

# Insider trading can signal a successful merger

August 5 2021, by Kevin Manne

---



Credit: Unsplash/CC0 Public Domain

Insider trading can be a key signal in determining the potential success of a merger, according to new research from the University at Buffalo School of Management.

Recently published in the *Journal of Financial Economics*, the study found that an acquiring firm enjoys higher returns and improved synergy when it takes over a business with higher insider trading—but it will pay a higher initial price for the acquisition. Insiders are legally permitted to buy and sell shares of the firm as long as they report their trades to the Securities and Exchange Commission in a timely manner.

"Based on our findings, insider trading at target firms can be predictably used to determine the success of future [acquisitions](#), and can also help reduce the chance of firms taking over a 'lemon,'" says Inho Suk, Ph.D., associate professor of accounting and law in the UB School of Management. "Such trading increases efficiency in the mergers and acquisitions market by signaling the target's potential for generating acquisition benefits."

To study the effects of insider trading on mergers and acquisitions, the researchers analyzed more than 5,300 acquisitions of public U.S. firms from 1987 to 2016 and insider trades made within a year prior to public announcements of the acquisitions. From that data, they constructed net purchase ratios for each acquisition by aggregating target firm insider trades made during that year before the announcement.

Suk says their findings show that [insider trading](#) at target firms is a reliable indicator of acquisition performance because returns and synergies increase with the target firm insiders' net purchase ratios.

"From a practical perspective, firms that plan to acquire other firms should take target insiders' [trading](#) activity into account," says Suk. "An acquisition of a target firm with high insider net buying is a win-win to the shareholders of both the acquirer and the target."

**More information:** Does Target Firm Insider Trading Signal the Target's Synergy Potential in Mergers and Acquisitions? (December 28,

2020). *Journal of Financial Economics* (JFE), Forthcoming, Available at SSRN: [ssrn.com/abstract=3760100](https://ssrn.com/abstract=3760100)

Provided by University at Buffalo

Citation: Insider trading can signal a successful merger (2021, August 5) retrieved 20 June 2024 from <https://phys.org/news/2021-08-insider-successful-merger.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.