



ELSEVIER

Contents lists available at ScienceDirect

J. Account. Public Policy

journal homepage: [www.elsevier.com/locate/jaccpubpol](http://www.elsevier.com/locate/jaccpubpol)



# Are corporate managers savvy about their stock price? Evidence from insider trading *after* earnings announcements <sup>☆</sup>

Adam Kolasinski <sup>a</sup>, Xu Li <sup>b,\*,1</sup>

<sup>a</sup> Michael G. Foster School of Business, University of Washington, 335 Mackenzie Hall, Seattle, WA 98195-3200, USA

<sup>b</sup> School of Management, University of Texas at Dallas, 2601 N. Floyd Road, Office 4.427 (SM 41), Richardson, TX 75083-0688, USA

## ARTICLE INFO

### JEL classification:

G14

M41

### Keywords:

Insider trading

Market timing

Post-earnings announcement drift

Underreaction anomalies

## ABSTRACT

We find that insiders trade as if they exploit market underreaction to earnings news, buying (selling) after good (bad) earnings announcements when the price reaction to the announcement is low (high). We also find that insider trades attributable to public information about earnings and the price reaction generate abnormal returns. By demonstrating that managers spot market underreaction to earnings news, our results imply that managers are savvy about their company's stock price.

© 2009 Published by Elsevier Inc.

## 1. Introduction

Most studies on insider trading focus on whether insiders trade based on their private information. In contrast, we study how public information about prices and earnings influences insiders' trading strategies. We find that insiders tend to buy more and sell less when a stock underreacts to good earnings news than when it underreacts to bad earnings news. Specifically, insiders engage in more net buying after release of good earnings news accompanied by a low price reaction than they do after release of bad earnings news accompanied by a high price reaction. We also find that when our model of insider trading based on public earnings and price information predicts high insider net buying in a stock, the stock subsequently experiences positive abnormal returns. We thus find evidence that

<sup>☆</sup> We are indebted to Richard Frankel, Jarrad Harford, Dirk Jenter, SP Kothari, Suresh Radhakrishnan, Jeremy Stein and Joseph Weber for their helpful comments. We also thank MIT and UT-Dallas workshop participants and participants of First Lone Star Accounting Research Conference for their helpful suggestions. We have benefited from the editor, Martin Loeb and two anonymous reviewers for their comments. We thank Bin Ke for assistance in computing abnormal returns after earnings announcements.

\* Corresponding author. Tel.: +1 206 543 8737.

E-mail addresses: [adamkola@u.washington.edu](mailto:adamkola@u.washington.edu) (A. Kolasinski), [xu.li@utdallas.edu](mailto:xu.li@utdallas.edu) (X. Li).

<sup>1</sup> Tel.: +1 972 883 6385.

insiders trade in response to market underreaction to earnings, confirming that they have some skill at judging whether their firm's stock price correctly reflects public information. These results support the notion that managers are savvy about their company's stock price, a largely untested assumption critical to some models in the finance literature (e.g., Baker and Wurgler, 2002; Schleifer and Vishny, 2003).

Our paper is one of the first to directly study insiders' ability to use public information to earn abnormal returns. Seyhun (1988) finds that aggregate insider trading patterns forecast aggregate market returns. These results indicate that insiders have a superior ability to identify macro-economic trends that tend to move the market, but it is possible that private information about trends in new orders, sales, or other fundamentals correlated with macro-economic factors may give them this ability. Seyhun (1990) finds evidence that insider purchases increased substantially following the 1987 stock market crash, and that such purchases were highly profitable, indicating that insiders exploited market overreaction to the crash. The study, however, is limited to only one brief episode, whereas ours covers a broad time period. On their face, the findings of Sivakumar and Waymire (1994) that insiders sell (buy) after good (bad) earnings news may seem to indicate that insiders attempt to exploit overreaction to such news. However, an equally plausible explanation is that insiders are using private information to identify earnings peaks and troughs.

Other studies on insider trading document that insiders profitably trade in a contrarian fashion in anticipation of events that signal a reversal in firm trends. Ke et al. (2003) document that insiders make profitable trades in anticipation of breaks in earnings trends, selling just before an earnings peak and buying just before a trough. Karpoff and Lee (1991) and Kahle (2000) find that insiders sell in anticipation of new issue announcements, which typically result in price declines and occur after price run-ups. Noe (1999), Cheng et al. (2007) and Givoly and Palmon (1985) find that managers trade on their superior foreknowledge of future earnings patterns as well as other private information. These results, and others like it, are important because they demonstrate that insiders successfully anticipate the direction in which prices will move in response to future disclosures about which they have private information. The results, however, have little bearing on insiders' ability to determine whether prices correctly reflect public information at a given point in time. In contrast, our results demonstrate that they have this ability.

While our results indicate that insiders use public signals to enhance their returns, it is likely that they also use private information when deciding their trading strategies. For example, Lustgarten and Mande (1995) find that insiders trade on private information about forthcoming earnings. Park and Park (2004) document a relation between insider sales and earnings management. Since there are many corporate events that we do not observe, the insider trading patterns we observe are likely based on some combination of both private and public information.<sup>2</sup> Nevertheless, we believe the fact that insiders do use public information, and in particular, information about prices, to enhance their returns, is an important result, because it provides evidence that insiders are price-savvy, at least when it comes to underreaction to the disclosure earnings news.

Our results complement Jenter (2005), who finds that insiders profit from buying when book-to-market ratios are high and selling when they are low, thus apparently exploiting the value effect. If the mispricing of value and glamour stocks causes the value effect, Jenter's results suggest that insiders are indeed skilled at detecting mispricing in their stock. By finding similar results in a different setting, namely, post-earnings announcement drift, we bolster Jenter's (2005) inference that insiders are indeed savvy about mispricing in their own firm's stock.

Our evidence has important public policy implications. The degree to which insider trading should be permitted is a matter of heated debate (see Hu and Noe (1997) for a summary). Some opponents of insider trading cite high insider trading profits as evidence that insider trading hurts liquidity traders. Others, such as Ronen et al. (2006), argue that insider trading may encourage earnings management. Our finding that insiders trade, at least in part, based on their interpretation of public information, suggests that not all insider trades have such negative effects, even during a

<sup>2</sup> Our results are robust by controlling for future earnings surprises in our tests, so insider trading on future earnings information cannot be driving our results.

متن کامل مقاله

دریافت فوری ←

**ISI**Articles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات