

Insider trading: offensive and defensive causes

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Insider Trading: Offensive and Defensive Causes This essay addresses the concept and the causes of insider trading. Insider trading is considered an issue of immense importance to the business and legal communities. The issue, in effect, is one of honesty and transparency in the conduct of corporate affairs. It is considered so important because this type of security transaction, insider trading, can potentially harm individual investors, industries, and a country's business reputation. This is a truly global issue. Insider trading is defined by the United States Securities and Exchange Commission as " buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non-public information of the security" (" Insider Trading", 2006: np). A corporate officer, for instance, who uses information known to him, but not to the public, to purchase or to buy securities is generally guilty of insider trading. Exceptions may be allowed for certain transactions which are immaterial or which are reported the United States Securities and Exchange Commission. It must also be noted, however, that the concept of insider trading extends beyond corporate officers and insiders in the technical sense. It also includes people who provide tips to outsiders. This secondary portion of the definition ensures that the primary subjects of the law, corporate officers and fiduciaries, cannot escape punishment by secretly providing information to outsiders and non-fiduciaries (" Insider Trading", 2006).

The causes of insider trading are both offensive and defensive, and quite easy to understand if the financial effects are pursued to the ultimate beneficiaries. First, to illustrate, there is the greed motivation. A corporate

officer knows when the value of the corporation is going to increase or decrease. Perhaps there are secret negotiations for a takeover in which share prices are going to increase. He can sell his securities in order to maximize his profits or minimize his losses. Because this information is not known to the outside world, it is considered unethical in many circumstances to act on this inside information. This is because there is an implicit conflict of interest. People in positions of trust are expected to act in the best interests of shareholders. The potential, therefore, to maximize profits or minimize losses, on a personal level, is a direct cause of many insider trading transactions. There is, in short, an incentive to lie in order to enhance one's personal wealth. This is a direct cause of insider trading.

Another causal factor, preserving or inflating the share value of a corporation, is more defensive in nature. It is defensive because the goal is not the enhancement of personal wealth, but of avoiding some other negative consequence. There are situations, for instance, where insider trading is used as a mechanism to prop up a corporation's value artificially as a defensive tactic. In this case, insider trading is used to manipulate share values in order to avoid corporate bankruptcy, to avoid criminal or civil liability for regulatory abuses, and to gain access to credit and business opportunities on more favorable terms. These causal factors may influence the actions of top executives; in addition, these causal factors may also influence outside contractors with access to inside information. In the Enron case, for instance, top accounting firms helped to manipulate share prices and later destroyed public records.

In the final analysis, illegal insider trading is an abuse of power and an abuse

of trust. It is an abuse because people in positions of trust take advantage of confidential and material information for their own personal benefit. This is the classic conflict of interest. The conflict exists. Individuals in positions of trust can opt to benefit themselves at the expense of investors; in the end, investors and countries lose confidence in corporations, industries, and countries. Transparency is the ultimate goal.

References

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