The Existence of Buying and Selling Herding Behavior by Institutional Investors and its Impact on Liquidity and Liquidity Risk in the Taiwanese Stock Market

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ABSTRACT
First, this study is few study that distinguishes the rational factors and irrational portion from overall buying and selling herding behaviors of institutional investors in the stock market. Then, using a stock’s turnover and its standard deviation to measure a stock’s liquidity and its liquidity risk, we find that overall buying herding and irrational buying herding by foreign institutional investors (FIIs) are more likely to increase the individual stock liquidity than their overall selling herding and irrational selling herding. However, FIIs’ buying herding behavior is more likely to accompany with the simultaneous increase in the individual stock liquidity risk than their selling herding behavior. Furthermore, FIIs’ irrational buying herding more significantly raises stocks’ liquidity but also more significantly expands stocks’ liquidity risk than their overall buying herding. Finally, FIIs’ irrational buying and selling herding behaviors more significantly expand stocks’ liquidity and its risks during a recessionary period. This study provides a reference for supervisors to strengthen their management of FIIs’ irrational buying herding behavior.

Keywords: Institutional Investors, Irrational Herding Behavior, Stock Liquidity, Liquidity Risk.
JEL classification: G23, G10, G14, G23

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