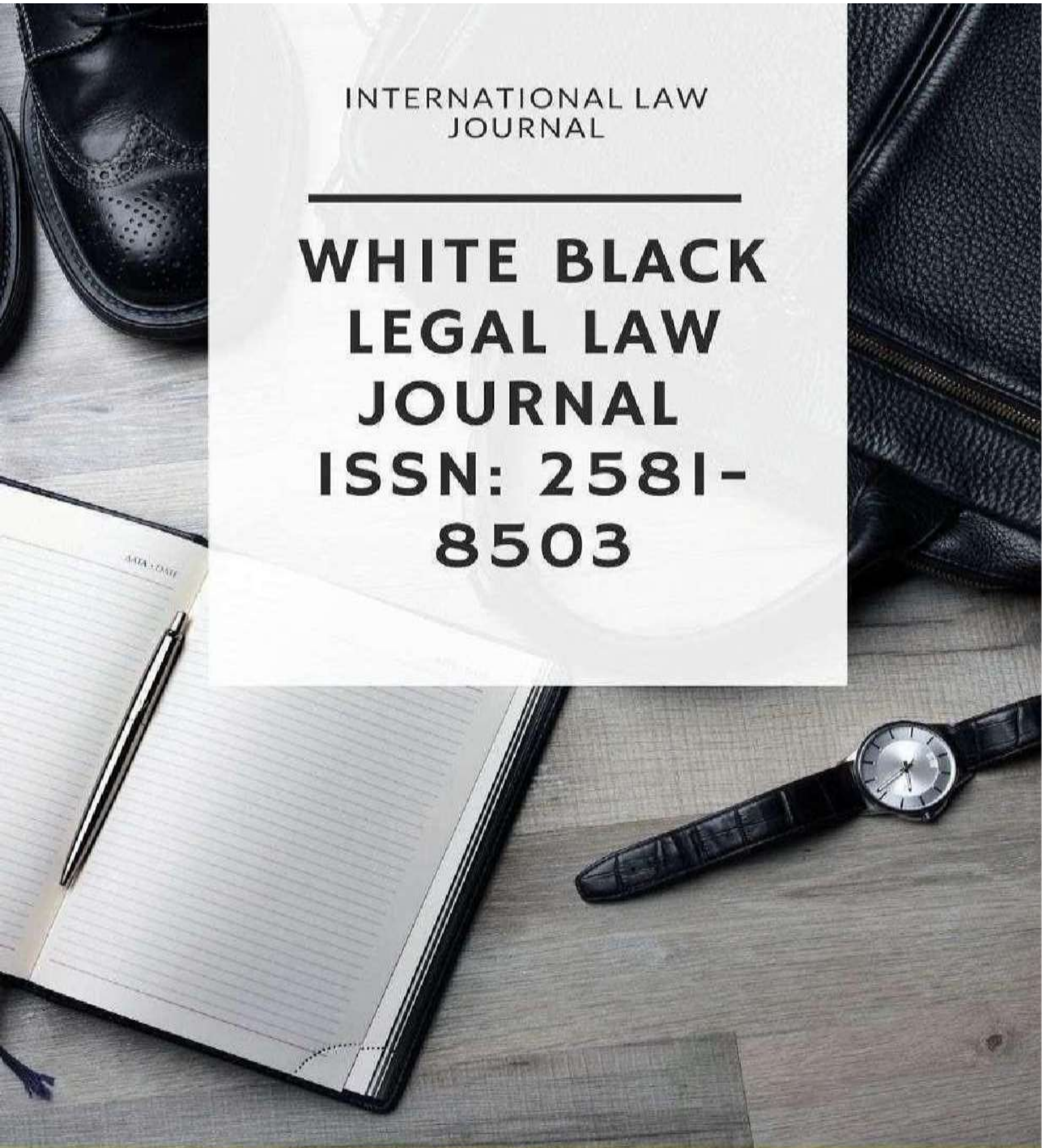

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ABOUT US

WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

INFORMATION CONTENT OF INSIDER TRADING

AUTHORED BY - SANYA YADAV

INTRODUCTION

The primary motive of imposing insider trading regulations is to create a level playing field in the securities market and to instill the investor confidence. Insiders such as a key managerial person, director/promoter of a publicly listed company have an advantage of information over outsiders as they possess valuable information about firm‟s earnings (Seyhun 1986; Jagolinzer et al. 2011). Corporate insiders are thought to have private information not available to others which provide them an advantage in investment activities. The media disseminate such information as news. News plays a significant role in framing trade and price patterns in stock markets (Foucault et.al. 2016). It has attracted the interest of the regulatory bodies and academicians to identify the unique information insiders possess, as well as the profits they earn (Jaffe 1974). The transaction made by the insiders of a listed company has to be reported to the respective stock exchange. Such information is helpful to assess the abnormal returns that arise before or after the transaction day. The study augments the inquiry by highlighting the information asymmetry of insider trades. This research aims to investigate whether insiders earn abnormal returns on their trades and to document any difference between abnormal return between the purchase and sale transactions. With this analysis and findings, the study can conclude whether the market is information efficient or not. Several studies which are centered on the US stock markets consistently confirm that insiders are certainly well informed and they do earn abnormal profits. Jaffe (1974) with insider purchase and sale transactions together, and Finnerty (1976) study with insider purchase or sale portfolios separately found that insiders can outperform the market. When compared to the emerging markets like India, developed markets are more efficient in dealing with the insider trading charges and prosecution of insiders (Misra 2011). Does insider trading signal any positive/negative information to the market and do they earn an abnormal return from their purchase/sale activity is the central point of this study. Rozeff and Zaman (1988) used the market model to find the abnormal returns by using US data and found that outsiders can profit from the publicly available insider trading data. On the other hand, Lin and Howe (1990) study from NASDAQ found that outsiders cannot earn abnormal returns by mimicking the insider trades. It has to be empirically tested to know the information content of insiders‟ trade and the profitability for outsiders if they follow and mimic insider trades. Many papers have investigated insider trading in US and European markets. The present research proposes to focus on the Indian stock market. The motivation of using Indian insider trading data is as noted by Bushman et al. (2005) that the analysts concentrate more in emerging markets after the enforcement of insider trading laws than in developed markets. It may be because of the existence of insider trading laws only in books but not in the prosecution of insiders in these markets (Bhattacharya and Daouk 2002; Manchikatla and Acharya 2017). In India, insider trading is regulated by Securities Exchange Board of India (SEBI) under SEBI (Prohibition of Insider Trading) Regulations, 20156. It prohibits the insiders from trading in securities while in possession of UPSI. As per the regulations, insiders are compelled to disclose the details of their trade to the specific stock exchange where the company is listed. Also, these disclosures of insider trading activities are publicly available. There is an intuition in the market that insiders possess valuable information of their company and they trade on private information. Lakonishok and Lee (2001) found that market initially ignores valuable information when it is reported. Media plays a significant role in the dissemination of news (Rogers et al. 2016) which reduces the future trading profits of insiders by publicizing regulatory disclosures (Dai et al. 2015).

DATA AND METHODOLOGY

The financial year-wise data about the listed companies of BSE is obtained from CMIE Prowess database. Market Capitalization (MC), Book Value (BV) per share were downloaded from the Prowess database on the financial year basis. If the market capitalization or book value per share for a company is unavailable, then that company is excluded in that particular year. 6It is the new regulation of SEBI, earlier it was; SEBI (Prohibition of Insider Trading) Regulations, 1992. 83 The Carhart (1997) model is found to be the most suitable performance yardstick for the Indian markets (Sehgal and Babbar 2017)7.The study of Sehgal and Jain (2015) based on the 493 firms listed on BSE investigated the role of macroeconomic variables about the momentum factor. They also found that momentum factor explains the abnormal returns better than CAPM and Fama and French (1993) three- factor models. However, a similar study by Dash and Mahakud (2015) by using Fama and French (1993) three-factor and Carhart (1997) four-factor model found that book to market equity ratio and momentum factors have a higher impact in explaining the cross-section of returns than other factors. Considering the findings of extant studies in the Indian context, the present study uses four-factor model.

EMPIRICAL RESULTS

Table 5.1 reports the insider purchase and sale transactions across size, BE/ME and momentum categories. There is concentration of both purchase and sale transactions in large size, followed by the medium and small size companies. This follows the general market trend, there is concentration of transactions in large size companies. Based on BE/ME ratio, insiders buy more in medium BE/ME, followed by low BE/ME and high BE/ME, whereas insider sales are conentrated in low BE/ME, followed by medium and high BE/ME ratio companies. Finally, mementum category presents a slightly different picture. Insider purchases are equally distributed across the three categories of momentum, namely low, medium and high momentum. In contrast, sale transactions are highly concentrated in the high momentum category and very less transactions are in the low and medium momentum category. Overall, there are more purchase transactions compared to sale transactions.

SUMMARY AND CONCLUSION

This study assesses the information content of insider trading by calculating cumulative abnormal returns of open-market insider transactions in BSE-listed firms 7Index has been constructed for „t" year by dividing the individual company market capitalization with the total market capitalization of „t" year. Value-weights are calculated by the (portfolio weight *log returns). Whereas, daily returns are calculated by Ln of daily closing market capitalization. 84 using event study methodology. The study examines the market reaction to the insider trades around 30 days of the trading day for purchase and sale transactions separately. The study classifies the insider purchase and sale portfolios based on standard investment strategies like size, BE/ME ratio and momentum. Further, the study compares the findings of the insider portfolio with rest of the market after neutralizing the impact of insider transactions. The result suggests that both purchases and sales are informative. However, purchase transactions cause a substantially higher impact on returns than the sales transactions. Further, comparison with the rest of the market shows that outsider group does not cause similar impact in the corresponding period. The study concludes that insider transactions release information to the market. Specifically, purchase transactions lead to positive abnormal returns, whereas sale transactions lead to negative abnormal returns. This study supplements previous studies by investigating in emerging market; it presents findings that are distinct from those witnessed by developed markets. Future research can be carried out to find the optimal trading strategies by considering the difference between the insider transaction date and the reporting date to the stock exchange/regulatory body.