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The Influence of Foreign Institutional Ownership and Domestic Institutional Ownership to Stock Market Liquidity (Study in Manufacturing Industry Listed in Indonesia Stock Exchange)

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Abstract

This research was conducted to determine the influence of structure ownership, foreign institutional ownership, and domestic institutional ownership, from stock market liquidity control variable in this research are return volatility, and size measure by market capitalization. This research utilizes a quantitative approach applying statistical tools in the form of multiple linear regressions. This study also employs secondary data from manufacture firms which fulfills the requirement and listing in Indonesia Stock Exchange from 2009-2010.

The result of this study concludes that foreign institutional ownership has a significant negative impact on stock market liquidity which is measured by depth and also has a significant positive influence on market liquidity which is measured by relative spread. The second result of this study is that domestic institutional ownership has a significant negative influence on stock market liquidity measured by depth but domestic institutional ownership measured by relative spread that hasn't held significant influence on stock market liquidity. The control variable has varied influence on stock market liquidity.

Keywords:
foreign institutional ownership, domestic institutional ownership, return volatility, size, market capitalization, stock market liquidity, depth, relative spread.

1. Introduction

Status of one country's market can be classified into two based on Financial Times Stock Exchange (FTSE Group)—one of the world's leading business news and information accuracy recognized for providing economic and financial data, namely the developed markets and emerging markets. Developed markets are known for markets of developed countries which are presumed to have highly developed and thus managed a lower risk. While emerging markets are known for market of developing countries which projects higher growth (Mody, 2004: 3).

One distinctive difference between its statuses is a matter of financial market liquidity. As we know, the emerging markets are not as volatile as developed markets. Lack of liquidity is considered as a key factor amid the soaring volatility of emerging markets, thus becoming a significant obstacle in the development of financial markets.

Disclosing domestic financial markets to global investors is part of the overall financial liberalization policies. It is expected to improve liquidity in the domestic market, as Stulz describes (1999a, b), a large participation of international financial institutions will increase the liquidity of the domestic market through better information disclosure. Thus, securities trading become more dynamic.

Although several studies have been conducted to assess the liquidity of emerging markets, research on the relationship of liberalization of financial markets with liquidity is still limited. Levine and Zervos (1998) and Bekaert et al. (2002) demonstrates that liquidity measured by the ratio of trade to GDP value upon trading value of the market capitalization has displayed an increasefollowing the capital markets liberalization in developing countries. The latest study, Bekaert et al (2007) demonstrated a positive effect of the level of openness to foreign investors to the liquidity in the capital markets of developing countries. This study takes into account the impact of the financial markets liquidity in emerging markets. Although the study does not include the impact real foreign trade liquidity, the relationship between foreign engagement and greater liquidity explains the economic success following market liberalization. For instance anincrease in private investment (Henry, 2000) helps to reduce the cost of capital and promotesgreater economic growth.

However, instead of contributing to positive influence, foreign capital inflow must also takes into account the risk of mobility over the flow of fund that can cause an extreme volatility for emerging markets. Recently, the proportion of foreign ownership in Indonesian capital market is still in the range between of 60% which directly or indirectly will be affecting the potential of the Indonesian capital market shock.

Research carried by Michael J. Schill (2006) mentions that the emerging markets, such as Indonesia, plays important roles in increasing international portfolio, which in turn will lead to the prospects of investment growth, the high average returns, high volatility and low correlation between emerging markets and developed markets.

Indonesia's economy itself is generally quite stable and secure. This is evident from the growth of the GDP *(Gross Domestic Product)* in the third quarter 2011, which is stable in the range of 6.5% year on year, or 3.5% from the previous quarter (www.bps.go.id). This condition is also supported by an increase in CCI *(Consumer Confidence Index)*, indicating an increase in consumer confidence towards national economy. GDP growth is largely

supported by trade and consumption. Throughout the third quarter of 2011 household consumption grew 2.7% in Indonesia, government consumption grew 0.2%, investment grew 1.7%, exports grew 8.3%, and imports grew 5% (www.bps.go. id). These conditions suggest the potential for an increase in aggregate demand and encourage business expansion and increased demand for loan funds.

This condition is sustained by the rise of Indonesia's rating to investment grade in the end of 2011. This achievement will certainly increase the flow of foreign capital into Indonesia. Indonesian capital market, especially in connection with the market equity, becomes the object of which requires interesting insight because it shows the transactions of foreign investors by 30% in each of the daily trading volume and stock ownership by foreign investors accounted for 63% of the shares listed on the Indonesia Stock Exchange.

The increase of foreign investor confidence more or less brings affect to the level of trust and participation of domestic investors in the Indonesian capital market. Fundamentally, foreign investors and domestic investors possess different characteristics and motivations (Douma et al., 2002). However, domestic institutional ownership has characteristics similar to institutional ownership as domestic institutional ownershiphas no special distinctivecharacteristic like those of foreign institutional ownership. This occurs due to the cluster of ownership structure as Zhekadescribes (2005), the ownership structure is composed of foreign holdings, stock ownership by managers, large institutions ownership, stock ownership by managers, and government ownership. Therefore, this study encompasses the common understanding between domestic institutional ownership and institutional ownership. The influence of institutional ownership on stock liquidity is driven further by the influence of their stock prices trading behaviour and practice (Sarin and Shastri, 2000). Unlike the foreign institutional ownership that is more familiar with information towards market or possess information in connection with shares where traders are lack of. Institutional ownership performs trade for informational matter only. Chakravarty (2001) discovers that a medium-scale trading is conducted by institutions which report result tounequal cumulative prices. This could result in increased costs that will reduce information asymmetry.

Based on the occurrence mentioned, researchers want to conduct a study to determine how the influence of foreign institutional ownership and domestic institutional ownership towards Indonesian capital market liquidity during the period 2009 to 2010. The background of this research is the existence of a previous study conducted by Rhee and Wang (2008) which examines the relationship of foreign institutional ownership and liquidity of capital markets in Indonesia in the period of 2002 to 2007, where the results show that foreign ownership has a negative impact towards capital markets liquidity in the future. 10% increase in foreign institutional ownership isequal to 2% increase in the bid-ask spread, a 3% decrease in depth, and a 4% increase in price sensitivity for the following month.

Referring to previous studies result, there are differences in this study, among others, author would like to re-examine the results of previous studies. Adding domestic institutional ownership variable as independent variables instead of foreign institutional ownership, is an effort to renew the discourse included in this study. Then regarding the time period of 2009 to 2010 where the observation takes a place is taken into account economic situation in Indonesia is in the process of recovery after the crisis in 2008 due to the global crisis in the world.

2. Literature Review

2.1. Market microstructure theory

Market microstructure theory is a new theory addressing the growing stock price in the market. O'Hara (1995) stated that this study discusses how asset prices are formed in the market with the existing trade rules. The frequent discussiontakes places in the stock market liquidity because the data are relatively more accessible. Many approaches are used to express the volume of liquidity such as stock transactions, stock transactions frequency and so on.

However, it is bid-ask spread that is largely growing to declare stock liquidity and this research is mostly done by academics and researchers. The simple market microstructure theory has categorized the vendors based on their information systems, namely, *the informed traders* and *uninformed traders. Informed traders* have information with respect to stock, while other traders do not have it. They exploit the advantage of this information to take advantage as much as possible when making trades. *Uninformed traders* do not trade for informational reasons. In many cases, they are termed as *"noise traders"* or investors who were noisy, because their trades are based on their beliefs and sentiments that are not based on fundamental information. Information arediscloseed in the market through the trading activity of *informed traders* (Vishwanath, R. and Krishnamurti, C., 2009).

To take full advantage of the possession of superior information, *informed traders* have an incentive to lower prices slowly with their trade. Barclay and Warner (1993) stated that *the informed trader* uses a medium-scale trading rather than large scale to prevent information moving fast in stock prices. Chakraverty (2001) found that medium-scale trading is done by institutional trading. This resultsin a large unequal cumulative stock price. This finding is consistent with the general view where institutions are *informed traders.*

The popular measurement for liquidity is popular using proxy bid-ask spread. This can be considered as a price implied by the dealer to provide order execution immediately. Amihud and Mendelson (1986) determined the relationship between the bid-ask spread with stock returns where investors will ask for a higher rate of return for high spreads stock. Therefore, investment decision regarding liquidity should be made under considerations as addition to risk. Although an investor can reduce risk by holding a diversified portfolio, but the cost of illiquidity cannot be diversified.

In addition to the conditioned rate of return, liquidity also affects the period stock holding. Costs created by the bid-ask spread should be borne by the investor only during the period of shareholding. The longer period holdings would effectively lower the transaction costs per unit of time. The longer the stockholding period is, the lower the additional return required to compensate for the bid-ask spread. Therefore, stocks with higher bid-ask spreads will be held by investors in the longer period. In contrast, short-term investors will hold stocks that have low spreads. Amihud and Mendelson (1986) show empirically that the return of securities reflects the percentage bid-ask spread. Observed Gross returns tended to increase as the spread increased. The results of this study have several implications for investment managers. First, investments that have low liquidity are conditioned to generate higher returns for investors. Second, the portfolio managers are advised to pay attention to their client's investment horizon. Clients with longer period of investment horizon will be able to withstand the assets load in the illiquid portfolio. While investors with short-term investment horizon should be directed to hold securities that have low spreads.

2.2. Theory Information Asymmetry

Information Asymmetry is a condition where there is unequal information within its management as information providers (prepaper), with shareholders and stakeholders in general as the user. According to Scott (2000), there are two kinds of information asymmetry, namely adverse selection and moral hazard. Adverse selection means the managers and other people inside it usually know more about the state and prospects of the company than outside investors. In addition, facts that may influence the decision to be taken by the shareholders are not submitted to shareholders. While the moral hazard, i.e. that the activities are carried out by a manager is not entirely visible to the shareholders and lenders. So that managers can take action without the knowledge of shareholders in violation of the contract and the actual ethics or norms that may not be worth doing. Ogden et al., (2002) stated that the quality of the stock market is closely related to the efficiency of the information. Therefore, stock prices reflect all available information. If all information is freely available to all investors (as in an ideal market), the market condition is said to be efficiently strong. However, under conditions of asymmetric information, the creation of strong market efficiency is an issue. In some studies, the level of information asymmetry associated with the bid-ask spread. The size of the spread reflects the size of the costs incurred by the market maker spreads within the stock, which is commonly referred to as adverse selection cost. Adverse selection cost is the cost gap information (information asymmetry) that arises when there are market participants who have better information compared to other market participants in connection with the estimated change in the price of securities traded.

2.3. Liquidity of Shares

Stock market liquidity is the ability to absorb the flow of buying and selling requests on the stock market. Capital market liquidity is used to look at the stock market reaction to the information given. Definition of liquidity according to Jones (2002:27) is the ease and speed to convert an asset into cash. An illiquid asset as it can be converted quickly and with little price change, assuming there is no new information in the market. While Jeff Madura (2003: 3) explains, that liquidity is a level of security that can be easily sold without a loss in value. According to the second explanation, stock liquidity is the ability of the company's shares to be sold as soon as possible on a wide range of conditions, without resulting in significant price reductions. An asset is said to be liquid if the asset can be traded in large quantities within short time, low cost, and without a significant loss on the value for anywhere near the price that occurred in previous transaction. The level of stock liquidity of a company can be measured by using the volume of stock transactions or trading volume and trading frequency. Reilly and Brown (2003:347) stated that the most important factor is the amount of money the liquidity of shares traded. The greater the trading volume is—compared to the total number of shares issued, the more liquid the stock will be. Rhee and Wang (2009) use a three-dimensional measurement in its study, namely, 1) the bid-ask spread, 2) depth, and 3) price sensitivity.

There are several ways to measure stock market liquidity, most researchers often use the *relative spread* and *depth*. *Relative spread is* used to measure the dimensions of *tightness* and *immediacy* stock, while the *depth* is employed to measure the *depth* dimension. *Depth* can be measured by the formula:

$$D_{Lt} = Bid_{Lt} x\ Q^{B}_{Lt} + Ask_{Lt} x Q^{A}_{Lt}.$$

Where:

$D_{i,t}$: *Depth* stock i in period t
$Bid_{i,t}$: Harga beli terbaik saham i pada periode t
$Ask_{i,t}$: The best selling price stock in period t
$Q^B_{i,t}$ and $Q^A_{i,t}$: Number of shares in the best deals

As for dimensions *relative spread* is measured by the formula:

$$S_{i,t} = \frac{(Ask_{i,t} - Bid_{i,t})}{(Ask_{i,t} + Bid_{i,t})/2}$$

Where:

$S_{i,t}$: *Relative spread* stock i in period t
$Ask_{i,t}$: The best selling price stock i in period t
$Bid_{i,t}$: Price in best buy stock i in period t

2.4. Ownership Structure

There are many categories of structureownership. According Zheka (2005), the ownership structure is composed of foreign holdings, stock ownership by managers, ownership owned by institutions, individual holdings, and government ownership. Meanwhile, Rubin (2007) classifies property into two levels, namely shared ownership becoming institutional ownership and insider ownership. Meanwhile ownership concentration is represented by block holder. In general, ownership structure can be divided into two, namely ownership by foreign investors and domestic investors.

Trying to distinguish from previous research, this study focuses on two categories, namely ownership by foreign institutions and domestic institutions. Ownership structure, by some researchers, is believed to affect the company operation, which in turn affects its performance in achieving corporate objectives in maximizing the value of the company. This happens due to control they have.

2.5. Foreign Institutional Ownership

Institutional ownership is ownership by a legal entity that can consist of investment companies, banks, insurance companies and other institutions or any form of ownership. Ownership structure specifically falls into 2 (two) categories, namely foreign ownership and public ownership. Foreign ownership is share ownership owned by foreign investors, while public ownership is share ownership owned by the public or domestic public. Foreign ownership owned by individual or institutional enterprises is an important tool for the company. Foreign holdings indicate that the company is experiencing growth that it attracts other investors to invest in the company stock. These results in higher liquidity, share price will also rise so that the performance of the stock and the company as a whole will also increase.

Doms and Jansen (1998) suggested that the presence of foreign ownership will enable companies to be more productive and more rely on capital intensive to hire employees with higher salary than domestic firms. Foreign investors as shareholders are able to influence management decisions.

In research, Stulz (1999a, b) explains that the international financial institutions large engagement will increase the liquidity of the local market through better better information disclosure and more active trading. The relationship between foreign engagement and liquidity can also be seen from the success of the economy followingmarket liberalization. For example an increase in private investment (Henry, 2000) helps to reducecost of capital and promote to greater economic growth

As foreign engagement enters local stock market, it shows that foreign investors have sufficient information about the existing market potential. This foreign engagement indicates that the information known or not known by local investors. According to Aggarwal et al (2005), foreign investors prefer stocks with high liquidity levels. In emerging markets, local investors have little information so they tend to be *follower*. This led to increased trade stocks by foreign investors which will also be followed by local investors. Interaction of foreign investors and local investors in the stock trading will encourage liquidity to increase.
This study analyses foreign institutional ownership which can be calculated by the following formula:

$$FINST = \frac{\text{Number of share}}{\text{Total of}}$$

2.6. Domestic Institutional Ownership

Domestic institutional ownership can be distinguished from foreign institutional ownership. According to a research by Patnaik and Shah (2008), foreign institutional investors prefer to buy stocks that are liquid, fresh, and private companies that have global visibility. While domestic institutional investors prefer companies that are not too liquid, mature with large fixed assets and high leverage.

Domestic institutional ownership basically has no special characteristic. Based on previous research, institutional ownerships that mostly associated with liquidity are foreign institutional ownership and institutional ownership. Thus, inside this study of domestic institutional ownership, variables are considered similar with characteristics of institutional ownership. This is in accordance with the ownership structure grouped by Zheka (2005), ownership structure consists of foreign holdings, stock ownership by managers, ownership by large institutions, holdings by individuals, and ownership by government. Therefore, to further domestic institutional ownership will be called institutional ownership.

Ownership by institutions can significantly reduce the agency costs for monitoring the management shareholders. Supervision carried by domestic capital ownership will help to ensure managers to act in the capacity and for shareholders' interest (Amidu and Abror, 2006). The influence of institutional ownership on stock liquidity is further driven by the influence of their trade behaviour and practices towards stock prices (Sarin and Shastri, 2000). The trade done by institutions often takes into account large amounts of stock transactions.

It will bring powerful impact towards price and liquidity of shares traded. Similarly, Rubin (2007) also stated that the stock transactions made by institutional holding will occurmore frequently than transactions made by other investors. Therefore, institutional holding has a positive effect on the stock liquidity.

Fundamentally foreign investors and domestic investors have different characteristics and motivations (Douma et al., 2002). Foreign investors feel better informed about the state of the country and companies in it, so they prefer investing in securities that he really knows his information (Dahlquist and Robertsson, 2001) while the domestic investors have already felt familiar with the condition of the country, investors know less so they search for fundamental information. So that both investors would process information they obtained differently according their respective intelligence and emotionally.

Based on the theory of market microstructure, traders have traditionally been categorized based on their information systems, namely *informed traders* and *uninformed traders*. *Informed traders* have information with respect to stock, where other traders do not have it. They exploit this information for merits as they enter the trade. Meanwhile *the uninformed traders* do not trade for informational reasons. Chakravarty (2001) find that trading is a medium-scale trading conducted by institutions that report on the cumulative impact on a large unequal cumulative stock price. This finding is consistent with the general view that institutions are *informed traders*. To cover losses that may occur as a result of trade done by the *informed traders*, the *market makers (dealers)* increase the cost of information asymmetry or *adverse selection cost* on the bid-ask spread stocks. Therefore, the higher the institutional ownership of the shares of a company is, the greater the bid-ask spread of the company's stock. In other words, institutional ownership has a negative impact on the liquidity of the company's stock.

Other studies also reinforce this conclusion, the institutional transaction is more likely to control or manage information (Ke and Petroni, 2004; Bushee and Goodman, 2007), and large institutional ownership increases the information asymmetry (Dennis and Weston, 2001; Brockman and Yan, 2009) and return volatility (Sias, 1996 and Wang, 2007). So that institutional ownership has a negative impact on the liquidity over stock.

The domestic institutional ownership can be calculated by comparing the amount of shares ownership owned by domestic institutions with the number of shares outstanding *(shares outstanding)*which is calculated by the formula:

$$DINS = \frac{\text{the number of shares owned by domestic insti}}{\text{the number of outstanding sha}}$$

2.7. Return Volatility

Return is one factor that is considered when making investments. Return is defined as the rate and the expected profits of an investment over a given period. The profit rate includes dividends and capital gain (loss). The extent profit return is changing all the time reflects the return volatility.

The source for return volatility comes from the company risk and the stock market volatility (Hirschey, 2001). Corporate risk is a risk caused by internal factors such as the quality of corporate management companies, operational leverage and financial leverage, as well as changes in the quality of the company's products. This risk can be addressed by diversifying investments investors. In contrast, the volatility of the stock market is the movement of the stock market as a whole, which is caused by factors outside the company such as inflation and interest rates. Because the source of returnvolatility is a risk,

return volatility will indicate the size of the risk embedded in such investment that can be measured by the standard deviation of stock returns.

Besides being able to calculate the risk, return volatility can also indirectly measure the degree of information asymmetry among market participants (Andersen, 1996). The higher the return volatility is, the higher the level of information asymmetry (adverse selection) among market participants. The higher asymmetry information means the larger the bid-ask spread is formed. So that it can be concluded that the higher the return volatility is, the higher the bid-ask spread. In other words, return volatility has a negative impact on the stock liquidity (Sarin and Shastri, 2000; Friedel and Martel, 2006; Rydge and Forde, 2006; Rubin, 2007).

When the stock's return volatility is too high, market participants tend to reduce their order they make. This measure is taken to reduce the risk of trading losses with *informed traders*. The higher volatility of returns means the lower the selling orders (buy) or depth , so it can be concluded that the return volatility has negative impact towards stock liquidity, which means the higher the stock's return volatility is, the lower the liquidity of the stock.

Calculating the return volatility employs standard formula which indicates the height of risk embedded in investment. The formula as follows:

$\sigma_{i,t} =$

Where:

$\sigma_{i,t}$	:	Standard deviation of stock i in given period t
R_{it}	:	*Return* company stock in given period t
μ_t	:	Average *return* of company stock i in given period t
n	:	The number of return sample of company stock i

2.8. Size (Market Capitalization)

The company size will affect its ability to bear risks that may arise in running the company. In addition to that, the size of the company also shows divulging the size of companies that can be seen from its value in market capitalization, the level of sales, number of employees and total assets owned by the company. According to Chan and Nai (1991), small companies are prone to more risky because small companies have low production efficiency, high *leverage* and lower profitability levels compared to larger companies, so the rate of *return* volatility that occurs also higher when compared with larger companies. Heflin and Shaw (2000) and Rubin (2007) use stock market value as a proxy for firm size. So does research conducted by Rhe and Wang (2008) who used the term market capitalization to proxy firm size by the same measurement to market value. Market value of a company is the result of multiplying the market price per sheet with the number of outstanding shares.

The number of market value indicates the value of markets shareholder equity. The larger the company is, the greater the company's stock market value. This condition causes many investors hunt the company's stock. The higher the demand for a company's stock is, the easier orders (buy) are offered. This could lower the holding cost component in the bid-ask spread. Thus, firm size has a positive affect on the liquidity of the stock, which means the larger the firm size (market capitalization) is, the greater the company's stockliquidity.

In addition to that, Dunerv and Kim (2003) stated that the larger companies will tend to attract more attention and spotlight from public, thus encouraging companies to implement better *corporate governance* structure. Therefore, the level of information asymmetry between management and shareholders of larger companies tend to be lower than the smaller firms. Stoll and Whaley (1983) states transaction in larger firms is easier than doing so in smaller companies because smaller companies require more information available in the market and the stock analyst. This leads to the liquidity of larger company's stock higher than the liquidity of smaller company stocks.

The results of study carried by Rhee and Wang (2009), Rubin (2007), and Friederand Martel (2006), also expressed firm size has a positive effect on the liquidity of a company's stock. The larger the size of the company means shares of the company's liquidity will be higher. This occurs because a large company stocks will be more frequent and easier to trade than stocks of smaller size companies.

Market capitalization is calculated with:

$$Market\ Cap = \ln(share\ market\ price \times \sum outstanding$$

3. Research Hypothesis

Based on the explanations that have been put forward, the research hypothesis as follows:

H_1 : Foreign institutional ownership has positive effect towards stocks liquidity.

H_{1a} : Foreign institutional ownership has positive effect towards stocks depth.

H_{1b} : Foreign institutional ownership has negative impact towards stocks relative spread.

H_2 : Domestic institutional ownership has negative impact towards stocks liquidity.

H_{2a} : Domestic institutional ownership has negative impact towards stocks depth.

H_{2b} : Domestic institutional ownership has positive effect towards stocks relative spread.

4. Research Methods

The data employed in this study is a secondary data in the form of financial statements of companies listed in the Indonesia Stock Exchange as well as the daily stock trading sourced from *Indonesian Capital Market Directory*, an IDX directory and *website:* www.idx.co.id ,www.ksei. co.id & www.finance.yahoo.co.id .

Samples of study are manufacturing companies qualified and listed on the Indonesia Stock Exchange in 2009-2010. By using purposive sampling, total sample of 79 companies areobtained which are included in the index stock index over the period 2009-2010.

Based on the models and hypotheses analysis, the researchers applied multiple linear regression analysis that is managed to explain and evaluate the relationship between one dependent variable and one or more independent variables. With liquidity as dependent variable and foreign institutional ownership, domestic institutional ownership, return volatility and firm size as independent variables.

5. Results

Results of Model I Regression (proxy *depth*) in Manufacturing Companies Stock 2009-2010

	β Coefficient		T	Sig.
	Unstandardized	Standardized		
(Constant)	-0,396		-0,276	0,3915
FINS	-1,071	-0,173	-2,254	0,0130*
DINS	-1,561	-0,240	-3,139	0,0010*
VOLT	8,841	0,073	1,328	0,0930
MCAP	0,708	0,813	14,913	0,0000*
F test	63,100			0,0000*
R^2	0,632			

*Significant with level of signicance 5%

Result of Model II Regression (proxy *relative spread*) In Manufacturing Companies Stocks 2009-2010

	B Coefficient		T	Sig.
	Unstandardized	Standardized		
(Constant)	0,536		6,861	0,0000*
FINS	0,063	0,275	2,591	0,0055*
DINS	0,033	0,138	1,314	0,0955
VOLT	-0,832	-0,186	-2,457	0,0075*
MCAP	-0,018	-0,568	-7,549	0,0000*
F Test	15,710			0,0000*
R^2	0,299			

*Significant with level of signicance 5%

5.1. Foreign Institutional Ownership Effect on Stock Liquidity

In this study, a foreign institutional ownership variable has a significant negative impact on the variable depth and significant positive effect on relative spread variable. Regression results of the two models shows that foreign institutional ownership can reduce liquidity in Indonesian shares. The higher foreign institutional ownership is, the smaller liquidity will be. The results are consistent with studies conducted by Rhee and Wang (2009) that states foreign holdings will decrease stock liquidity due to increased information asymmetry.

Negative impact of foreign institutional ownership due to the depth of the foreign institution is considered to have a better experience, background in higher education, better training, and better information about the company than domestic investors. Besides, the high ownership by foreign institutions will lead board of directors members of the company are reserved for foreign institutions. This condition causes the existence of information asymmetry between domestic and foreign investors. More informal information channels flowing to foreign institutions that have greater ownership and this will not only weaken buat also limit the flow of information to domestic investors. To take full advantage of the superior information ownership, foreign institutions as the informed traders have an incentive to slowly lower prices with their trade. Informed traders use medium-scale trading rather than larger scale to prevent information moving too fast in stock prices. The declining in number of transactions in the stock market will make liquidity measured by the depth decrease, so that foreign institutional ownership can decrease stock liquidity as measured by depth.

Relative spread can be considered as a price implied by the dealer to provide order execution immediately. The positive influence of foreign institutional ownership as a variable towards the relative spread demonstrates the higher degree of foreign institutional ownership, the dealer will charge high in trade transactions. This is done because it considers foreign institutional ownership as the informed trader. The higher relative spread showed a decline in liquidity, so that foreign institutional ownership can decrease stock liquidity as measured by the relative spread.

5.2. Effect of Domestic Institutional Ownership on Stock Liquidity

The results on Domestic Institutional Ownership variable against liquidity is a significant negative effect towards depth and insignificant positive effect on relative spread. Results of the study showed that the depth proxy Domestic Institutional Ownership decreases stock liquidity

Significant negative influence on the Domestic Institutional Ownership to depth variable is not due to the asymmetry of information as well as research Sarin and Shastri (2000) which states that institutional ownership is not associated with information asymmetry. However, the negative effect is more significant in this study because it uses the period after the panic selling due to crisis in United States. At the moment where most of the period after the panic selling, many domestic investors do not purchase shares to be sold in the short term but they invest in the long run in order to earn abnormal profits. This condition leads to low frequency trading activity or stock so that stocks liquidity fell as measured by the *depth* variable whichis measured by multiplying best buy price and best sell price by the number of shares available at the best prices.

The influence of domestic institutional ownership is insignificant to the relative spread variable due to the improvement in Indonesia stock exchanges within period of study. Its rapid recovery following panic selling in 2008 is owed to the increased investor confidence that serves as fundamental conditions in Indonesia.

5.3. Influence Volatility Return on Equity Liquidity

Volatility variable in this study shows that there is insignificant effect on the depth and significant negative effect on relative spread. Results of studies with variable relative spread is opposite to the results of research Rydgeand Forde (2006), Frieder and Mertel (2006), as well as Rubin (2007) which states that the volatility has a negative effect on the stock liquidity. Higher the volatility will decrease the liquidity due to higher occurring information asymmetry.

The negative significant influence of volatility towards relative spread proxy is caused by the period of study for it is conducted after the *panic selling* caused by US financial crisis. During *of panic* selling, most investors sold their shares which led to a decrease in stock price. This also caused an increased volatility in the stock market due to fluctuations in the overall stock market. However, after the incident, the stock market in Indonesia is not constantly declining. In fact, it shows growth or recovery. This condition urges investors, both foreign and domestic, flocking the exchange transaction hoping to capture potential return in the future. This enables selling order goes with ease (buy) helping to lower

the holding cost component in the relative spread. A low relative spreads indicates high liquidity. Hence, a high volatility remains followed by high liquidity.

In contrast to the results towards relative spread, the effect of volatility on liquidity as measured by depth shows insignificant positive results. This occurs as not all investors flocked exchange transaction following panic selling period due to a recovery in the market. There are investors remain by holding their stock when most investors are currently experiencing *panic selling*. Investors who remain holding shares seek for a return in the long term regardless of the economic conditions at that time. This condition causes little change in the number of shares available at the best prices. So when liquidity is measured by depth, there is no significant effect of market volatility on the liquidity of the stock.

5.4. Effect of Company Size (size) the Liquidity of Shares

Variable size in the results of this study indicates there is a significant positive effect on the variable depth and there is a significant negative effect on the relative spread variable. This suggests that the larger size will increase the stockliquidity. This study is consistent with research conducted by Frieder and Martel (2006), and Rubin (2007) which states that the company size has a positive relationship towards stock liquidity. The larger the company is, the greater the company's liquidity would be.

The size of market value indicates the equity size of shareholders' market value of. The larger the company is, the greater the company feasibility to grow and be the centre of attention among investors. This condition causes many investors to hunt company shares as considered being able to achieve company objective, so is to provide welfare for its shareholders. The higher demand towards stock, it will increase the number of shares available at the best prices in the stock trading transactions. This will increase the liquidity of the stock as measured by depth. So, the higher the size is–which is proxied by market capitalization, the greater the liquidity stock as measured by depth.

The company size which will also facilitate greater selling orders (buy). This could lower the holding cost component in relative spread. The low relative spread indicates high liquidity stocks. Thus, firm size (market capitalization) may increase stock liquidity as measured by the relative spread.

6. Conclusion

This study results to a conclusion. First, the foreign institutional ownership has significant negative effect towards shares liquidity with proxy depth, and a significant positive effect towards stock liquidity with proxy relative spread. Second, domestic institutional ownership holds significant negative effect towards stock liquidity with proxy depth, and insignificant positive effect towards stock liquidity with relative spread proxy. Third, return volatility is not a significant positive effect on the liquidity stock with the proxy depth, and but hold a significant negative effect on the shares liquidity with proxy relative spread. Fourth, company size which in this study utilizes the proxy market capitalization shows significant positive effect on the stock liquidity proxy depth, and shows a significant negative effect on the shares liquidity with proxy relative spread.

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