

Market Perception of Information Asymmetry: Concentration of Ownership by Different Types of Institutions and Bid-Ask Spread

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September 2002

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Abstract

Total institutional ownership, institutional ownership by type of institution (e.g. banks, insurance companies, mutual funds), and a new measure of ownership concentration (similar to the Herfindahl Index) are used to explain contemporaneous bid-ask spreads for 72 quarters (1983-2000) of NASDAQ-traded stocks. When controlling for a number of commonly-used variables, relative bid-ask spreads are found to be significantly negatively related to the level of institutional ownership and significantly positively related to the concentration of ownership. The results are consistent with expectations of market perception of information asymmetry. The impact of ownership by type of institution and concentration within each type of institution on bid-ask spreads and future returns vary between five major groups of institutional investors. These differences are explained by alternative investment goals and strategies, and by regulatory factors.

Key words: institutional ownership, bid-ask spread, information asymmetry, concentration, NASDAQ.

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