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The Effects of Institutional Investor Objectives on Firm Valuation and Governance *

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Abstract

We find that ownership by different types of institutional investors has varying implications for future firm misvaluation and governance characteristics. Dedicated institutional investors decrease future firm misvaluation, in both direction and magnitude, relative to fundamentals. In contrast, transient institutional investors have the opposite effect. Using the U.S. Securities and Exchange Commission (SEC) Regulation FD as an exogenous shock to information dissemination, we find evidence consistent with dedicated institutions having an information advantage. Similarly, dedicated investors are associated with better future governance characteristics, while transient investors are not. The valuation effects are primarily driven by institutional portfolio concentration while the governance effects are driven by portfolio turnover. These results imply a more nuanced relationship between institutional ownership and firm value and corporate governance.

Keywords: Institutional investors, investor type, dedicated, transient, misvaluation, corporate governance, blockholding, portfolio turnover, information dissemination, SEC Regulation FD

JEL classification: G30, G32, G14, G23

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