Available online at www.sciencedirect.com
ScienceDirect
International Review of Financial Analysis 15 (2006) 450–461
IRFA
INTERNATIONAL REVIEW OF
Financial Analysis

Insider ownership, bid–ask spread, and stock splits: Evidence from the Stock Exchange of Thailand

Maneeporn Gorkittisunthorn [a], Seksak Jumreornvong [b], Piman Limpaphayom [c,*]

[a] *Thanachart Securities Public Company Limited, Thailand*
[b] *Thammasat University, Thailand*
[c] *Sasin Graduate Institute of Business Administration of Chulalongkorn University, Chula 12, Phyathai Road, Bangkok 10330, Thailand*

Available online 20 March 2006

Abstract

This paper examines the moderating effect of insider ownership on bid–ask spread changes during stock splits in Thailand, an economy with highly concentrated ownership structures. Consistent with the liquidity hypothesis, the overall finding shows that bid–ask spread declines significantly after stock splits. The results also indicate that there is a significant relation between insider ownership and the change in bid–ask spread. Specifically, significant reductions in bid–ask spread occurred mostly among firms with low levels of insider ownership before stock splits. Bid–ask spreads remain virtually unchanged for shares with high ownership concentration. The findings highlight the link between corporate governance structure, market microstructure, and corporate financial decisions in emerging markets.

JEL classification: G14; G15; G32
Keywords: Bid–ask spread; Liquidity hypothesis; Insider ownership; Stock split; Thailand

1. Introduction

During the past decades, considerable attention has been devoted to examining the relation between insider ownership and various corporate financial decisions. The reason is that insider ownership plays a critical role in the agency conflicts between managers and shareholders arising from the separation of ownership and control (Jensen & Meckling, 1976). Morck, Shleifer, and Vishny (1988) and McConnell and Servaes (1990) investigate the relation between managerial

* Corresponding author.
E-mail address: piman.limpaphayom@sasin.edu (P. Limpaphayom).

1057-5219/$ - see front matter © 2006 Elsevier Inc. All rights reserved.
doi:10.1016/j.irfa.2005.09.004

ownership and firm valuation among U.S. firms. Jensen, Solberg, and Zorn (1992) examine the relation between insider ownership and financial leverage and dividend policy among U.S. firms. Mikkelson, Partch, and Shah (1997) study the change in levels of insider ownership of companies going public in the U.S. and the impact on firm performance after initial public offerings. In recent studies on East Asian firms, Claessens, Djankov, and Lang (2000) posit that highly concentrated insider ownership can lead to poor investment and financing decisions. In conclusion, insider ownership appears to be an important factor that can significantly affect corporate financial decisions.

Despite the attention to the role of insider ownership in corporate finance, there is little evidence on the effect of insider ownership on the market microstructure aspects of the firm. This study represents the first attempt to integrate corporate governance research with market microstructure research by examining a link between a well-known corporate governance variable, insider ownership, and a market microstructure variable, bid–ask spread. The Stock Exchange of Thailand provides an interesting setting for this investigation because of its unique institutional environment. Claessens et al. (2000) show that the ownership structures of many East Asian companies, including many Thai firms, are highly concentrated. Most of these companies are also family-controlled firms. Claessens et al. (2000) also note that the use of pyramid shareholding structures is commonplace in East Asia. Further, the management group, along with family members, is usually the largest blockholder at the top of the pyramid. Thus, controlling managers at the top of the pyramid are generally able to exercise effective control of all firms in the pyramid. Lins (2003) finds that in emerging markets, the management group is the dominant type of blockholder, controlling 69% of sample firms. As in most East Asian countries, Thai firms have highly concentrated ownership structure with insiders holding a significant proportion of the outstanding shares. Lemmon and Lins (2003), who examine the relation among ownership structure, corporate governance and firm value in East Asian economies, state that, relative to the U.S. and many other well-developed economies, the widespread use of pyramidal ownership structures and cross-holdings in East Asian economies allows insiders to exercise effective control over the company. Moreover, the absence of strong legal protections and other external governance mechanism in many emerging economies further increases the severity of the agency problem between controlling insiders and outside investors. For example, Limpaphayom and Polwitoon (2004) find a significant relation between insider ownership and the use of short-term debt among Thai companies before the Asian financial crisis. Mitton (2002) finds that East Asian firms with less concentration of insider ownership exhibit better performance during the Asian financial crisis.

A recent regulatory change in Thailand also provides a natural experimental setting for testing the relation between changes in bid–ask spread and insider ownership. Specifically, stock splits were prohibited under rules established by the Stock Exchange of Thailand. Before the 1997 Asian financial crisis, the par value of all Thai firms was set at ten baht per share. Recently, however, stock splits have become a common occurrence in the Thai market because, in 2001, the government passed the New Public Company Act B.E. 2544, which states that there is no longer a required minimum par value. Since there is no longer a minimum requirement, the par value can be as low as 0.01 baht per share. The authorities hope that the new regulation will make firms' capital structures more flexible and enhance liquidity, which will in turn attract more investors. Since 2001, more than 90 out of 407 listed firms have completed stock splits as a result of the new regulation. Twenty-five firms split their shares in the first half of 2003 compared to twenty-eight firms during the whole of 2002. Some of the listed firms (e.g., TUF, AMATA, ASIAN, CFRESH, FANCY, LEE, and PICNIC) have even split their shares twice since the regulation was amended.

The purpose of this study is to investigate the moderating effect of insider ownership on the effect of stock splits and stock liquidity, as measured by bid–ask spread. First, the study investigates how stock splits affect stock liquidity in the Thai market. Furthermore, it is hypothesized that insider ownership is