The Relationship between Short Selling and Stock Market Liquidity: Evidence From İstanbul Stock Exchange

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Short selling is an important strategy that investors take short position on stock with the expectation of gain. Having a short position in a stock is that selling borrowed stock on a particular date and buying the stock on a later date in order to give the stock back to the stock lender. After giving the stock to the lender, investor closes out the short position. Individual and institutional investors can have short position for speculation, hedging or arbitrage. Short selling is expected to contribute to the stock price formation and stock liquidity. The positive relation between short sale process and stock liquidity reduce transaction costs and contribute market efficiency. Stock prices have become more informative with short selling. This result affect investor's behavior and investor's short term and long term investment decisions about the stock. In reviewing the literature on short selling strategy, the relationship between short sale process and stock liquidity is two-way. However, it has been determined that there are a few studies which test the relationship between stock liquidity, trade in İstanbul Stock Exchange, and short sale process. The purpose of our study is to provide evidence whether short sale process affects stock liquidity. The sample consists of the firms from ISE30 index. ISE30 index comprises of the stocks with the highest liquidity due to the intensity of trading volume. For this reason, the relationship between the stock liquidity and the short sale process is expected to be explained better. In the study by making use of daily stock data with the number of trading days. Furthermore, our sample period covers trading days between 1 January, 2011 and December 31, 2011. In this study, regression analysis was used and determined a relationship between short selling and stock liquidity.

Keywords: Short Selling, ISE, Stock Market Liquidity, Market Efficiency, Regression Analysis.