The Relation between Common Institutional Ownership and Internal Control Weakness

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ABSTRACT: This study examines the impact of common institutional ownership (CIO) on the disclosure of firms' internal control weaknesses. The findings reveal a negative association between CIO and the likelihood of co-owned firms disclosing internal control weaknesses. This association operates through multiple mechanisms, including internalization of externalities and enhanced monitoring. This premise is supported by a variety of cross-sectional tests, which employ four types of empirical settings as proxies for these mechanisms. Specifically, the negative effect of CIO is more pronounced in firms with worse information environments or higher agency costs. The effect is also stronger when common owners are dedicated institutions. The primary inferences of this study can broaden our understanding of the interactive dynamics between ownership structure and financial reporting.

Keywords: Institutional investors; Common ownership; Internal control weakness.