Institutional Trading and Stock Liquidity: Evidence from Taiwan Stock Market

Yu-Fen Chen, Fu-Lai Lin, Sheng-Yung Yang

E-mail: fllin@mail.dyu.edu.tw

ABSTRACT

This paper uses panel dataset of listed stocks in an emerging stock market, Taiwan from 2001 to 2012 to investigate whether foreign institutional trading facilitates stock liquidity. Three dimensions of foreign institutional trading are associated with stock liquidity, institutional holdings, institutional herding and institutional aggressive/passive trading. Though foreign institutional holdings decrease stock liquidity, their net purchase does provide stock liquidity. Foreign institutional herding to buy provides stock liquidity; while their herding to sell deteriorates stock liquidity. Both aggressive and passive trading facilitate price impacts as measured by Amihud (2002). On the other side, their trading narrows the quoted spread as stock returns increase and deteriorates liquidity as stock returns decrease.

Keywords: stock liquidity, foreign institutional trading, herding, passive trading, aggressive trading

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