

INSIDER TRADING FROM THE PERSPECTIVES OF TWO ETHICAL THEORIES: UTILITARIANISM AND KANT'S APPROACH

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Abstract

Utilitarianism is a general term for any view that holds that actions and policies should be evaluated on the basis of the benefits and costs they will impose on society but in the respect of Kant's categorical imperative approach, intention is more important than result while we behave in an action. The purpose of the study is to investigate the insider trading which is about buying or selling of securities on the basis of material, non public information, with these two theories as utilitarian principles and Kant's approach from the perspectives of Business Administration Students. The data was collected by different scenarios which reflect the insider trading in the stock market. The results show that insider trading should be analyzing according to the condition of this perspectives in order to find out that is ethical or unethical.

Key Words: *Insider trading, business ethics*

JEL Classification: M1, M14, M19

1. INTRODUCTION

The main function of capital market is to transfer funds efficiently between borrowers and lenders and the prices of stocks as an indicator of investors' assessment of companies' past performances and future prospects have an important role in this transaction. For this reason having any non-public information about the company provides privilege of its owner. Since people at such a position may use the information to generate gains at the expense of other investors, insider trading and its regulation so important for market operation.

To consider the ethical feature of insider trading, we must first understand the main characteristic of inside information, insider and insider trading. Inside information is privileged, price sensitive and material non-public information (Doffou, 2003:1) and so that prior knowledge of information that will affect prices of the securities and investment decisions of capital market investor when publicly announced (Elliott, Morse and Richardson; 1984:528; Tezcanlı, 1996:9). Inside

information can be obtained from large number of sources from which such private information can be used unfairly for financial or other gain (O'Hara, 2001:1047).

Insider refers to any individual who possesses crucial, unpublished information about the firm and trading on securities to make profit or a loss (Tezcanlı, 1996:9; Engelen and Liedekerke, 2007:499). According to the definition, status of the person is not important so insider trader has extended its scope from corporate insiders to any person such as temporary insiders or constructive insiders who gain crucial information indirectly from such managers or directors (Engelen and Liedekerke, 2007:499; Ausubel, 1990:1024; O'Hara, 2001:1047). Corporate insiders can include directors or officers of the corporation or major shareholders, those who have managerial positions in the company, are assumed to have superior information about the company's future prospects, unavailable to the investing public and the current shareholders (Du and Wei, 2004:917; Ma and Sun, 1998:68). However, temporary insiders or constructive insiders can refer to outside auditors, lawyers, investment bankers who are temporarily retained by the corporation but have access to material non-public information (Du and Wei, 2004:917) or persons who have a contractual or supply linkage to such a firm, such as those who print annual reports or stockbrokers who may unintentionally gain an information advantage (O'Hara, 2001:1047). Or they can refer to managers' or directors' friends, family members, or close but to external business associates (O'Hara, 2001:1047).

Insider trading is the buying or selling of securities on the basis of information that is material and not publicly available (Lekkas, 1998:193; Ausubel, 1990:1023; Du and Wei, 2004:919; Engelen and Liedekerke, 2007:498; Szockyj and Geis, 2002:273). Insiders may trade stock because of portfolio diversification and liquidity adjustment, corporate control, sentimental reasons (Ma and Sun, 1998:68) and also because of changes in wealth, preferences, and consumption opportunities (Elliott, Morse and Richardson, 1984:522). Unlike other investors, insiders have access to price sensitive and material information and may trade to realize the benefits of that information especially for the second category (Elliott, Morse and Richardson, 1984:522).

Insider trading was first regulated and restricted by the Securities Act of 1934 to insure a "fair and honest market" so the USA were the first major country that place restrictions on insider trading (Curtis and Mwangi, 2007:2; Bernardo, 2001:7; McGee, 2008:207; Bhattacharya and Daouk, 2002:81-84). Before the 1934 Act, insider was able to buy and sell securities of their own corporations using private information with no legal restriction (Bettis, Duncan and Harmon, 1998:54). The USA have the most comprehensive anti-trading laws, the most severe requirement on information disclosure, and the strictest enforcement to deal with fraud and manipulation in the securities markets and the definition and regulation of illegal insider trading in the USA evolves over time in response to concerns about the effect of insider trading on public confidence (Du and Wei, 2004:919; Ma and Sun, 1998:69; Bettis, Duncan and Harmon, 1998:55).

France established an insider trading law in 1967 as a second country and other countries followed them slowly. The UK, Japan, Australia and parts of Asia have generally similar legislation to USA (McGee, 2008:207; O'Hara, 2001:1049). The European Union (EU) passed a directive that required all member countries to pass legislation prohibiting certain kinds of insider trading by 1992 and any country that wants to join the EU must also have an insider trading law on the books (McGee, 2008:207).

In May 1992, Capital Market Law (CML) established a direct and explicit article considering insider trading, manipulation and disclosure approved by the Parliament in Turkey. This statement includes five conditions (Tezcanli, 1996:83):

- Insiders are identified individually and specifically,
- Individuals with price sensitive information should have traded for the advantage of themselves or their relatives,
- The equilibrium of equal information principle among the market participants should not be damaged by the usage of inside information,
- Individuals who have material information should have made a profit or eliminated a loss after such a trading and
- The information should be non-public information.

The paper critically focused on the principal ethical arguments against insider trading. The arguments fall in to two main ethical theories: Kant's approach and utilitarian approach.

First of all, it is needed to begin by looking at utilitarian approach to moral decision making. Utilitarianism is a general term for any view that holds that actions and policies should be evaluated on the basis of the benefits and costs they will impose on society (Velasquez, 2002:75).

People should look at the various alternatives and make cost-benefit analysis to decide a value judgment. It should provide a common and acceptable norm for society. One problem with the utilitarian approach is that it is impossible to precisely measure gains and losses. One may only make estimates. Another related problem is that individuals rank their choices; they do not calculate that Option A is 20% better than Option B. Several studies show that insider trading results in a positive-sum game. There are more winners than losers. Thus, it is ethically justified from a utilitarian perspective, at least in the cases where the result is a positive-sum game. (McGee, 2009:66- 78).

In the respect of Kant's categorical imperative approach, intention is more important than result while we behave in an action. There are some universal rules for goodness, equality and justice of people and these rules are categorical. Kant emphasized the use of reason to work out a consistent set of moral principles that cannot be overridden. Kant is so a deontologist. Deontology focuses strongly on the ethical act and most deontologists have been rule deontologists who believe that there are universal rules that provide standards of right and wrong behavior (Knights and Leary, 2006:130). Deontology requires ordinarily a person may be penalized for an act only when that act involves committing a wrong against someone. (Strudler and Orts, 1999:387).

2. RESEARCH METHODOLOGY

2.1. Purpose of the study

The purpose of the study is to investigate the insider trading which is about buying or selling of securities on the basis of material, non public information, with these two theories as utilitarian principles and Kant's approach from the perspectives of Business Administration Students.

2.2. Limitations of the study

The sample of the study is relatively small. It should be consist of more other business administration students by reflecting of culture of their universities. And also some other ethical theories (virtue ethics, justice and rights and so on) can be added to research model.

2.3. Hypotheses

Developed hypotheses in this study are showed below:

H1: There will be statistically differences among students' perceptions about insider trading in the Kant's approach

H2: There will be statistically differences among students' perceptions about insider trading in the utilitarian approach.

2.4. Method

2.4.1. Participants

Students of business administration undergraduate degree at a Yıldız Technical University in Istanbul is the sample for the research. Table 1 exhibits the summary of demographics.

Table 1: Demographic characteristics of sample

Demographic variables			
	Frequency		Frequency
Gender		Class	
Women	87	1	23
Men	65	2	60
Age		3	46
Under 20	10	4	21
20-25	139	Tenure	
26-30	3	under 1 year	4
		1-5 yer	10
		6 and above	1

The sample for this study was drawn from the business administration students of Business Administration Department of Yıldız Technical University in İstanbul. A majority of the respondents is women. Most of the respondents are in second class. In terms of working experience, 10 have at least 1-5 years of working experience.

2.4.2. Measures

In the research model there are mainly two variables. Those are;

- Ethical judgments
- Insider Trading

Two different scenarios were developed by the researchers and in each scenario type of insider trading was manipulated. Each scenario includes 2 alternatives each of them representing different

ethical theories. Participants were asked to rate if they agree with the insider trading on a 4 point scale and 1 means “never” and 4 means “too much likely”.

2.4.3. Data Analysis

Data was analyzed with SPSS software. Reliability analysis was done for insider trading. For the demographics frequency distributions, means and standard deviations were calculated.

3. RESULTS

3.1. Reliability analysis of the study

For the reliability analysis of the scale used in this study, the most frequently used Cronbach alpha coefficient was examined. As Cronbach alpha coefficient of the scale in this study is higher than the commonly accepted .50-.60 for social sciences as shown in Table 2.

Table 2: Reliability analysis scores for insider trading (Scenario 1 and Scenario 2)

Insider Trading(Scenario1)	
Kant's approach	,550
Utilitarian	,662
Insider Trading(Scenario2)	
Kant's approach	,513
Utilitarian	,626

According to Kant's approach, cronbach alpha value of insider trading was determined as ,550, according to utilitarian approach, it was performed as ,662 in scenario 1. And also, According to Kant's approach, cronbach alpha value of insider trading was determined as ,513, according to utilitarian approach, it was performed as ,626 in scenario 2.

Table 3: Descriptive Statistics

	Mean	Std. Deviation
Insider Trading(Scenario1)		
Kant's approach	1,76	,94
Utilitarian	1,64	,84
Insider Trading(Scenario2)		
Kant's approach	1,83	,97
Utilitarian	1,52	,84

According to the results of the descriptive statistics, mean and standard deviation for the insider trading from the perspective of Kant's approach, were found as 1,76 and of utilitarian approach were found as 1,64 in Scenario 1. According to the results of the descriptive statistics, mean and standard deviation for the insider trading from the perspective of Kant's approach, were found as 1,83 and of utilitarian approach were found as 1,52 in Scenario 2. This result indicates that respondents accepted mostly to the “never” and “rather” alternatives.

3.2. Test of hypotheses

As it explained before, research hypotheses are summarized below in Table 4.

Table 4: T-Test Results

Scenario-1					
Kant's approach	N	Mean	Standard Deviation	t- value	p-value
Women	87	1,80	,93	-,737	,461
Man	65	1,69	,91		
Utilitarian	N	Mean	Standard Deviation	t- value	p-value
Women	87	1,67	,88	-,560	,571
Man	65	1,60	,80		
Scenario-2					
Kant's approach	N	Mean	Standard Deviation	t- value	p-value
Women	87	1,80	,96	,462	,643
Man	65	1,87	,99		
Utilitarian	N	Mean	Standard Deviation	t- value	p-value
Women	87	1,32	,65	3,493	,001
Man	65	1,78	,97		

According to the result of the t test and under the estimation of variance equality, p values were found as >0,05, except utilitarian approach according to gender in Scenario-2.

Table 5: One Way ANOVA Results

Scenario-1					
Kant's approach	N	Mean	Standard Deviation	t- value	p-value
1.Class	23	1,8696	,91970	1,553	,203
2.Class	60	1,8833	1,00998		
3.Class	46	1,5217	,80937		
4.Class	21	1,6667	,85635		
Utilitarian	N	Mean	Standard Deviation	t- value	p-value
1.Class	23	2,0000	1,08711	2,189	,092
2.Class	60	1,6833	,87317		
3.Class	46	1,4783	,65791		
4.Class	21	1,5238	,74960		
Scenario-2					
Kant's approach	N	Mean	Standard Deviation	t- value	p-value
1.Class	23	2,1304	1,14035	1,792	,151
2. Class	60	1,8667	,99943		
3.Class	46	1,5870	,88383		
4.Class	21	1,7500	,71635		
Utilitarian	N	Mean	Standard Deviation	t- value	p-value
1.Class	23	1,4783	,84582	1,727	,164
2.Class	60	1,5667	,81025		
3.Class	46	1,3043	,62786		
4.Class	21	1,7619	1,13599		

According to results of the One-way ANOVA analysis, p values were found as $> 0,05$. It showed that there wouldn't be any differences among student's perceptions according to class dimensions for both scenarios.

4. CONCLUSION

Insider trading in the stock markets has been of interest to social scientist as well as the legal community. The purpose of this study is to analyze the often discussed issue of insider trading. The issue is important both in terms of ethics and of damages and also benefits of insider trading. Some researchers could determine as its beneficial, other researchers accept that it is unethical. There is also lots of discussion in the moral perspectives on insider trading, but this discussion focus on only some dimensions of business ethics as relativism, virtue ethics and so on.

In this study, it is aimed to show the determining the ethical perspectives of insider trading by analyzing in two different ethical theories in two scenarios. Is it right or wrong, is it ethical or unethical.

Principal ethical arguments as Kant's approach and Utilitarian approach against insider trading show that the practice is unethical according to perceptions of business administration students. It shows that there is something wrong and it can be accepted as unethical situation according to the some cases. As it explained in its definition, it is an illegal activity interferes with the free market. Supported by the results, in this study, conclude that it can be evaluated as an unfair activity in some circumstances.

According to results of the study about the differences between to demographic variables as class and gender, there weren't significant differences of student's perceptions about insider trading from the perspectives of ethical theories as Kant's and Utilitarian approach, but there is only one significant value in differences. Man students consider that insider trading is unethical from the perspectives of utilitarian approach according to women students.

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