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Abstract
The previous studies suggest that there are two different views concerning the institutional ownership and the extent to which stock prices reflect future earnings. One is that institutional investors overemphasize the current profitability. Therefore, as institutional ownership increases, stock prices show few telltale signs of the future period earnings. The other is that institutional investors have more access to information, compared with individual investors. It is predictable to see them make use of the current information to anticipate future earnings. Thus, stock prices are more likely to reflect much about the future earnings. That is to say, the institutional ownership has impact on the extent to which stock prices reflect future earnings.
The purpose of this study is to provide evidence on the extent to which stock prices lead earnings conditional on institutional ownership of the group-affiliated firms and non-group-affiliated firms. It also investigates whether the extent of pricing of forward-looking information increases with the level of institutional ownership. The samples of this study consist of the listed companies in Taiwan Stock Exchange from 2001 to 2003. We estimate the earning-return relation for both =1 and =2 using a seemingly unrelated regressing approach.
The empirical result shows that the stock prices reflect more future earnings, and the institutional ownership does influence the extent to which stock prices reflect future earnings. This phenomenon is more visible in the group-affiliated firms than in the non group-affiliated firms. Their institutional ownership as well as the predictability of stock prices is in proportion to the information of current earnings.
However, a regression of stock return on R&D expenditure is affected by the percentage of institutional ownership. The outcome of the regression indicates institutional investors of the group-affiliated firms cannot exert their power in monitoring effectively owing to the excessive expenditure of R&D. The non group-affiliated firms, on the other hand, show signs of over investment. This result only explains that R&D is not a good plausible piece of forward-looking information for institutional investors. The institutional investors have much access to forward-looking information but little power in monitoring.
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