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Insider trading in Hong Kong: Some stylized facts

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Abstract

This paper examines the characteristics and price movements of legal insider transactions in Hong Kong. Abnormal returns are analyzed for intensive trading, as well as for samples grouped by industry classification, firm size, book-to-market ratio, price–earnings ratio, and relative trading volume of the insider transactions. Results show that insiders are able to earn abnormal profits from both buying and selling activities. The magnitude of and duration for abnormal profits depend significantly on firm-specific and transaction-specific factors. We also document the persistence of abnormal returns associated with insider sales, while abnormal profits associated with insider purchases are concentrated in certain transactions.
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1. Introduction

Many studies (e.g., Jaffe, 1974; Finnerty, 1976a,b; Seyhun, 1986, 1988a,b; Rozeff and Zaman, 1988; Lin and Howe, 1990) conclude that insiders can earn abnormal profits through trading stocks of their own firms. Apart from investigating the abnormal

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performance of the stock price around insider transactions, research efforts also focus on whether outsiders are able to earn abnormal profits by mimicking the trades of corporate insiders (e.g., Seyhun, 1986; Rozeff and Zaman, 1988; Chang and Suk, 1998). The conclusions on these issues, however, are mixed.

The main objectives of this paper are to document the stylised facts of legal insider transactions on the Hong Kong stock market, to examine the abnormal stock price movements associated with insider trading, and to comment on the profitability for insiders through insider transactions. We are interested in Hong Kong because most studies on insider trading are based on U.S. data, and the results of these studies may not be robust in the Asian or emerging markets. It has been widely accepted and supported that efficiency and transparency are low in most emerging markets. In many cases, especially in small firms, the separation of management and ownership is rare. Since manager–owners are, in general, more informed about the business prospects of their own firms, insider trading which involves the directors of small corporations is likely to be the most profitable. In a study by Claessens et al. (2000), it is reported that about 60% of Hong Kong firms are group-affiliated, while 66% of Hong Kong firms are controlled by families. Hence, a study of insider trading in Hong Kong can shed light on the impact of information asymmetry on the profitability of insider transactions.

Our results show that Hong Kong insiders do far more buying than selling and this contrasts sharply with the U.S. case (Seyhun, 1998, pp. 12–13). Hong Kong insiders can make abnormal profits from both buying and selling activities. The magnitude of these abnormal profits associated with insider sales is considerably larger than that associated with insider purchases. When insider transactions are grouped by industry, firm size, book-to-market ratio, price–earnings ratio, and relative intensity of insider transactions, we find that both the magnitude of the abnormal profits and the duration for which these abnormal profits persists depend significantly on firm-specific and transaction-specific factors.

Small firms are found to generate the largest and most persistent abnormal profits. In addition, abnormal returns can persist up to 20 days after an insider transaction has occurred. Outside investors can make abnormal profits by mimicking insider activities.

The remainder of this paper is organized as follows. Section 2 contains a summary of the two Ordinances relating to insider trading in Hong Kong. Section 3 describes the data and provides the summary statistics. Section 4 describes the methodology, followed by results and discussions in Section 5. Section 6 concludes the study.

2. Insider trading regulations in Hong Kong

The main provisions in Hong Kong relating to insider trading are contained in the Securities (Insider Dealing) Ordinance (SIDO), and the Securities (Disclosure of Interests) Ordinance (SDIO). Both ordinances were implemented on September 1, 1991 to replace the then existing provisions of the Securities Ordinance. The purpose of the legislation is to ensure a “level playing field” for all participants in the market, so that no one is allowed to benefit from trading a firm’s securities by making use of undisclosed private information about the firm.

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