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Insider Trading: A White-Collar Crime and its Impact on Share Market

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Abstract *Since inception, the growth of the Indian stock market has been constrained through unethical, illegal and self-actualised activities of swanky persons involved in different capacities in the market. The stock market was trying to retrieve itself from the devastating effect of Harshad Mehta share market scam, when within a gap of ten years it was once again pushed into the darkness of the dungeon by another demon-child of the country - Ketan Parekh. Corporations have been looted by the insider traders, diversifying internal information to an external in lieu of 'cash'. Investigations in the majority cases have proved the involvement of the high ranking officers of the companies in the crime, sophistically referred to as "white-collar crime". It has an adverse impact on the growth and sustainability of the share market.*

Under the light of the above issue, this paper endeavours to study the impact of such crime on the share market. It focuses on the mechanism behind the insider-trading, its impact on the share market and the regulators supervision on the issue. Finally, suggestions have been provided which will contribute towards the dream of every Indian-a fraud-free share market focusing towards the overall development of the country.

Keywords *White-Collar Crime, Insider Trading, Share Market, Unethical, SEBI Regulations*

"*Insider trading is unfair in the same way as a fixed horse race is unfair; it gives birth to a different breed of white-collar criminal: inside traders. It also gives the market a bad image.*"

INTRODUCTION

Year 2001 passed through a dark phase in the history of Indian Stock Market, when Mr. Ketan Parekh, a bull of the share market rig up stock prices influencing the promoters of listed companies, overseas corporate bodies, or cooperative banks. The share market was shattered; the growth became restricted once the matter was investigated by Securities and Exchange Board of India (SEBI) and it was discovered that the promoters and the banks funds were used to rig the market. India witnessed one of the biggest scam on insider trading. The event today has become a history but the trauma is still remembered by every Indian investors and the fear of insider trading still looms on the share market.

An insider trading may be negative or positive. An insider trading may be called negative when it harms the organisation or its stakeholders. On the other hand it may be positive when an individual exposes an unpublished data of an organisation to the public which may protect the interest of the common stakeholders.

The paper endeavours to study how such insider trading hampers the growth of an organisation and the remedial measures that should be adopted to manage such white-collar crime in the share market.

OBJECTIVES OF THE STUDY

The objectives of the study are

i. To know the mechanism behind insider trading;
ii. To know how the share market is being affected;
iii. To know how the investors are being affected;
iv. To know the SEBI's strategies to curb such illegal malpractices.

Mechanism Behind Insider Trading

Insider trading is the act of buying and selling a company's stock on the basis of 'inside' information about the company. The "inside" or "insider" information of a company is proprietary information which is not available to the general public outside the company, but whose availability would have a material or significant impact on the price of the company's stock. Insider trading is not only illegal, it is unethical too. The person, who trades on insider information, in effect "steals" information and thereby gains an unfair advantage over the general public. Many people argue that insider trading is socially beneficial and, on utilitarian grounds, it should not be prohibited but encouraged. Insider trading is highly discouraged by the SEBI to promote fair

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trading in the market for the benefit of the common investors.

The definition of insider can be very wide and may not only cover insiders themselves but also any person related to them such as brokers, associates, and even family members. Any person who becomes aware of non-public information and trades on that basis may be guilty.

Generally a person likea key employee or an executive who have access to strategic information about the company and knows any price sensitive information of that company, buys stock and shares that information with another person or a group of persons (those who are involved in their racket) so that the information can spread like wildfire. Immediately an artificial demand for the stock is generated and the reflection can be seen in share market very rapidly resulting in hike in the price of that stock. While the price of the stock touches a particular level, the insider, along with his aids exit the market by selling their whole lot making huge profit. After a few moments the script crashes and the ordinary investors lose their hard earned money. Most of the retail investors do not have the capacity of timing the market. They don't know when to enter and when to exit so they are the maximum victim of such foul game.

Insider Trading: Its Impact on the Share Market

Evils of Insider Trading

In majority of the cases, it is observed that the retail investors suffer loses. The big mutual fund houses, foreign institutional buyers, and even the big investors have their own research team. So they never indulge in this kind of hearsay or gossips in the market.Thus the major exertion created by insider trading is a dearth of faith in the capital markets where these illegal or foul trades carried on. Conviction is implied between a company and its investors. The company's ordinary employee to an officer everyone is supposed to act in the best interest of the shareholders of the company. Insider trading is a treachery of that conviction. The insider is making profit at the cost of those innocent shareholders who had put trust on the same company which is not only breach of trust but also immoral and unethical.

Benefits of Insider Trading

Occasionally it acts as a price accelerator and brings the price of shares to their correct level. Insider trading is beneficial to the management because it sometimes acts as boost to them as regards to the market capitalisation. They may have more bargaining power in money market too. If non-public information is made public for the interest of common people without having profit motive by an insider, it may be a boon to the ordinary investors. Also it is found that the insider trading may be commendable for the market as it can provide increased movement of price and volume of trade of a particular script which drives the market at a new high. Other views about the possible benefits of insider trading included the observable fact that it is beneficial for the people interested to get out of the script.

FEW CASES OF INSIDER TRADING

Merger of Reliance Petroleum Ltd with Reliance Industries Ltd

At the time of merger of Reliance Petroleum Limited (RPL) with Reliance Industries Limited (RIL) in 2007, RIL had 4.1% stake in RPL in future market and also in spot market to hedge a major slide in price of RPL shares. This transaction was carried through Reliance Petro investment and as per SEBI's calculation the amount involved was Rs. 4023 crore from which RIL made a profit of Rs. 513 crore. This was declared as insider trading by the market regulator.

Table 1: Insider Trading: Nature, Personnel Involved and Fine Imposed

Name of the Company	Nature of Insider Trading	Personnel involved	Fine imposed
Reliance Industries Limited	Ahead of merger with RPL acquired shares in future as well as spot market	Mr. Mukesh Ambani	Rs.11 crore
ITC Limited	Not disclosing the sale of 10,000 ITC shares to SEBI within the stipulated time	HR manager	Rs. 5 lakh
Wipro Incorporation	Violation of Insider Trading Regulations and selling of 8,000 Wipro shares	Top Official	Rs. 5 lakh
Mahindra& Mahindra	Selling of 644 shares of M&M during the silent period — the 'no transaction period.	General Manger	Rs. 2 lakh

Source: Compiled by the author based on data from The Statesman, dated 1st July, 2014 and ET BureauAug 22, 2014.

ITC Limited, WIPRO Incorporation and Mahindra & Mahindra: Top Corporates Involved in Insider Trading

The executives and top officials of ITC, WIPRO and M&M were baffled with the notices from SEBI in mid-August, 2014 when the latter imposed fine on them. According to SEBI those who were involved in illegal trade sold shares which either they bought from open market or got under stock option scheme. All of them were aware of price sensitive information and hence they violated the insider trading rule.

A Case on Harshad Mehta

In 1990 Harshad Mehta, an ordinary graduate in commerce, began trading heavily in the shares of ACC the price of which rose all of a sudden from Rs. 200 to nearly Rs. 9000. That mechanism was known as "ready forward" transactions financed by collateralised bank receipts, which were in fact uncollateralised. In 1991 he got a nick name as "big bull" because he was the cause of starting bull run in the market. Few high officials of banks were involved with him. In 1998 SEBI initiated charge for insider trading against him and the executives of three companies, namely Sterlite, BPL, and Videocon. Those companies resorted to insider trading to push their scripts prices. Between April to June,1998 the share prices of those companies rose up to 137%, 232%, and 41% respectively though BSE Sensex declined by 11% due to the national and global uncertainties (Fernando, 2014).

RULES UNDER REGULATOR'S LENS

In India, the first set of regulations for insider trading was introduced in 1992 by SEBI.In our country the chairman of SEBI Mr.U.K. Sinha is trying to enforce stricter rules to curb such malpractices so that there will be a fair play in the share market.

Declaration from the desk of the Chairman

1. Any employee of a listed company should disclose the number of shares held by him within two working days.
2. Any change in such holdings over Rs. 5 lakh in value or 25,000 shares or 1% of total shareholding should be disclosed within two working days.
3. All employees should conduct transactions of company's shares only in a valid trading window.
4. Trading window will remain closed when results, dividends, rights, bonus, expansion plans, change in policies will be published.
5. Trading window will remain opened 24 hours after price sensitive information is published.
6. Any person aggrieved by a SEBI order may appeal in Securities Appellate Tribunal.

Source: E.T. Bureau, 22nd August, 2014

As per the notification of the Union Government on 28th August, 2014 SEBI is now empowered to attach properties, arrest defaulters and secure access to call data. This will enable SEBI to prove insider trading cases. (The Statesman, 2014)

CONCLUSION

An insider who makes profit at the cost of common investors is a thief who steals company information for his gain. It is a white-collar crime and difficult to prove. So SEBI should get all power to curb it at its initial stage. It is a sorry state of affair when our Government is inspiring the common public to save their money either through direct investment in equity market or through mutual funds and ELSS. If it happens frequently, common public may lose their faith in capital market and may mislay their superannuation funds too.

ROAD AHEAD

By imposing fine and sending the culprits in to prison, nothing can be changed until and unless the moralities of those people are not being changed. So it is advisable that every company should have certain codes of conduct and ethical practices. Not only that, each and every employee should be aware of the consequences of not following the ethical practices and particularly the consequences he may follow for not adhering to the insider trading rules.

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