

MEDIA RELEASE



Tuesday, 21 October, 2008

Call for tighter regulation of SME directors' trades

A Deakin University academic has called for tighter regulation surrounding directors' trades following research which showed that directors of small and medium companies, especially in their sales trades earn abnormal returns after selling shares in their own companies.

Dr Harminder Singh from Deakin University's Faculty of Business and Law said it was clear from the results of the research that the regulator had been unsuccessful in stopping trading by these insiders, which, may not be in the interest of other small investors

"The policy implications from our findings are clear; directors do appear to disregard the law and the current regulatory environment does not seem to deter them," he said.

"ASIC may want to pay closer scrutiny to the trading activities of directors of small and medium companies and take further action if necessary."

Dr Singh said the researchers had examined the trading activities of directors in shares of their own companies on the Australian Stock Exchange during July – December 2005.

"We wanted to find out whether insider trading was prevalent in the market, even though the regulatory environment prohibits it," he said.

"We also wanted to find out if an outsider could benefit if they mimicked a director's trades."

Dr Singh said directors were required by law to disclose any changes to their interests in the company to the ASX within five days. "As corporate insiders, directors have an intimate knowledge of the working of a firm and timely access to financial performance figures. "If they are buying or selling stock you would reasonably expect to something is up."

Dr Singh said director's 'sales' trades were more profitable over a longer term – 90 or 60 days – rather than over a 20 day period. In the case of small companies directors even 'purchase' trades have provided abnormal returns up to a period of 160 trading days after they purchased the shares in their own company.

Dr Singh said the research had shown that directors of small and medium companies outperformed the market and seemed to time their trades perfectly.

"Directors of these companies have an uncanny ability to time the market by trading when mispricing is greatest and are able to predict the short term performance of their firms because of their exclusive position," he said.

"The most significant finding of our study is that when directors sell stocks, they are pretty much informed that something is going to happen to their stocks and that is why they are

MEDIA RELEASE



Tuesday, 21 October, 2008

selling or buying. "Abnormal returns are earned before the sale and negative returns after it.

"In small companies the effect is quite pronounced. Share purchases by directors of small companies show significant abnormal returns. While purchases by directors of medium companies are not profitable in the 90 days post-trade interval, they are timed to avoid significant negative abnormal returns and could be an indication that the period of poor performance has ended."

Dr Singh said directors' trades contained information regarding the future predictability of the firm's share price, especially in the case of small companies. However the firm's share price was slow to adjust to this news.

"If a naive investor mimicked the 'purchase' trade of a director of a small or medium sized firm they would make up to an approximately 18% and 4% respectively after ignoring the transaction cost, which should not happen if the market was efficient."

Media contact: Dr Singh is available for interview. Please contact Sandra Kingston 0422 005 485 in the first instance.

The Information Content of Directors' Trades: Empirical analysis of the Australian Market, Lisa Hotson, Harminder Singh and Navjot Singh