

CORPORATE DRIVERS OF MARKET LIQUIDITY ON THE WARSAW STOCK EXCHANGE

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ABSTRACT. Following the adoption of a liquidity support programme by the Warsaw Stock Exchange in June 2008, this paper investigates the corporate financial signals on which firms can rely in their communication to investors to enhance the liquidity of their securities in the market. More specifically, this paper takes a new look at the corporate determinants of the liquidity of the shares of Polish firms listed on the WSE. Our analysis notably confirms the role played by corporate financial signals in explaining the cost of transacting and the depth of this market. The reported evidence further identifies the price-to-book ratio as a discriminating variable affecting liquidity in the equity segment of the Exchange.

JEL Classification: C21 ; G15 ; G30.

Keywords: Market Liquidity; Transaction Costs; Market Depth; Corporate Financial Signals; Warsaw Stock Exchange.

RÉSUMÉ. Suite à l'adoption d'un programme de soutien de la liquidité par la bourse de Varsovie en juin 2008, cet article examine la sensibilité de la liquidité du marché aux signaux financiers émis par les entreprises dans leur communication avec les investisseurs. Plus spécifiquement, cet article se focalise sur les déterminants financiers de la liquidité des actions des entreprises polonaises cotées à Varsovie. Notre analyse confirme notamment l'impact des signaux financiers sur les coûts d'exécution et sur la profondeur de ce marché. Les résultats présentés mettent par ailleurs en évidence le caractère discriminant du ratio capitalisation boursière-capitaux propres comptables dans la détermination de la liquidité du segment action de la bourse de Varsovie.

Classification *JEL* : C21 ; G15 ; G30.

Mots-clefs : Liquidité du marché ; coûts d'exécution ; profondeur du marché ; signaux financiers ; bourse de Varsovie.

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1. INTRODUCTION

From an academic perspective, the literature on market liquidity essentially focuses on the microstructure determinants of its three dimensions: transaction costs, market depth, and resiliency indeed appear significantly driven by the behaviour of investors (Genotte and Leland 1990), market activity (McInish and Wood 1992, Chordia *et al.* 2001), or the design of the trading mechanisms (see e.g., Grossman and Miller 1988, Affleck-Graves *et al.* 1994, or Stoll 2000). Liquidity co-movements are also documented at the local (Chordia *et al.* 2000, Hasbrouck and Seppi 2001) and global (Brockman *et al.* 2009) levels. Such exogenous drivers as the corporate signals issued by companies in their communication to investors remain however poorly documented. This paper accordingly contributes to the literature by taking a new look at the corporate determinants of the transaction costs and market depth of the securities listed in the equity segment of the Warsaw Stock Exchange.

Since the launch of quotations in 1991 after a break of more than 50 years, the Polish stock market has become one of the largest equity Exchanges in Eastern Europe, notably in terms of market capitalisation, trading volume and number of companies listed (Federation of European Securities Exchanges, 2010). From an international perspective, its evolution towards a developed market has eventually increased its attractiveness to foreign investors. According to data from the Federation of European Securities Exchanges, the turnover in foreign equity has increased by 127.44% between 2006 and 2011. Over the same period, the number of trades in foreign securities listed on the Exchange has increased by more than 230%. In February 2010, the exchange further gained the 'Recognised Stock Exchange' designation from the British HM Revenue and Customs department, hence increasing its attractiveness and accessibility to Britain-based investors.

Market quality has also become increasingly important over the years. The launch of a liquidity support programme in a resolution adopted by the management board of the Warsaw Stock Exchange in June 2008 has notably placed the liquidity of this market under closer scrutiny. In an attempt to protect investors, the programme has indeed reinforced the surveillance of market liquidity, that is, the ability to execute large (buy or sell) orders with limited (or no) impact on the stock price. The programme notably forces the Exchange to constantly monitor the liquidity of the securities listed on its market. Securities facing severe market liquidity dry-ups³ are placed in the *lower liquidity space* which forces issuers to take additional actions⁴ to improve the liquidity of their shares and to inform investors.

Against this background, monitoring and managing market liquidity takes on particular importance for the managers of Polish firms. First, as the literature shows, by pursuing corporate financial policies that improve liquidity, managers can maximise the value of their

3. The liquidity support programme triggers a liquidity alert when the security is very infrequently traded (less than 10 transactions per day) or when the turnover falls below the 25,000 PLN threshold defined in the resolution (Warsaw Stock Exchange, 2010).

4. Among these actions, issuers can enter the liquidity support programme which requires that they enter into a market-making relationship with a specialist and that they intensify their communication to investors through a dedicated section on their website (Warsaw Stock Exchange, 2010).

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