market and therefore the corporate stock will incur the high cost of liquidity. So the monitoring performance of these institutions can be done at the expense of reduction in stock liquidity of company (Queto, 2009).

Ownership Structure and Market Liquidity

The ownership level of internal shareholders or company inside, influence on company stock liquidity. When the peoples include managers and employees, after changing, their transactions are done so unusual in company's stock return. Institutional investors play an important role in monitoring and usually there is a relation between institutional ownership and liquidity of a stock company. Also, due to the effect of institutional investors on the stock exchange on stock price, the stock liquidity may increase, considerably (Visheni, 1992).

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According to theory, there is a negative relation between liquidity of stock market and investor's ownership inside the company. It has been argued that the higher potential benefits are more in companies which the lower profitable operation are visible. And companies are faced with the uncertain environment and they have higher local property owners. Also, the level of information asymmetry relates to a functional company, so it states a type of relation between information asymmetry and inside investors ownership. Also, high levels of information asymmetry leads to higher price differentials between buy or sell. High levels of investor ownership may be more likely associated to the final information (Denis, 1994).

Ownership structure is related to the difference between the price of sell or buy. Although higher institutional ownership is related to the suggested prices of sell and buy but there is no clear relation between institutional ownership and information asymmetry. One of the likely reason for this phenomenon is that firms with higher institutional ownership may impose greater costs and inventory control. This hypothesis is true when there is a positive relation between institutional investors and trading size and higher trading require higher inventory by markers and consequently the inventory cost increases as a component of price distance between sell and buy. The studies show that the average size of inventors reduced in relation to property owners and increases in terms of institutional ownership. It means the for companies with higher institutional ownership, transactions are done in a wide ranges of data and explicitly refers that assets costs can explain a likely relation between the prices of selling and buying and institutional ownership and its non-positive relation with information asymmetry (Sarin *et al.*, 2000).

CONCLUSION

It Can be Said That

1-the presence of institutional investors in Iran's stock market, led to reduction stock liquidity. Since, the institutional investors are enter to company as strategic shareholders, a high percentage of company stock is blocked which reduces the fluent stock in market and as result the decreasing the liquidity market. It is suggested that to avoid the reduction of fluent stock and market liquidity, by applying the rules, the companies that have lower amount of fluent stock, they will be removed from the listed company.

2-according to the rule 44 of Islamic republic of Iran of Constitution about privatization, it is suggested that by applying the company stock to the corporative investors, it is prevented from the ownership focus in companies or by creating variety between ownerships, the competition will be possible between them so the monitoring will be done on management performance and second by transferring information from them to market, the market intelligence will be improve and stock liquidity will increase.

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