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# Delayed disclosure of insider trades: Incentives for and indicators of future performance?☆



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### ABSTRACT

We investigate incidences of delayed disclosure of trading by corporate insiders (directors) in Australian firms and link this activity to personal wealth incentives and future firm performance. Delayed disclosure represents discrepancies in timing between trades reported as they occur and trades as disclosed in the firm's annual report. Over the period from 2007 to 2011, the rate of late reported trading was about 6%, being at its lowest in 2010 at 5.3% and peaking at 6.8% in 2007. The rate of delayed disclosed purchases was higher than the rate of sales. The likelihood of delayed disclosure was affected by insider wealth factors such as total compensation levels, equity compensation, and shareholdings and their positions within the firm. When executive and nonexecutive directors in small firms delayed the reporting of their purchases, these purchases signaled positive future returns. In large firms, only executive directors' sales were indicative of one year ahead negative returns. These findings suggest that delayed disclosed trades have information content about future firm performance and compensation structures influence the decisions by some insiders to engage in such activity for personal gain.

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## 1. Introduction

We explore delayed disclosure of trading by corporate insiders<sup>1</sup> and pose two questions about this activity: 1) What incentives drive certain insiders to delay the disclosure of their trades? and 2) Is this type of trading predictive of future firm performance?

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<sup>1</sup> The term "insider" refers to directors under the Corporations Act (2001) in Australia, where a director is defined in Section 9. It differs from the use of the term in the US where it includes officers, executives and large shareholders. In Australia, large shareholders are known as substantial shareholders and they report changes in their shareholdings separately.

Economic incentives are likely reasons for delayed disclosure. [Bhattacharya and Marshall \(2012\)](#) use [Becker's \(1968\)](#) economic rationality model when exploring the illegal insider trading activities of top management in US firms indicted for insider trading. We cast delayed disclosure in the same frame, that is, one of white collar crimes, by assuming that the decision to conceal the trade or trades is a rational economic one where the benefits and costs have been considered and a decision has been made because the expected benefits of doing so outweigh its expected costs.<sup>2</sup> Our expectation is that the benefits of delayed reported trades are linked to future firm performance specifically, where the firm's future performance affects the insider's personal wealth directly. This expectation is based on studies which have examined the link between managerial incentives in the form of equity and corporate malfeasance ([Johnson et al., 2009](#); [Armstrong et al., 2010](#); [Bhattacharya and Marshall, 2012](#)). The closest existing study to ours is [Cheng et al. \(2007\)](#) where delayed disclosure of insider trading was allowed via a Form 5 filing in the pre SOX period. They examined insider transactions which could be disclosed with a Form 5 filing and since these disclosures were only made annually, they could determine whether trades disclosed through this channel were more profitable than quickly disclosed open market sales. Employing a sample of 445 US companies from the S&P 500 index between 1998 and 2002, they found that insider sales disclosed via Form 5s (delayed disclosure) were predictive of future negative returns between 6–8% and lower future earnings. Conversely, trades disclosed in a timely manner were not price-sensitive or profitable and reflect personal liquidity needs. The main difference between our study and [Cheng et al. \(2007\)](#) is the use of unsanctioned delayed disclosure and its linkage to personal economic incentives.

Timely disclosure of trading by insiders is crucial for the functioning of efficient capital markets. Such disclosure is imperative because insiders have the opportunity to trade on private information ([Grossman and Stiglitz, 1980](#)). Therefore other investors in the firm should be kept informed of their trading activities. According to Eric Mayne, the Chief Supervision Officer of the Australian Securities Exchange (ASX):

*"Timely disclosure of changes to directors' interests helps maintain an informed market and investor confidence in the market's integrity. While the compliance level is at a record high—almost is no satisfactory excuse for failing to meet the disclosure rules every time. Directors are expected to set the best example. Failure to properly disclose creates the perception of misconduct. To be useful, information about directors' holdings must be up-to-date and, where changes have occurred, must enable investors to understand the nature of the changes"* (ASX Media Release, 20 May 2010).

Delayed disclosure of changes to an insider's shareholding is estimated using publicly available information in a novel way. We compare each insider's aggregate purchases and sales over the financial year (as disclosed in the firm's annual report) with the reported changes in their shareholdings (via purchases and sales as they occur) over the same financial year, made as announcements to the Exchange. A discrepancy between the purchases and sales in the annual report and the net change in shareholdings (purchases and sales) reported by insiders themselves is taken to be a case of annual delayed disclosure (DDT) by an individual insider. We label these cases "delayed" (instead of unreported) because trades are eventually disclosed in the annual report. We investigate delayed disclosure in the top 300 Australian firms (by market capitalization) and examine its relation with future firm performance to determine whether such trading leads future returns. Analysis is conducted at the insider level because not every insider in a firm engages in delayed disclosure, and personal wealth incentives<sup>3</sup> are predicted to play a role in explaining this behavior.

Our results show that delayed disclosure is influenced by insider wealth incentives because their personal wealth and means of increasing or maintaining this wealth is interconnected with the firm's future performance. Insiders delay the reporting of both purchases and sales ahead of positive and negative return performances, respectively. That is, these trades have information content about one year and two year ahead returns and some insiders with foreknowledge of firm performance exploit their private information. The

<sup>2</sup> However [Bhattacharya and Marshall \(2012\)](#) found that illegal insider trading indictments were focused in the richer top management strata (those with more to lose), thus contradicting the economic motive hypothesis.

<sup>3</sup> When investigating illegal insider trading by top management, [Bhattacharya and Marshall \(2012\)](#) report that indictments of "richer" management were more prevalent. [Johnson et al. \(2009\)](#) find that in firms where managers committed corporate fraud, there were more incentives to do so from unrestricted stockholdings and when there was lower likelihood of detection. Similarly, in an experiment to identify the determinants of non-compliance with insider trading laws, [Beams et al. \(2003\)](#) find that expected profit, guilt, cynicism, and fairness of law were important determinants.

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