POSTGRADUATE SEMINAR SERIES

Research Findings Seminar

Topic Title : **Stock Liquidity and Value Relevance of Earnings: Evidence from a Natural Experiment**

Presenter : **Mr ASAMOAH, Joseph Maxwell**
MPhil Student of Accountancy

Abstract :

This thesis investigates the relationship between stock liquidity and the value relevance of earnings within the context of the Tick Size Pilot (TSP) Program initiated by the SEC in 2016. Addressing the longstanding challenge of endogeneity in empirical studies on this topic, the TSP Program's quasi-experimental nature provides a unique opportunity to establish causal relationships by offering an exogenous liquidity shock. This is crucial because the program's primary aim is to assess the impact of tick size on trading liquidity, and its random assignment of stocks into treatment and control groups significantly reduces the likelihood of outcome variables being influenced by unobserved factors related to the program itself.

Employing a difference-in-differences approach to study the unique dataset around this regulatory change, this study aims to unravel how exogenous changes in stock liquidity affect the market's reaction to earnings announcements.

My findings reveal that decline in stock liquidity led to a reduced market response to earnings information, suggesting that liquidity decline facilitate a reduced efficiency in the incorporation of earnings information into stock prices. Specifically, I observe that stocks experiencing a decline in liquidity after the implementation of the Tick Size pilot Program exhibit declined earnings response coefficients, indicating that earnings news is less value relevant for these stocks. I find that this is mediated by two primary channels: a decline in the participation of Institutional Investors and Block Holding formation due to the decline in stock liquidity which makes these stock less attractive to the institutional investors.

The implications of these findings are in manifolds. First, they underscore the critical role of market liquidity in enhancing the efficiency of financial markets, suggesting that regulatory policies aimed at improving liquidity can have substantial benefits in terms of information dissemination and price discovery. Second, our results highlight the importance for investors of considering liquidity as a key factor when assessing the informational value of earnings reports. In environments with higher liquidity, earnings information is more likely to be quickly and fully reflected in stock prices, potentially altering investment strategies that rely on trading on earnings announcements. Lastly, for corporate managers, the enhanced value relevance of earnings in more liquid markets may increase the incentives for transparent and timely financial disclosures, as the market rewards or penalizes firms more directly based on their financial performance.

By contributing novel insights into the consequences of stock liquidity on the value relevance of earnings from a shareholder's perspective, the study provides evidence on the causal relationship between stock liquidity and the value relevance of earnings and offers insights into the mechanisms through which liquidity influences the efficiency of financial markets. The findings have important implications for regulators, investors, and corporate managers, highlighting the significance of liquidity in the dissemination and impact of financial information.

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Time : 14:30 – 16:00

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LINGNAN UNIVERSITY 香港嶺南大學 香港商學研究所 HONG KONG INSTITUTE OF BUSINESS STUDIES HONG KONG

*** All are Welcome ***

Enquiries: HKIBS, 26168373 or by email(hkibs@ln.edu.hk).

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