Quality of Financial Information and stock liquidation

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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 be 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 main objective of this paper is to explore the relationship between the quality of financial information and illiquidity in the Tehran Stock Exchange. For this purpose, illiquidity considered by Amihud (2002) illiquidity criterion and the quality of financial information were studied by the model leoz & et.al (2003). The results of testing research hypotheses show that there is a meaningful relationship between stock liquidation and financial information quality. But, there is a meaningful and positive relationship between institutional ownership level and illiquidity. With regards to results, we concluded that one of the effective factors on stock liquidity is structure of company ownership.

Keywords: Illiquidity, Quality Of Financial Information, Ownership Structure.

1. Introduction
In the aftermath of the corporate scandals of the Enron era and the recent financial crisis, policy makers and regulators have called for improved quality of financial reporting and greater transparency. However, the evidence regarding the costs and benefits of financial reporting and disclosure remains limited (Leuz and Wysocki (2008)).1 The benefit of disclosure best supported by theory is the increase in liquidity of a firm’s shares (Verrecchia (2001)). Liquidity is negatively related to the level of adverse selection in the market, which results from some traders
having informational advantage over other traders (Katsiaryna (2011)). If better quality financial information reduces the level of adverse selection in the market, then liquidity will increase.

Empirical literature on the relation between the quality of financial information and liquidity is limited (Leuz and Verrecchia (2000)). Several papers examine the association between liquidity and analyst evaluations of disclosure quality (Welker (1995), Healy, et al. (1999) and Heflin, et al. (2002)). They find that better disclosure increases liquidity.

Ng (2008) examines other measures of information quality and finds that management forecast frequency is negatively associated with a firm’s liquidity, while relevance of earnings and accrual quality are not significantly associated with a firm’s liquidity. Jayaraman (2008) finds that the bid-ask spreads and the probability of informed trading are higher when public information is less informative, e.g. when the difference between the volatility of earnings and the volatility of cash flows is high. This relation holds both when earnings are smoother than cash flows and when earnings are more volatile than cash flows. Bhattacharya, Desai and Venkataraman (2010) find that accrual quality is positively associated with high frequency measure of the adverse selection component of the bid-ask spread, and that firms with poor earnings quality experience a greater increase in information asymmetry around earnings announcements. Ascioglu, Hegde and McDermott (2005) find that auditor compensation, which has been found to be associated with disclosure quality, decreases liquidity for firms with weak corporate governance.

since the most general information source is accessible for firms' financial reporting investors, recognizing the role of these data is extremely important in the amount of stocks' liquidation.

2. Hypotheses and literature review

Several papers have examined changes in liquidity around restatement announcements. Anderson and Yohn (2002) study the change in bid-ask spreads during three days before announcement of the problem through three days after restatement filing and find that spreads increase for revenue recognition restatements. Controlling for other factors, they find that information asymmetry decreases upon restatement of restructuring items and increases upon revenue recognition restatements. However, Palmrose, Richardson and Sholz (2004) are unable to replicate these results, finding no changes in bid-ask spreads around restatement announcement. They do find that dispersion of analyst expectations increases substantially at
restatement announcement, suggesting increased uncertainty. Using a sample of Canadian restatements, Kryzanowski and Zhang (2010) find that relative quoted and effective spreads increase at restatement announcement and remain higher 46 trading days after restatement. They also find that relative (not absolute) spreads and Amihud’s (2002) illiquidity estimates increase for revenue recognition restatements. Katsiarina (2010) studied the relationship between quality of accounting information and stock liquidation. He used Amihood's liquidation criterion to measure liquidation and hypothesized that the improvement of firms' financial data quality will reduce information asymmetry and by reducing information asymmetry, the stock liquidation will increase. The results showed a positive and meaningful relationship between quality of accounting information and stock liquidation. Badertscher and Burks (2010) analyze changes in liquidity 90 days prior to restatement, the period between restatement announcement and disclosure of the full impact of restatement (the disclosure period), and 90 days after disclosure. They find no difference in liquidity in these three periods for the full sample and find that fraudulent restatements result in lower liquidity during the disclosure period. In their sample, the disclosure period has a median of zero days for the full sample and 20 days for fraudulent restatements, which is a much shorter window than the one analyzed in this study. The focus of this paper is to analyze long-term changes in liquidity for all restatements.

Izadinia & Rasaeeyan (2010) found out in their research entitled: "Ownership dispersion and stock liquidation” that there is not any meaningful relationship between stock liquidation whose criterion is the difference between the suggested stock's purchase and sale prices and the ownership dispersion whose criterion is the block stock ownership percentage. Rooney Satca (2011) studied the relationship between quality of accounting information and stock liquidation. He found out that the information transparency will reduce liquidation risk.

According to a history that was presented in this study, following hypothesis has been investigated;

**H1:** There is a relation between quality of financial and illiquidity

Based on literature and history and theoretical framework presented in the following, conceptual model represented below is designed:
3. Research methodology
Among the accounting researches this research is of capital market research and in terms of methodology as the study title causal and from purpose point of view is application research. These types of researches are done to gain information about the relationship between variables. In other word researcher wants to know whether there is correlation between the two groups of information or not, and if there is any starts to evaluate the independent variable effect and the way it affects (positive or negative) the dependent variable.

3.1 Sample and data selection
Statistical population of this research is composed of all companies accepted in Tehran stock Exchange. Study period is the financial information relating to the companies’ performance of the years 2007-2011 listed in Tehran Stock Exchange in 5 years.

1. Companies which to the end of 2003 to be listed in the stock;
2. Companies which their financial period to be ended in 29 March of every year;
3. Companies which don’t halt their activities and have not changed their financial period during 2007-2011;
4. The required information in this research, to be available.
5. Not to be among the Banks and credit and financial investment institutions.

According to above terms, 70 companies were selected as samples listed.

4. Variable definition
4.1 Measure of illiquidity
The dependent variable in this research is illiquidity (ILLIQ) in which Amihod’s illiquidity criterion (2002) has been used and it is as follows:

$$ ILLIQ_{id} = \frac{|R_{id}|}{VOLD_{id}} \times 10^6 $$
4.2 Measure of quality of financial

\[ EQL = \frac{SDOL}{SDCFO} \]

SDOL: Standard deviation of operating profit
SDCFO = Standard deviation of operating cash flow

4.3 Control Variables

CFO: operational cash flows which are extracted from cash flows’ statement

RET: the ratio of earnings before interest and taxation on total assets

LEV: the ratio of total long-term liabilities to total assets is called the leverage ratio.

INST: the percentage of firm's stock which are held by main investing institutions (own more than %5 of firm's stock) to total stocks issued and accessible to stockholders.

5. Research findings

5.1. Descriptive statistics and correlation coefficient tables of the variables.

<table>
<thead>
<tr>
<th>variable</th>
<th>Number of observation</th>
<th>max</th>
<th>min</th>
<th>Standard deviation</th>
<th>average</th>
</tr>
</thead>
<tbody>
<tr>
<td>ILLIO</td>
<td>350</td>
<td>5.244</td>
<td>0</td>
<td>0.852</td>
<td>0.852</td>
</tr>
<tr>
<td>EQL</td>
<td>350</td>
<td>0.932</td>
<td>0.0076</td>
<td>0.461</td>
<td>1.177</td>
</tr>
<tr>
<td>RET</td>
<td>350</td>
<td>0.958</td>
<td>-0.197</td>
<td>0.167</td>
<td>0.149</td>
</tr>
<tr>
<td>LEV</td>
<td>350</td>
<td>0.932</td>
<td>0.0004</td>
<td>0.191</td>
<td>0.107</td>
</tr>
<tr>
<td>INST</td>
<td>350</td>
<td>98</td>
<td>13</td>
<td>16.576</td>
<td>73.152</td>
</tr>
<tr>
<td>CFO</td>
<td>350</td>
<td>1.23</td>
<td>-1.95</td>
<td>0.690</td>
<td>0.310</td>
</tr>
</tbody>
</table>
5.3. Hypotheses test results

Table (2): The hypothesis test results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>statistic t</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>EQL</td>
<td>1.761</td>
<td>4.455</td>
<td>0.863</td>
</tr>
<tr>
<td>RET</td>
<td>-1.322</td>
<td>-5.728</td>
<td>0.000</td>
</tr>
<tr>
<td>INST</td>
<td>0.007</td>
<td>2.876</td>
<td>0.004</td>
</tr>
<tr>
<td>LEV</td>
<td>0.190</td>
<td>0.924</td>
<td>0.356</td>
</tr>
<tr>
<td>CFO</td>
<td>0.010</td>
<td>0.182</td>
<td>0.856</td>
</tr>
<tr>
<td>Adj R²</td>
<td>0.103</td>
<td></td>
<td></td>
</tr>
<tr>
<td>P-Value, F</td>
<td>0.000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Regarding the results of testing the model's hypothesis which have been presented in table (2), the meaningfulness amount of F (0.000) is less than the acceptable error (%5) and the total regression model is meaningful. Regarding the high amount of (P-Value) the t statistics of acceptable error level for coefficient β₁ of test results show that there is not any relationship between financial information quality regarding Leoz & et al. perspective and stocks' illiquidity. Thus we can not accept the research hypothesis in the assurance level of %95. Also the test results show that there is a meaningful relationship between stocks' illiquidity and controlling variables of profit ratio before interest and taxation to total assets and institutional stockholder. The results show that stocks' illiquidity has a reverse relationship with profit ratio before interest and taxation and it has a positive and meaningful relationship with institutional stockholders' percentage. The determination coefficient and the adjusted determination coefficient also show that the variables included in regression could describe about %11 of the changes of the dependent variable.

6. Overall Conclusion

In this research the hypothesis posed about the existence of a meaningful relationship between stocks' liquidation and financial information quality was tested. The results of testing research hypotheses show that there is a meaningful relationship between stock liquidation and financial information quality. But, there is a meaningful and positive relationship between institutional
ownership level and illiquidity. It means that if the institutional ownership level increases, the illiquidity will be increased meaningfully. When institutions enter a company as a strategic stockholder, a vast percent of firm's stocks will be locked. Although, the presence of long-term institutional investors can entail supervising advantages, considering the fact that the stockholders own great blocks of firm stocks, the flowing stock amount in the market may decrease. The reduction of flowing stock in the market will result in increasing transactions' expenses in the market and thus, the firm's stocks will incur high liquidation expenses. Thus, the supervision performance of these institutions can cause the reduction of firms' stocks liquidation. The results of the present research agree with findings of Cueto (2009), Agarwal (2008) and accord with findings of Katsiarina (2010), Roney Satca (2011).

**The peripheral results of the research:**

There is a meaningful and positive relationship between institutional ownership level and the lack of stock liquidation. It means that if the institutional ownership level increases, the lack of stock liquidation will be increased meaningfully and vice versa.


The first outlooks posed about the effects of institutional ownership on liquidation can be discussed and the role of institutional owners can be investigated in information environment. The tilted based hypothesis states that: when a group of stockholders have an information advantage over others, information asymmetry will occur which reduces liquidation. While institutional ownership level represents the transactional behavior of institutional owns, the increase in institutional ownership shows information asymmetry because besides the existence of institutional ownership concentration, there are only few acknowledged stockholders that can use their information privilege to do transactions. Institutional ownership concentration shows that only a few numbers of stockholders are motivated enough to collect and analyze information and finally transact based on them. This enforces tilted based risk for other stockholders and thus the stimulus of investors to exchange the shares will decrease and finally liquidation will be lowered (Rubin, 2007, 58).

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References


