Asymmetric Signaling Power of Insider Trading and Its Impact on Information Environment and Market Reactions

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Abstract: We document that market reactions to insider purchases and sales are different in terms of price and volume. With an extensive data set that covers the period from 1991 to 2006, we systematically segregate the asymmetric effects of these two types of insider transactions. We follow the design of previous studies (e.g., Basu, 1997; Ball and Shivakumar, 2005, Leone et al. 2006) to understand the asymmetric information provided by insider purchases and sales. We pioneer the forecast approach developed by Barron, Kim, Lim, and Stevens (1998) to test the precision of the information environment. We find that market can distinguish and discriminate the signaling strength of insider purchases and sales. Insider purchases are a stronger signal than insider sales, and insider purchases create a better environment to alleviate information asymmetry; thus enhancing average investors to trade and mimic.

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“At Peridot Capital, I tend to ignore insider selling completely. Sure, a lot of sales inside a company can indicate management feels their stock is overpriced, but there are dozens of other reasons top brass sell stock, and they are never required to give the reason for their actions. Investors should be able to tell if a stock is grossly expensive or not on their own, if they indeed manage their own money, so insider selling data really can't be relied upon…. Insider buying,