Corporate Governance and the Stock Liquidity in Australia: A Pitch

Searat Ali
Griffith University, Australia

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1. Introduction

This pitch paper applies the template developed by Faff (2014) to an academic research in the finance discipline. About myself, I am currently doing PhD from Griffith University, Australia since January 2013. In a broader sense, my primary field of research is corporate finance. Specifically, I am investigating the association of corporate governance with various corporate activities and outcomes such as risk taking, financial distress, bankruptcy and stock liquidity in Australia. I completely agree with Faff (2014) that there are two hardest things about doing research; the starting and the finishing. Putting it into the perspective of my PhD journey, the first year of PhD was tough but brought plenty of experiences to my research. The experiences are similar to what Faff (2014) tagged "IDioTs" i.e. generating research ideas, checking the availability of relevant data and developing the econometric skills. My confirmation seminar was held on March 27, 2014. Since then, I have completed a paper titled "corporate governance and the financial distress in Australia: Index based evidence" and presented it at 27th Australasian Finance and Banking Conference held on 15-18 December 2014. Also, I participated, as a PhD travel grant recipient', in the 75th annual meeting of American Finance Association (AFA) held in Boston on 2-5 January 2015.

Keeping other tasks and deadlines in consideration, I started working on this pitch from second week of January 2015 and completed it on 18 January 2015. This pitch exercise includes the background reading on pitching research and discussion with my supervisors. Similar to Beaumont (2014), I used a "non-linear" approach to complete this pitch. I started completing the sections that were top of mind and skipping the sections that required deeper contemplation. After this initial pass, I worked randomly to complete each section. Once I had each section roughly outlined, I went back and worked on refining each section paying attention to the advice given by Faff's (2014) 'cues'.

The remainder of this letter is organized as follows. Section 2 gives a brief commentary on the completed pitch, section 3 covers personal reflection on the pitch exercise, and final section concludes the pitch.

2. Brief Commentary on the Pitch

Table 1 presents the pitch on the topic of corporate governance and stock liquidity which was completed on 18, January, 2015. The primary research question (Item B) is "do better governed firms have greater stock liquidity in Australia?". The key research papers (Item C) which relate to the stated research question are Chung, Elder, and Kim (2010), Chai, Faff, and Gharghori (2010) and Beekes, Brown, and Zhang (2014). Of these papers, the most critical and directly linked paper to proposed research idea is Chung et al (2010) who investigate the association between corporate governance and liquidity in US. Other two papers are also important as they are related to Australian context. Specifically, Chai et al. (2010) paper guides us on the determinants of stock liquidity in Australia. While the paper does not incorporate corporate governance quality (CGQ) it provides an insight on the stock liquidity measures. Since I argue that CG affects stock liquidity through the channel of information disclosure, it is vital to prove that the relation between CG and disclosure exists. The paper of Beekes et al. (2014) is important in this regards. Using the Horwath CG ratings as measure of CGQ (in this proposed research I am using the same ratings), they find a significant positive relation between CGQ and informativeness of disclosure in Australia. The proposed research is mainly motivated, as mentioned in the item D, by a lack of empirical research on the corporate governance as a critical determinant of stock liquidity in Australia, plus the institutional differences that Australia has as compared to US. The remainder of Table 1 outlines "answers" to all the required fields from Faff's (2014) template, namely, Idea, Data, Tools, What's New, So What, Contribution, and other Considerations. The material included relating to all of these is self-explanatory from the pitch template itself and, thus, I feel that no further comment is needed here.

3. Personal Reflection on the Pitch Exercise

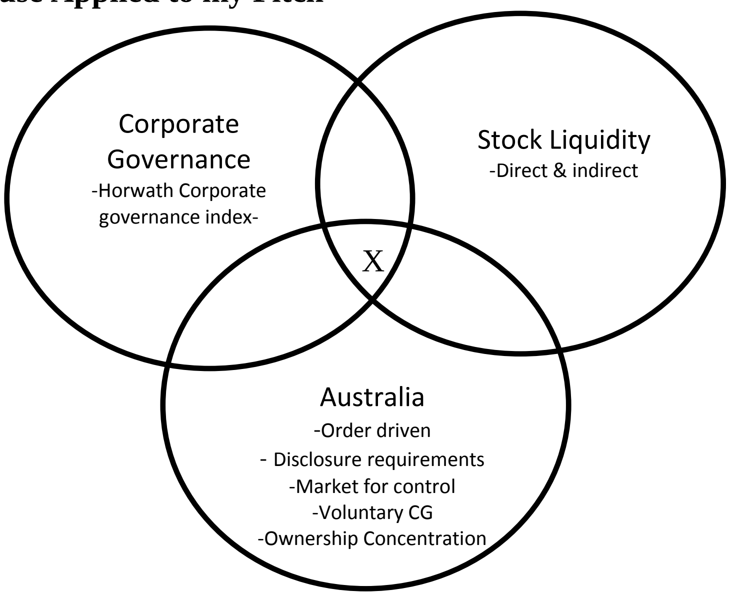
First hearing: *How do I come to know about pitching exercise?* First time, I heard about "pitching a research" from my fellow PhD student who was participating in AFAANZ PhD symposium in 2014. At that time, I was analysing the data and interpreting the results of my first research paper on CG and financial distress. As my memory helps me, I asked my colleague: Can I use this pitch template?. He told me yes, you can! What you have to do is, you need to seek permission from Professor Faff, and after completing you have to send him the pitch for feedback. It takes few minutes to send email and seek permission but I could not do so (pitch exercise) for couple of reasons. Firstly, I work best when there is a certain deadline and it is approaching, this might be a bad habit, but it works for me. Since there was no deadline, I was unable to motivate myself. Secondly, I thought I am half way through to my paper, and pitch exercise might not be useful at this stage, though I was not right in my stance.

Second hearing: *How do I come to know about pitching exercise?* Second time, I heard about "pitching a research" through SIRCA when they sent email with a subject Call for Paper - SIRCA YRW 2015 'Pitching Research' Symposium 20 November, 2014. At this time, I was reviewing literature for second paper on stock liquidity. I thought this is the perfect time to use the pitch template! On top of this, the deadline to submit pitch letter is there. I discussed with my supervisor who strongly encouraged me to participate.

Biggest challenge: *What's new/contribution?* The biggest challenge to any research is contributions, as to my research too. While I was doing pitch exercise, I asked myself if the CGQ and liquidity relation has been tested outside Australia (e.g., Chung et al., 2010), why there is a need to test such relation in Australia? (Item D). I found the recommendation of Faff (2014) very useful in this regard. He recommends that "the researcher needs to make a compelling case as to why it is 'dangerous' to extrapolate the distilled evidence from X, Y and Z to country A". Following his advice, I searched and read more literature and then identified several regulatory and institutional differences (e.g., such order-driven trading mechanism, voluntary CG environment and high ownership concentration) that cast doubt on the generalizability of results to Australia (Item D). In addition to this, recent corporate governance reforms of 2003, and availability of unique corporate governance dataset in the form of Horwath report make Australia an interesting setting (Item F). I also spent some time and searched the papers which applied ideas from US-based papers to non-US based settings and published in top tier journals. The common theme, I learnt is that these sort of papers pay special attention to the institutional setting. I realize that I have to spend more time on this aspect of my research, to make it a success story.

Venn diagram and past experiences: *How Mickey mouse and Venn diagram match my aptitude?* I believe "picture is worth a thousand words", reason why I am inclined to deliver lectures and tutorials by using graphs and flow charts. Transcribing the complex passages and concepts into flow charts and graphs makes it easy for the readers to understand. I am so obsessed with this habit of mine, that my students gave me a title of Mr flow chart. I found Venn diagram, as can be seen in Figure 1, as a simple but effective way to position my research in the context of existing literature.

Figure 1: Mickey Mouse Applied to my Pitch



Some Insights: *What I have learnt from pitch exercise?* After completing this pitch, I realised that the Faff (2014) pitch template is useful not only for new ideas, but also for working papers. I also believe that Faff's template can be used to evaluate the key papers in terms of 3-2-1 "countdown". Further, I realised that there are high chances that you are going to make mistakes. You are going to claim contributions that do not make sense and may fail to pick the contributions that do make sense. To mitigate these concerns, I feel it is very important to discuss your research idea to as many people as you can in the early phase including your advisors and senior faculty both internal and external. The problem one might face is experienced researcher having a tough schedule and they might not be able to read research proposal of 10 to 15 pages. In this scenario, 2 pages pitch template would be quite helpful.

4. Conclusion

Based on the Faff's (2014) guidelines, this letter covers the basic pitch for a proposed finance research project on corporate governance and stock liquidity in Australia. This is the first draft of pitch specially developed to be submitted to SIRCA's 'pitching research symposium'. The purpose of preparing this pitch and participating in the symposium is to receive a constructive feedback from experienced researchers that would ultimately enable me to refine the research idea. One of the best aspects of the pitch exercise is that it reinforced me to think over and over on each section, and enabled me to synthesize scattered ideas in a systematic way. For sure, I would be using the pitch template throughout my PhD research and afterwards. Also, I strongly encourage other researchers to use pitch template to develop and map their research ideas.

Table 1: Completed Pitch on "Corporate Governance and Stock Liquidity"

Pitcher's Name	Searat Ali (18/01/2015)
(A) Working Title	Corporate Governance and Stock Liquidity in Australia
(B) Basic Research Question	Do better governed firms have greater stock liquidity in Australia?
(C) Key paper(s)	Chung, K. H., Elder, J., & Kim, J.-C. (2010). Corporate Governance and Liquidity. Journal of Financial And Quantitative Analysis, 45(02), 265–291 (A* Journal). Chai, D., Faff, R., & Gharghori, P. (2010). New evidence on the relation between stock liquidity and measures of trading activity. International Review of Financial Analysis, 19(3), 181-192 (A Journal). Beekes, W., Brown, P., Zhang, Q. (2014), Corporate governance and the informativeness of disclosures in Australia: a re-examination. Accounting & Finance. doi: 10.1111/acfi.12088 (A Journal).
(D) Motivation/Puzzle	Prior literature on stock liquidity either focuses on the determinants or consequences of the stock liquidity. The proposed study falls under the former group where the role of corporate governance quality (CGQ) as a critical determinant of liquidity is largely ignored, particularly in Australia (See Chai et al., 2010). The studies which examine the relationship between CGQ and liquidity outside Australia (e.g., Chung et al., 2010) may not be generalizable to Australia because of several regulatory and institutional differences. Particularly, as compared to US, in Australia there is a different trading mechanism (order-driven), intensive disclosure requirements (signal G); weak 'market for control' (threat of takeover); voluntary CG environment (if not, why not); and high ownership concentration that I assume have considerable bearing on CGQ and stock liquidity, making it imperative to investigate the role of CGQ and stock liquidity in Australia.
THREE	**Three** core aspects of any empirical research project i.e. the "**ID**io**T**s" guide
(E) Idea?	CGQ is assumed to affect stock liquidity through the channel of information disclosure and quality. Specifically, strong CGQ improves operational and financial transparency of a firm (e.g., Beekes et al., 2014) and mitigates information asymmetry between insiders (e.g., managers) and outsiders (e.g., investors), as well as among outsiders, which ultimately improves stock liquidity. **Central Hypothesis:** CGQ improves stock liquidity in Australia.
(F) Data?	(1) **Country/setting:** Australia because of the implementation of CG reforms (2003) during the sample period, availability of unique dataset, different corporate environment, lack of empirical literature on CGQ and stock liquidity. **Unit of analysis:** Individual non-financial firms. **Sample period:** 2001 to 2008 (Main analysis), 2009 to 2013 (Additional analysis). **Sampling interval:** Annual because CG is available on yearly basis. **Type of data:** firm specific. (2) **Expected sample size:** 1600 firm-year observations on 450 unique firms (unbalanced panel dataset) (3) **Data Sources**: CG index data (Horwath CG report), CG individual variables (SIRCA and hand collection through firm's annual reports), Stock liquidity data (SIRCA), firm characteristics (Morningstar DatAnalysis Premium). **Data availability**: Data is assessable through university's trading room annual subscriptions, Horwath CG reports are not publically available and requested from the concerned person. **Timeframe:** No major time delays. **Research assistance**: Not required. **Funding/grants:** No. (5) **Data Collection:** Standard issues of missing firm years, unavailability of annual reports of few firms, tracking the name changes of firms to properly merge the data from different sources, and to eliminate undue influence of extreme values in the data, possibly due to spurious outliers, all continuous variables will be winsorized to the 1st and 99th percentiles. (6) **Variation in the test variables:** Main independent variable i.e. CG does not change much over time but the prior literature has used it in various context and found statistically and economically significant results. (7) **External validity: 1)** Findings may not be generalizable to small firms as Horwath CG report only covers the top 250 firms. However I do believe that top 250 firms have a major influence on the capital market of Australia in that they represent over 80% of market capitalization and

	have greatest appeal to the investment community. **2)** Horwath CG reports are not available beyond 2008 and findings may not capture current market developments. To overcome, I plan to develop an index similar to Horwath CG index from 2009 to 2013, and check if the results are robust. **Construct validity:** Yes, because the Horwath report pays special attention to the aspects that have been viewed as important in CG best practice codes in Australia and elsewhere. I use four alternative proxies of stock liquidity that has been considered good proxies in literature.
(G) Tools?	**Empirical framework:** (A) Pooled OLS regression approach where standard errors are clustered by firm to control for heteroskedasticity and within-firm correlation in residuals. (B) Alternative panel data estimation methods such as GLS Random Effect regressions and Between Estimators. Year and industry dummies are included in regression model. (C) To preclude reverse causality, lagged values of independent variables will be used. (D) Also, GMM to control all sources of endogeneity. (E) Robustness Checks, deals with survivorship bias and sensitivity of results to global financial crisis and ownership concentration. **Econometric software**: STATA 13. **Econometric Skills:** Own + supervisors.
TWO	**Two** key questions
(H) What's New?	**Novelty:** The relationship between CGQ and stock liquidity has not been tested in Australia, so the novelty is in the data. To capture CGQ, I am using unique dataset of Horwath CG report + developing a similar index beyond 2008 + key individual CG variables. The prior studies using Horwath CG index are either cross-sectional or linked CG to organizational activities other than stock liquidity such as firm performance, information disclosure and corporate social responsibility. Data is the driver whereas idea/tools is the passenger. **Mickey Mouse/ Venn diagram**. Yes
(I) So What?	Given CGQ is instrumental to stock liquidity in Australia; investors, firms and regulators may wish to monitor the CG mechanisms more closely so as to devise a sound trading strategies, corporate environment and trading regulations respectively. **1)** Stock liquidity provides an ease of converting cash into stock and vice versa. Knowing that CG improves stock liquidity, investors can select stocks and construct portfolios with better CG. **2**) Stock liquidity can lower transaction costs and increase demand of a firm's stock, hence reduces cost of capital of a firm. Knowing that CG improves stock liquidity, firms can focus on CGQ and accrue the benefits **3)** If CG improves stock liquidity, this gives an empirical support to the regulators to design appropriate trading regulations.
ONE	**One** bottom line
(J) Contribution?	Investigating the relationship between CG and stock liquidity in the context of unique corporate environment of Australia
(K) Other Considerations	**Collaboration:** It is desired. Idea: Not required Data: CG affects liquidity through the channel of information disclosure. External collaboration may be required to obtain corporate disclosure data. Tools: Yes, internal collaboration. **Target Journal(s):** *Journal of banking and finance*; or *Accounting and Finance* or *Australian Journal of Management*. **"Risk" assessment:** -"no result" risk: Very low. -"competitor" risk: Medium as Horwath CG reports are not publically available. Even if available, it needs sufficient time to organize data in testable format. - "obsolescence" risk; Low, CG has received a wide attention of researchers and policymakers in the recent decade, and expected to remain as a hot topic. **Other Challenge:** The main challenge I have in executing this plan, is why Australia?

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