CHAPTER 5 CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary and conclusions

The results of this study demonstrates that insider trading exists in the KLSE. There were stock price movement before and after "insider sell" and "insider buy" respectively. Insiders were able to earn abnormal returns after they have purchased their stocks. The existence of insider trading is statistically tested positive for "insider buy" on both the KLSE Main Board and KLSE Second Board. Nevertheless, insiders are able to earn a higher abnormal return on "insider buy" on the KLSE Second Board compared to KLSE Main Board.

As for "insider sell", it is found that there is a strong evidence showing insider trading exist on the KLSE Main Board. There is evidence of increasing abnormal returns and non-existence of such abnormal return after insiders disposed off their stocks on the KLSE Main Board. Only a general observation can be drawn on the existence of "insider sell" on the KLSE Main Board. It is quite difficult to ascertain the quantum of gain on "insider sell" due to the fact that it is difficult ascertain the corresponding purchases prior to disposal.

Although the statistical evidence for "insider sell" on the KLSE Second Board did not reveal similar trend as compared to "insider sell" on the KLSE Main Board, there is evidence to show that insiders managed to sell their stocks prior to a sudden dip of the stock prices. This observation demonstrates that insiders on the KLSE Second Board can predict future market time, able to sell their stock before a price decline and avoid losses albeit on a short horizon of less than 10 days.

It can be concluded that generally insider signals do exist in the KLSE. However, such signals may not prove the misuse of private information because there are alternative explanations for the observed outcome. For example, insiders may believe that their companies may not be competitive enough or losing its competitiveness in the market place. As a result, these insiders may want to reduce their holding accordingly (Bettis, Duncan, and Harmon (1998)). Outsiders are able to develop optimal trading strategies, following the actions of insiders. In other words, outsiders can use the information filed with the KLSE on changes in interest of directors or substantial shareholders to earn abnormal returns by mimicking the insiders. The result of this study showed that abnormal returns can be derived after the day statutory notices have been filed to the regulatory authorities. By mimicking "insider buy", uninformed traders could potentially earn up to 6% abnormal returns from the filing date made by the registered insiders. Under the "insider sell" category, in order to maximise their returns, outsiders could potentially earn up to 2% extra abnormal returns in disposing off their stocks after insiders have disclosed their disposals.

5.2 Suggestions for Additional Research

This study to empirically test the strong-form efficiency of the EMH in the Malaysian context could possibly be one of the first, especially so for dissertation in fulfillment of the requirements for the degree of MBA in the University of Malaya, to empirically test insider trading based on daily stock price movement. Hence an exploratory research was conducted here to statistically prove the mere existence of insider trading.

Owing to the limitations of this study, the existence of insider trading based on filings of change in interest made to the KLSE over different time period and over a long horizon is not covered in this study. Further research could be conducted to empirically test whether insider trading exist based on filings at different time line e.g. filings made in years other than year 2000 or on other months other than March 2000. It is also proposed that a more extensive study covering a longer horizon, for example 5 years or 10 years, be conducted to test whether there are insider trades over such extended time period.

Alternatively, future research could also be carried out to further test whether insiders are more active in the KLSE Main Board or Second Board over the longer time horizon for example over a 5 year period or 10 year period. The test could be based on different filing dates over a span of time. Such study may include empirical test on the trading volume of stocks traded by insiders to observe the significance or activeness of such trades both prior to and post insider trades.

If outsiders or non-insiders are keen to use publicly available information about insider transactions to earn abnormal profits, the accuracy and timing of insider signals are important to enable these outsiders to maximise returns. Further research could also be carried out to test the information content of insiders. Different insiders possess differences in quality of information. Insiders who are more knowledgeable with the overall affairs of the company such as chairman of board of directors or managing directors may be more successful predictors of future abnormal stock price changes than substantial shareholders. Nevertheless, there has not been a study carried out to empirically test this perception.

Does open market share repurchases achieve positive abnormal returns? Such repurchases are carried following thorough managerial decisions consisting of mainly insiders who are better informed about their companies' prospects. Further research could also be carried out to test whether there are any positive correlation between the share buyback and abnormal returns.

5.3 Policy implications

Insider trading is socially costly and unfair to uniformed investors. Insider trading may undermine investor confidence in the fairness and integrity of the securities markets. This may result in the public losing faith in the stock market and channel their savings elsewhere and pose a threat to companies which need to raise capital via share issues. Are the laws put in place to curb such activities effective? Presence of abnormal returns post "insider buy" and evidence of abnormal returns pre "insider sell" may be an indication that the laws and regulations governing insiders may not be effective. However, Bettis, Duncan and Harmon (1998) argued that although studies have shown a correlation between insider trading and abnormal returns, the studies do not link the abnormal returns to specific information. The researches argued that the mere presence of abnormal returns is not evidence that the laws and regulations governing insiders are necessarily ineffective.

There is certainly a need to minimise insider trading to ensure a fair and honest market where all pertinent and available data is made known immediately to everyone. In the US, there is a requirement that there must be full and prompt disclosure of information in the stock market. Such requirement can also be replicated in the Malaysian context where there must be immediate disclosure of all price-sensitive information as soon as it is known by the company. The definition of insider under the SIA is very wide but insiders required to register and disclose their trades are limited to only directors and substantial shareholders. Such disclosure should also be extended to analysts and employees of the companies who have gained non public price sensitive information and should also include legal and financial advisers to the companies.