Research Proposal

Title

Abnormal Returns around the Trades of Corporate Insiders on the Swiss Stock Exchange

Introduction

According to the fundamental principle of *market egalitarianism*, corporate insiders are not allowed to trade shares of their own company unrestrictedly. The Swiss Criminal Code prohibits management transactions which are based on confidential information that has significant impact on security prices. Additionally, insiders are required to disclose their trades to the Swiss stock exchange within a reasonable period of time following the date of transaction. This information is contemporary provided to the public and is critically analyzed by investors perceiving that corporate insider transactions are based on private information. The relatively lax stipulations for insider trading in Switzerland calls for a comprehensive examination of such transactions.

Research Context

The profitability of insider trades has been the subject of numerous studies, mainly focusing on the United States. These studies corroborate that insiders are better informed about their company’s prospects and, hence, are able to trade profitably on their superior knowledge. However, there is mixed evidence whether uniformed outsiders can successfully mimic corporate insiders.

*Seyhun (1986)*:

Based on a sample of about 60'000 management transactions from 1975 to 1981, this paper examines the availability of abnormal profits to insiders and outsiders who imitate insiders in the United States. Furthermore, the main determinants of insiders’ predictive ability, the impact of insider trading on the costs for uninformed investors and implications for market efficiency are comprehensively investigated.

*Friederich, Gregory, Matatko, and Tonks (2002)*:

This study examines patterns in abnormal returns around the days of management transactions on the London stock exchange with a sample consisting of 4’399 insider trades for the period between 1986 and 1990. Additionally, they assess the predictive content of future returns on the basis of different firm and trade specific determinants.

*Zingg, Lang, and Wyttenbach (2007)*:

This paper analyzes the distribution of abnormal returns to insiders immediately around the trades of corporate insiders in the shares of their own company on the Swiss stock exchange. The sample consists of 3’475 insider transactions for the period between 2005 and 2006. Moreover, the authors evaluate the security returns to strategies mimicking corporate insiders’ trades in the following days of the transaction. Within the scope of this analysis, implications for market efficiency are derived.

This thesis will primarily refer to the procedure applied by Zingg, Lang, and Wyttenbach (2007) and includes some additional considerations and adoptions of previous research studies.
Objective

The fundamental objective of this thesis is to investigate the profitability and the information content of legal management transactions\(^1\) on the Swiss stock exchange. Hence, the magnitude of abnormal returns to insiders and the determinants of insiders’ predictive ability are examined. A further aim of this thesis is to assess the net abnormal returns\(^2\) to strategies mimicking insiders’ trades in the days following the trade. Moreover, implications for market efficiency are deduced.

Contribution

This thesis contributes to the scarce research of insider transactions on the Swiss stock market. New insights into the research field of management transactions are generated by taking into account the total transaction costs of mimicking strategies and by considering further essential determinants of insiders’ abnormal returns.

Empirical Methodology

To assess abnormal returns around the trades of corporate insiders on the Swiss stock exchange, the event study methodology originally described by Fama, Fisher, Jensen, and Roll (1969) is applied. In general, the event study approach is a well-established research method to measure the impact of specific events on the market valuation of the company. As mentioned by MacKinlay (1997) there exist several economic and statistical models to estimate abnormal returns and various frameworks to test their significance. This thesis will primarily refer to the event study applied by Zingg, Lang, and Wyttenbach (2007), whereas small adjustments will be made.

Timeline

The starting date will be at the beginning of August. A rough time schedule is given as follows:

**Week 1-4:**
Coarse arrangement, selecting the statistical software to implement the event study and getting familiar with it, data selection and download

**Week 5-10:**
Refining the structure, understanding the event study methodology, gathering literature, data adjustments, conducting empirical analysis, descriptive statistics

**Week 11-19:**
Compiling the draft version, analyzing and interpreting empirical results, conducting robustness checks, considering potential shortfalls

**Week 20-24:**
Elaborating final version, final proofreading

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\(^1\) This thesis considers only legal management transactions, which were correctly reported under the current law to the Swiss stock exchange. Thus, throughout this thesis the notion insider trading corresponds to the definition of legal insider trading or management transactions.

\(^2\) To assess the profitability of mimicking strategies properly, abnormal returns need to be adjusted for transaction costs like commission fees as well as spread-induced transaction costs.
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