Insider Trading in Hong Kong: Tests of Stock Returns and Trading Frequency

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Summary

Using a comprehensive database of insider transactions in Hong Kong over the period 1993 to 1999, we examine the characteristics of directors' share dealings and their impact on stock prices. Directors make trades very frequently and for a substantial number and value of shares. In addition, they often reverse their trades (buy, sell, buy, sell, etc.) in a short period of time. The trading frequency and volume of insider purchases are higher than those of insider sales. The "Buy" transactions are less profitable than the "Sell" transactions. We find that insider purchases are made when stock prices have been declining and insider sales are made when stock prices have been rising. The event study identifies small positive cumulative abnormal returns for insider trading activity. The magnitudes of the abnormal returns are quite modest and so the scope for outsiders to earn substantial profits from an investment policy that mimics insiders' transactions is low. Based on the abnormal return measured using the control firm approach over 360 days, we estimate insiders earn an average profit of HK$91,297 per trade. In addition to personal motives, we conclude that there are two other reasons for insider dealings. First, the directors trade so as to signal mis-valuation of the shares. Insiders often trade frequently in order to reinforce the signal. Second, for firms with relatively infrequent trading, the directors may purchase or sell shares so as to maintain a market in the stock. This latter explanation is a relatively little explored area but it represents an opportunity for future research.