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A framework for combating insider trading on developing stock exchanges: Evidence from the Zimbabwean stock exchange

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Stock exchanges play a vital role in any capitalist economy as they provide a secondary market where investors can buy and sell shares under orderly conditions at fair and competitive prices. This role requires stock exchange operations to be regulated in order to enhance the efficiency, transparency and full disclosure in their operations. This is particularly true with respect to the potential harm associated with insider trading. In Zimbabwe the trading of shares is conducted through Zimbabwe Stock Exchange and is regulated by the Zimbabwe Securities Commission. The Zimbabwean Stock Exchange is a typical emerging stock exchange whose performance has been noteworthy in the past two decades in terms of returns on investment in United States dollar terms and in terms of share price increases. In recent years however, the Zimbabwe Stock Exchange has faced some challenges associated with insider trading. On the other hand principles of corporate governance, business ethics and morality have been emphasized as critical managerial attributes that result in fair trading and business practices. Based on literature review on the subject and responses to qualitative interviews with stakeholder groups on insider trading in Zimbabwe, this paper discussed the concept of insider trading and its causes and proposes a framework for combating insider trading in developing stock exchanges.

Key words: Insider trading, developing stock exchanges, combating insider trading.

INTRODUCTION

Stock exchanges play a vital role in any capitalist economy as they provide a secondary market where investors can buy and sell shares under orderly conditions at fair and competitive prices (Manne, 1966). This role requires stock exchange operations to be regulated in order to enhance efficiency, transparency and full disclosure in their operations. A well regulated stock exchange mitigates the potential harm associated with insider trading (Duan, 2009; Aktas et al., 2007; Battacharya and Daouk, 2002). Zimbabwe has made significant progress in developing a legal framework that facilitates the orderly trading of securities. A closer look at the legislative and administrative system of trading of securities however

reveals that there are some inadequacies that require to be addressed to minimize loopholes that have potential harm to the market's ability to function effectively and efficiently. This paper discusses the subject of insider trading from a Zimbabwean (developing economy) perspective and proposes mechanisms that could be used to address the inadequacies of insider trading regulation currently in place.

In Zimbabwe, the trading of shares is conducted through the Zimbabwe Stock Exchange (ZSE) and is regulated by the Securities Exchange Commission of Zimbabwe as prescribed by the Securities Act Chapter (17 of 2004). The Zimbabwean Stock Exchange is a typical emerging stock exchange whose performance has

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been noteworthy in the past two decades. In 2001, for example, the Standards and Poor survey voted the ZSE as the best performing emerging market both in terms of returns on investment in United States dollars and in terms of share price increases. In recent years however, the Zimbabwe Stock Exchange has faced some challenges associated with insider trading, (Kalonga, 2003; Saburi, 2003; Nyakazema, 2008). For example, in 2008, the Zimbabwe Stock Exchange Committee, investigated allegations of insider trading after certain counters' share prices were alleged to have been inflated, depressed and in some cases some share prices had fluctuated under suspicious circumstances (Nyakazema, 2008). On the other hand, principles of corporate governance, business ethics and moral imperatives have been emphasized as critical managerial attributes that result in fair trading and good business practices, (Newkirk and Robertson, 1998). Based on literature review on the subject and responses to qualitative interviews with stakeholder groups on insider trading in Zimbabwe, this paper discusses the concept of insider trading, its causes. It further proposes a framework for combating insider trading in developing stock markets.

LITERATURE REVIEW

Insider trading is a controversial subject internationally (Beny, 2008; Bris, 2005; Durnev and Nain, 2007; Chitimira, 2008). This subject still receives considerable attention in academic, policy circles and in the media fraternity (Kalonga, 2003; Saburi, 2003; Bainbridge, 2010). Globally there is no consensus on a definition of insider trading (Newkirk and Robertson, 1998; Bainbridge, 1999). Literature points to two approaches to defining insider trading. The first approach assigns property rights to insider information advocating that the shareholders have a property interest in the information held by the company (Bainbridge, 2007; Hogan, 1989; Goshen and Parchomovsky, 2001). According to Bainbridge (1999) law and economics scholars, mostly favour this approach as they contend that the property right to inside information should be assigned to the corporation and not subject to contractual reassignment. Under this approach, insider trading is defined as the use of information not publicly available, by a participant in a securities transaction whose access to that information is derived directly or indirectly from a fiduciary relationship, which gives the participant or associate a financial advantage over others (Dooley, 1980; Sudhakar, 2004). The financial advantage mentioned may be secured from trading in securities of the company in which the fiduciary relationship is established or in other companies whose market values may be influenced if confidential information held by the initial company is acted upon. In the latter case, this is most commonly expressed in

mergers and takeovers.

The second approach, which Hogan (1989) describes, emphasizes equality of access to information about a company by all participants in a securities market and sets aside the property concept. With this approach, the definition of insider trading relates to the use of information, not publicly available, by a participant in a securities transaction to his financial advantage at the expense over other participants without access to similar information. Under the second approach, emphasis is placed on fairness by participants and trust in the trading system of securities, (Newkirk and Robertson, 1998; Bainbridge, 1999).

Beny (2008) arguing from a political economy perspective, points out that when insider trading is unregulated, by default, the state assigns the property rights to private capital information to corporate insiders, enabling them to maximise their private rents from the use of such information. Further, Beny (2008) adds that when insider trading is prohibited, the state removes insiders' monopoly on the use of private corporate information and thus redistributes rent to outsiders.

In Zimbabwe, Part X of the Securities Act (2004) identifies directors, advisers, consultants and shareholders or an issuer of listed securities as insiders. The act prohibits such individuals who know or ought to know from trading or dealing directly or indirectly in any affected security or from misuse of inside information. The term outsiders as it applies to insider traders, relates to all other stakeholders other than insiders (as defined before). These include informed traders (arbitrage traders) such as market professionals, market analysts, brokers, dealers and individual investors. This term can also be applied to institutional investors such as pension funds, mutual funds, insurance companies, index traders and foreign investors.

In a bid to try and curb the negative effects of insider trading activities, many economies have promulgated insider trading laws as mechanisms for minimizing illegal insider trading. The United States of America (USA) has since 1934 been in the forefront in terms of developing legislature to govern insider trading (Newkirk and Robertson, 1998). Sudhakar (2004) suggests that it is critical that legislation should reflect both approaches described by Hogan (1989) in order to allow the true nature of the wrong elements perpetrated by the offence of insider trading to be clearly outlined. It would be ideal that the legislation dealing with insider trading also incorporates features of the second approach with regards to the disclosure requirements imposed on listed companies. In essence, legislation will therefore, be in a position that to encapsulate both definitive approaches. This notion aims at ensuring an all encompassing approach to the definition which will ensure that there are no loopholes left for technical abuse by securities market and legal experts.

Beny (2002) states that insider trading is synonymous

with financial greed and wheeler dealing. In academia and policy circles, the debate centers on the desirability of regulating insider trading. Advocates of insider trading regulation (Barlev and Haddad, 2010; Fernandes and Ferreira, 2009), state that the objective of insider trading laws is to reduce the information asymmetry between insiders and outsiders which ultimately enhances efficiency. Opponents of insider trading laws on the other hand, claim that such legislation favours special interest groups at the expense of efficiency (Beny, 2002). On an international scale, with a few exceptions, insider trading legislation and enforcement are a phenomenon of the 1990s.

It must be stressed that the whole notion of making insider trading an offence stems from the well-known company law principle that directors owe a fiduciary duty to the company not to make a secret profit and further, the equitable notion that a director must not be allowed to put himself in a position in which his fiduciary duty and personal interests conflict (Bainbridge, 1995). It should be noted that there is an ethical duty for insiders to observe high standards of commercial integrity. This, in turn, would create confidence in the securities market, thus leading to the development of any stock exchange where securities can be traded with greater confidence and efficiency, hence creating the potential for increased foreign investment.

Insiders and their associates

Corporate insiders consist of traditional or 'primary' insiders, including executives, board members, officers and controlling shareholders. Their status gives them privileged access to corporate information and thus a potential trading advantage relative to outsiders.

There are also 'constructive' or secondary insiders. These include lawyers, accountants, investment bankers, brokers and dealers, "...who may be privy to private information by virtue of a contractual relationship with the firm or its shareholders. To the extent that they receive private information (that is, information unavailable to the rest of the investing public) "from insiders, relatives, personal and political associates of insiders might be classified as insiders (Beny, 2002).

From the aforementioned definition, inference can be made to the effect that an insider is a person in possession of specific information, which relates to securities of a firm which is not generally known but which if made public, would likely have a significant effect on the market price of those securities. An insider will try to buy or sell or suggest that others (tippees) buy or sell securities when he is in possession of information that may alter the price. The insider will do so before the information has been made to others in the investing community.

Jeng et al. (2003) suggest that primary insiders make

superior profits (relative to the market) when they trade on the basis of insider information, which is not available to the public domain. Jeng et al. (2003) also applied performance evaluation techniques to reported United States insider transaction over 1975 to 1996 and found that a constructed portfolio of insiders' (top executives and other insiders) purchases over the previous year, earned abnormal returns of approximately forty basis points per month. Most professionals like brokers, dealers, investment bankers and institutional investors might also benefit from insider trading due to the special relationship they have established with corporations and management (Goshen and Parchomovsky, 2001).

Insider trading on the basis of material, non-public information is undoubtedly even more profitable in countries where there are fewer legal constraints on insiders' self-dealing. Tippees clearly gain when they trade on the basis of private information received from insiders. Beny (2002) argues that in several countries, "... much insider trading is done by politicians and government bureaucrats who receive private information in exchange for economic or political favours." Beny (2002) argument was empirically tested by Bris (2005) who presented international evidence suggesting that insider trading on the basis of private information is highly profitable in the context of corporate takeovers.

Legal and illegal insider trading

Legal insider trading occurs when insiders (officers, directors and employees) buy and sell stocks in their own companies (Kalonga, 2003). Their conduct can only become illegal and restricted at certain times and under specified conditions. On the other hand, "Illegal insider trading is the buying and selling of securities while one is in possession of privileged and confidential information, which is not available to the general public" (Kalonga, 2003). This research will be dealing with illegal insider trading and not the former. Whenever illegal insider trading occurs, the perpetrators or those who practice insider trading would have gained an unfair advantage over everyone else and could earn super profits from trading on shares.

The ideal scenario would be one where on one hand insiders can buy and sell shares in their companies at any time provided that the information they have is more or less the same as that of everyone else in the market. On the other hand insiders would not be allowed to buy or sell shares when they have price sensitive information such as of the contents of financial statements just prior to their publication or when they have confidential information of an intended merger, acquisition or any important piece of information that has a bearing on the share price.

Some companies have policies for rewarding their employees and company executives with shares whereby they are given options to purchase company shares

under special arrangements. A company for example, may provide them with funds to buy shares at a huge discount to the market price. In such cases, a larger percentage of insiders will most likely take up the option, thereby participating in the buying and selling of their company's shares.

In some instances, some individuals are expected to hold a certain quota of the company's shares when they qualify as directors. From the aforementioned examples, after accumulating sizeable chunks of the company's securities, insiders are allowed to sell their shares and diversify into other counters if they so wish. This is legal and does not constitute illegal insider trading if conducted in a transparent way and not induced by price sensitive insider information.

Illegal insider trading is however not limited to company employees only. One can also be entangled in this illegal dealing business through getting a tip from someone with privileged information. A typical example could be that an employee of a company can pass on confidential information of his company to members of his family, friends or other associates. If these tippees decide to act on particular securities based on the information so supplied, either to buy or sell securities, then they will be guilty of practicing insider trading.

In many cases, it is usually difficult to prove that a third party may be involved in inside trading. An example that comes to mind on this aspect is that of an investor who gets a tip from a broker with inside information relating to a particular security. The investor may be aware that he is acting on inside information but this will be very difficult to prove or establish in a court of law.

Insider trading can also take the form of "...overhearing some confidential information about a company being discussed by other people directly involved with the company. Where a counter is concerned, if a person or an investor decides to act on the basis of the information they overhead, then that person could be involved in illegal insider dealing. On the other hand, the other parties may not be responsible for disseminating confidential information but will be liable to being careless where confidential matters are concerned (Prevention of Financial Markets Abuse Act, 2002, Chapter 476, Republic of Malta).

The aforementioned analysis has given the general world's view of what insider trading is. However, as has been mentioned before, for the purpose of this research, whenever insider trading is mentioned, it means illegal insider trading. In this regard, insider trading can be seen as the misuse of price sensitive information by a corporate insider in order for him and/or his tippees to obtain an unfair advantage for himself or themselves in the market for securities of the corporation. It is an unethical practice that is motivated by greed on the part of perpetrators which in turn leads to the distortion of the operations of a securities market. Insider trading breaches the fiduciary obligation and trust that insiders

would have been bestowed by the corporation, in particular, and by the public eye, in general.

Taking a snapshot of the international picture on insider trading regulations, the provisions to regulate dealings in a company's shares emerged because of widespread concerns about the misuse of confidential information by officers of the company, in particular, and also by their associates, their families and friends to whom they had relayed information about the company's shares. Regulation, on the other hand, has also sought to prevent misuse by others outside the company, such as accountants, auditors and bankers who might equally have access to restricted information about the company, which might affect the value of its shares on the market.

The effects of insider trading

When dealing with insider trading it is necessary to understand the extent and effects of insider trading on the market, on an individual and on the international reputation of the stock market in question. Insider trading is most harmful to the market. The harm, according to some brokers in its simplest form of insider trading, dislodges the market (Newkirk and Robertson, 1998; Bainbridge, 1999).

Stock market prices act as signals for resource allocation, which help investors to make economic decisions as to where they should allocate their resources. "The harm" to international investors is significant as the investors constitute an avenue through which a country gains foreign currency injections. International investors tend to shun markets that have a reputation of allowing insider trading. This has a negative impact on issues of national economy.

Insider trading is a form of stealing which, in turn, damages the share trading system. Investors "miss out on value and the vast majority of shareholders suffer" because "they should be able to share profits (Bris, 2005). Manne (1966) argues that insider trading acts as a price accelerator and brings the price of securities to their proper level more quickly than would otherwise be the case. He further goes on to argue that insider trading is beneficial because it provides an additional incentive to management to be more entrepreneurial in running the companies they control.

Bushman et al. (2005) summarise the effects of insider trading as follows: investor confidence is eroded; the raising of capital is made more difficult; the efficiency of the market is destroyed; the perception of unfairness leads to disinvestments by both local and international investors; insider trading has the effect of corrupting or debasing the market; the international reputation of the stock exchange suffers and insider trading causes a reduction of direct foreign investment.

There are several propositions that have been tabled in literature that seek to guide the manner in which stock markets must govern insider trading. These can be

grouped into two major parts, those that are against legislating insider trading and those that are promote legislating insider trading.

The insider trading regulatory school

The arguments in favour of regulating insider trading can be separated into one set sounding in economic terms and a second set premised on fairness, equity, and other non-efficiency grounds (Bainbridge, 2001: 70). Such scholars as Bushman et al. (2005), Newkirk and Robertson (1998), Bainbridge (2001, 2010) and many others, believe that insider trading is immoral and defeats the objectives of good corporate governance. They argue that the use of privileged information for the purposes of gain (or to avoid a loss) at the expense of others is morally and legally reprehensible and as such should be regulated. They are of the view that a legal system, with specific laws, is the best way of protecting investors engaged in securities transactions and assuring public confidence in the integrity of the securities markets

The insider trading deregulatory school

The deregulation school posits four major theoretic arguments are raised. First based on the Efficient Market Hypothesis (EMH), the proponents favouring deregulating insider trading argue that markets react to information in their price determination role. Allowing insider trading will reduce the time information travels from the time it is generated to the time it is made public to the rest of the investing community (Manne, 1966). Further the argument for insider trading as vehicle for market efficiency advances the notion that once an insider trades on the basis of insider information, then the insider has practically disclosed the information and as such have allowed the market to move to a state of equilibrium or efficiency.

Secondly some argue that insider trading is a legitimate form of compensation for corporate employee (Newkirk and Robertson, 1998; Manne, 1966; Dye, 1984; Carlton and Fischel, 1983). Carlton and Fischel (1983) argue against regulating insider trading. They argue that enacting laws that prohibit insider trading does not creates an uneven playing field only a more costly one as outsiders interested in the inside information may obtain the information in a more costly manner than the insiders. Rather than viewing insider trading as a problem, Carlton and Fischel (1983) view it as a means of conveying the value of the firm's stock continuously and reliably. In a nutshell, the allocation of this "intellectual" property right to the managers is optimal. Critiquing this argument, Newkirk and Robertson (1998) state that this argument "fails to address the real and significant hazard of creating an incentive for corporate

insiders to enter into risky or ill-advised ventures for short term personal gains, as well as to put off public release of important corporate information so that they can capture the economic fruits at the expense of shareholders" (Black, 1992).

Thirdly it is also argued that insider trading regulations is against the work of analysts or market researchers who diligently seek for any information that might help their clients beat the market. After all, profits can only be appropriated when someone has better information than others. Empirical evidence from international securities markets in the United State of America for example, show that it is possible for analysts to conduct their business within the ambits of the law (Newkirk and Robertson, 1998; Bainbridge, 2010).

Lastly there is yet an argument that focuses on the cost of enforcing insider trading. The proponents of deregulation argue that it is simply not cost effective to regulate and enforce insider trading regulations. They argue that the money and human capital spent on investigating and prosecuting insider trading far out weights the benefits that may accrue. Other even argue that such cost fall back on the transaction costs associated with trading on shares as investors pay some form of tax or levy to the enforcing authorities. This argument however has been rejected on the basis that it takes a myopic perspective to the cost element as it focuses only on direct costs that can be traced to enforcing agents and related areas and negates the external costs such as the costs that results from a perspective that insider trading is unchecked.

Given the aforementioned debate, stock exchanges should therefore strive to have the best protection for investors and the public through the efficient operation of the capital market. This cannot be underestimated in developing economies where stock markets play a critical role in attracting foreign direct investment (Priotoski and Smith, 2005). The ideal situation, in mind, results in an efficiently developed market where investors can be confident that the market price accurately reflects a company's prospects, which ensures the efficient allocation of capital within the market. The aforementioned scenario is only achieved when there is no insider trading and there are mechanisms for discouraging it.

This study advances the theoretic notions shared by scholars who argue that insider trading must be regulated (Bushman et al., 2005; Newkirk and Robertson, 1998; Bainbridge, 2010). The study focuses on six propositions related to legislation, institutional structures, guidance to individuals, firm specific efforts, use of technology and the use of international lessons.

Research propositions

Based on the earlier discussion, this study investigates

the following six propositions:

1. Legislating insider trading minimize insider trading
2. Institutional structures dealing with insider trading minimize insider trading
3. Technology interventions minimize insider trading
4. Individual support/guidance to persons working in insider trading environments minimize insider trading
5. Institutional/firm specific support/guidance minimizes insider trading
6. Utilising international lessons in developing insider trading structures minimises insider trading

RESEARCH METHODOLOGY

An exploratory-descriptive study was adopted to inform the findings of this research. This study utilised qualitative empirical data collection methods to collect data to inform the proposed framework for combating insider trading in developing stock exchange. Primary data was collected through in-depth interviews. Stock brokers, members of the ZSE, ZSE officials, members of the Securities Exchange Commission of Zimbabwe (SECZ) and representatives of stakeholder institutions such as the Institute of Directors and the Zimbabwe Institute of Management were invited to participate in a voluntary interview process. Targeted interviewees were contacted telephonically, via email or through the snowball techniques after a responded either referred or introduced the research team to them. In total 53 in-depth interviews spanning across all stakeholder groups on insider trading in Zimbabwe were recorded and used in this research. After collecting 53 interviews the responses obtained from interviewees were more or less the same and the data collection process was stopped. Additional data was collected from official historical data available online relating to the ZSE, SECZ, companies listed on the ZSE and commentaries from newspapers and academics were utilised. Lastly the research also utilised the published information and pieces of legislation from Zimbabwe, the USA, the UK, Malta and South Africa. The responses to the various questions from the interviews together with the information from published sources and from beyond the borders of Zimbabwe were collated and triangulated and used to inform the findings presented in this paper. The research analysed each interview using predetermined themes from literature and other published sources. As each interview was analysed, peculiar themes identifiable to Zimbabwe and developing stock exchanges that emerged were added to the predetermined themes. After completing the analysis, a first draft of the findings compiled was sent to the major stakeholders for their comments. Feedback from 30 original respondents was incorporated into this final version.

FINDINGS

Causes of insider trading

Based on the analysis of the qualitative interview and from historical data analysis, this research identified three broad areas as causes of insider trading at the ZSE.

Under legislation of insider trading

Insider trading is illegal in Zimbabwe. The Securities

Act Chapter (2004) provides regulations on insider trading that covers both individuals and institutions that regulates or is affected by insider trading. The Act established the Securities Commission, a new institution in the Zimbabwean regulatory landscape, to undertake the overall role of managing insider trading. Part X of the Act concentrates on the misuse of insider information. The Act defines insider trading and insiders. It also prohibits against the misuse of insider information and ascribes both criminal and civil penalties to perpetrators. The regulation allows for a maximum of 5 years and or a fine for criminal offences emanating from insider trading activities. In terms of civil liabilities, the Zimbabwe Securities Commission, the issuer of securities and holders of securities, are allowed to seek for civil remedies through the courts. The Class Action Act (10 of 1999) allows for a group of persons such as shareholders through their own action or through the Attorney General to institute criminal or civil action against perpetrators of insider trading. While an attempt to regulate insider trading have been made through legislation, there is still room for improvement. The regulation is currently contained within the Securities Act. This Act covers a wide variety of legislative provisions. The ideal scenario would be to have a standalone act that covers all areas of insider trading activities from compliance, minimisation mechanisms, penalties and enforcement activities. Further the law does not clearly give guidelines to the SECZ on exactly what it has to do to minimize insider trading. A lot of room is left to the commission to do what it sees fit in regulating the trading of securities. In the USA for example, the securities commission provides clear guidelines to all stakeholder on what they have to do to comply with the legislative arrangements. The commission literary manages a number of related acts. In South Africa, the Financial Service Board is guided by a comprehensive Act on Securities. A total of 80% of the respondents indicated that the lack of detailed legislation to govern insider trading allowed individuals and other corporate institutions to attempt insider trading on price sensitive information.

Lack of institutional structures to deal with insider trading

On the international front, well-developed stock exchanges have their operations reinforced by other state and private institutions. There are insufficient institutional structures to deal with insider trading in Zimbabwe. The problem is compounded by poor participation in the operations of the Zimbabwe Stock Exchange by the Reserve Bank of Zimbabwe, limited experience of the Zimbabwe Stock Exchange Committee and the Securities Exchange Commission of Zimbabwe in determining insider trading offences, non-participation by specialised police fraud section and a non existence of an economic crimes court in the Zimbabwean legal structures. What is

lacking is an all-encompassing policy framework incorporating the ZSE, the legislature, state-controlled regulatory institutions and law enforcement agencies to deal with insider trading. The Act alluded to in the preceding paragraph would allow for such coordinated efforts to combat insider trading.

Limited firm specific guidelines to individual behaviour with respect to insider trading

A survey of all firms listed on the ZSE indicated that out of the 72 firms listed, only 5 (6.9%) had some form of policy on insider trading and only one firm had its policy well documented on the company website on the internet. The unavailability of and the limitations in policy frameworks to guide individuals within firms, points to a deficiency that can be managed from a micro-firm perspective. A micro to macro perspective to the management of insider trading is essential as it reinforces the elimination process from all levels. Individual at firm level will have firm defined boundaries sanctions and guidelines on how they are expected to deal with insider trading. Clear well defined legislation supported by state and ancillary institutions will then add the macro perspective to the micro perspective at firm level.

Other causes

The other causes of insider trading in Zimbabwe include the following:

Poor investor education

There is limited investor education particularly in the area of governance and fair trading practices. An examination of the ZSE, the SECZ and other related institutions such as Universities, corporate bodies and support institutions such as the Institute of Directors shows that these ancillary institutions have limited role in educating the investor community on insider trading and its implications to the market and on the statutory provisions in place.

Poor technology utilisation

To date the ZSE and the Securities Exchange Commission utilises minimal technology in managing the trading, information dissemination and educational role. Technology has taken over the administration and implementation of this role particularly with the rise of the internet as a medium for information dissemination and real time trading. Real time information dissemination systems, online banking, transfer systems and stock market activity system are the much desired and

preferred systems today as they allow for mass broadcast of information; real time trading and real time funds transfer between trading parties. Technology also benefits in shareholder information updating. In addition to the non existence of an online trading system, a notable challenge that affects the efficiency of the ZSE is the non – existence of a central depository system. A central depository system would allow for the electronic settlement of financial transactions within Zimbabwe and across other securities exchanges and economies globally. In 2002, the Real Time Gross Settlement system was introduced in Zimbabwe, pioneering a new era for settlement of funds across financial institution and between individuals. In the USA systems such as the EDGAR system allows for listed companies to transmit information to the Securities Exchange Commission within the allowed time frames. Such systems have reduced the incidences of insider trading.

The use of brokers as intermediaries in dealing in shares

Individuals in Zimbabwe may not approach the stock exchange for purposes of trading on any shares. This is done by registered stock brokers, who are usually linked to a specific stock broking firm. There are 20 stock brokering firms in Zimbabwe of which there are more than 50 registered stock brokers. The use of brokers in the trading of shares creates a gap that is problematic with respect to share trading. Respondents pointed out that when an individual wants to trade in shares, he/she would approach a stockbrokerage firm. The firm would then request the investor to deposit the amount of money into their share trading bank account. Shares are only traded once the money deposited reflects in the stock brokerage firm's trading account. In some cases, individuals pointed out that it could take as many as 7 to 14 days to trade on shares. During this period, a stockbrokerage firm would have "access" to the investors' funds allowing for possible "misuse" of the funds even for insider trading.

Conclusion

It has been demonstrated in this study that insider trading poses a serious challenge to good corporate governance and to the efficiency of developing stock and undermines the capital allocation role of a stock market. Developing economies require efficient markets to attract foreign direct markets. The framework developed earlier allows developing stock markets to develop acceptable institutions to support the minimising of the insider trading. In particular the study highlighted the need for a micro perspective to the combating of insider trading in developing stock markets. Lastly the research identified

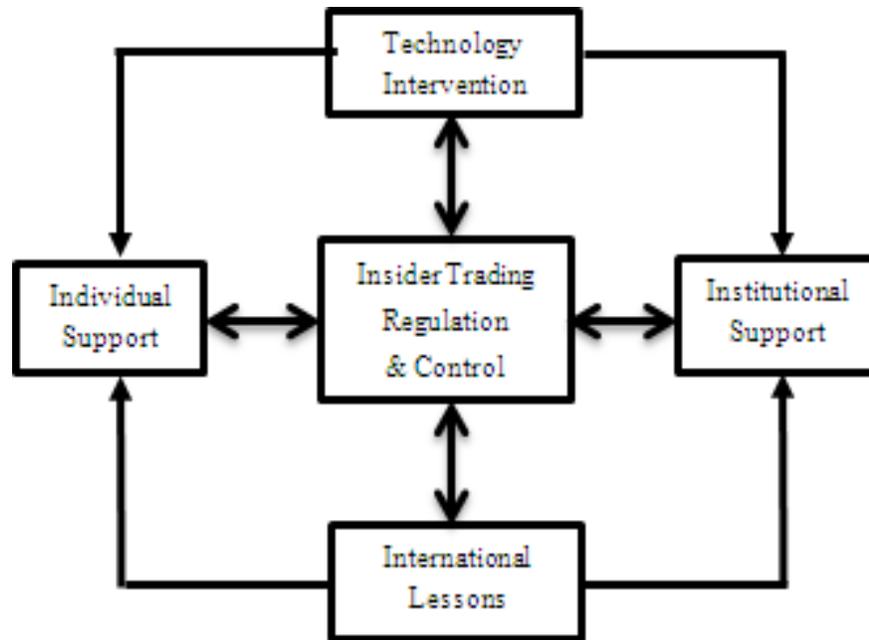


Figure 1. The individual, institutional insider trading minimisation framework.

the development of a framework for company specific insider dealing as an area that requires more empirical investigation.

Managerial implications

Based on the earlier discussion in relation to the Zimbabwe Stock exchange, this paper identifies five critical elements that can be used to manage insider trading on any developing stock exchange. Figure 1 summarised these main components into a proposed individual, Institutional insider trading minimisation framework for combating insider trading on developing stock exchanges.

Perpetrators of insider trading are individuals, therefore any initiative to minimize insider trading ultimately should end up influencing the individual to act against any insider trading activities he may be inclined to engage into. The aforementioned theoretical framework proposes that insider trading can be minimized through the use of two main mechanisms that are directed towards individuals through micro (individual firm specific efforts) and macro (institutional dependent efforts). These initiatives would be generally driven by a robust legislative framework, state of the art technology and be influenced by lessons from the international community. This all encompassing framework should never be an event but a process that is periodically reviewed by stakeholders and improved upon.

The framework proposes that firms should embark on individual specific efforts such as training aimed at

developing an individual's capabilities to act in a morally sound, ethical and honest way when dealing with stock market instruments. Induction courses, organisational handbooks, refresher courses, company policies and periodic reminders should be key governance enhancing activities that firms use to enhance positive insider trading behaviour. Respondents indicated that this might not be easy to achieve because of the growth in greed and dishonesty, but they acknowledged that individuals who are trained are most likely to be inclined to work in a morally correct way. Organisations therefore should invest in the training of staff to enhance their understanding of the impact of acting in any manner that could perpetrate insider trading. Such training should highlight the company specific guidelines on insider trading, legal elements of insider trading and the consequences of insider trading on the individual, firm and the economy at large.

Further the framework proposes that the challenges associated with insider trading can be minimized by developing clear insider trading regulations and control mechanism. Both civil and criminal elements of insider trading must be clearly highlighted at law. The legislative provision must be enhanced through control and supervisory mechanism that allow for the use of systems and other infrastructures to be used to check the effectiveness of the regulatory framework. We note the success of using the EDGAR system in the United States of America as a typical influential example. Other countries such as Canada, the United Kingdom, Germany and Australia have also exhibited similar successes through the use of technology. Developing

economies have argued that technology is costly and they tend to face challenges with implementing modern technology. We dismiss this rather limited view and argue that strategies to enhance political and economic ties have been developed in the past 60 years amongst developing economies. With developments in technology and the political and economic ties in place, we suggest that developing economies are able to acquire and share technology and systems to enhance stock market activities.

Added to the technology is the supervisory role played by regulatory institutions. To supervise insider trading activities, calls for primary regulatory institutions such as securities commissions, stock exchange insider trading supervisory committees, central bank financial institution supervisory units and dedicated legal specialised courts such as commercial courts to develop expertise that are capable of supervising and providing the necessary regulatory guidelines and reports. Having regulatory institutions is one thing but having effective regulatory institutions is another. We propose that regulatory and supervisory institutions should regularly provide reports and statistics that communicate their mandates. This will enhance access to information and argument research on insider trading and other related regulatory activities.

The development of legislation and system of enforcement should take lessons from international enforcement. Such foresight will allow the incorporation of modern practices that have been developed in some economies over the year. The case in point is the American system of insider trading which has evolved to the current levels where investors are confident of the mechanisms in place to protect their wealth. Significant to the use of international lessons is the consideration of the local circumstances. In most developing stock markets, the economies are also in their developmental phases. This requires that governments invest significant funds in developing infrastructure and capacity to bring their financial services and securities markets to world class standards.

To complement the primary institutions, the aforementioned discussion also singled out the role of ancillary institutions in minimizing insider trading. Institutions that are influential and are highly regarded by the business community and whose mission clearly indicate objectives that seek to promote high levels of corporate governance are better placed to use their network to influence their members.

Lastly, the debates around insider trading have mainly focused on the macro perspectives in particular the legislation aspect. This paper suggests that an equally important aspect to the minimization initiatives is the need for the micro perspective that focuses on the firm specific initiatives. Firm specific activities will approach the problem at root level an approach that allows individuals and management within a firm to micro manage the problem. An individual insider trading and ethical behaviour frame work driven by firm initiatives

through clear policy development is likely to be more successful than one that comes from beyond the firm though legislation. This paper submits that this view must be compounded by development of empirically grounded policy frameworks that will help managers develop local initiatives to the minimisation of insider trading. This paper highlighted the importance of the judiciary system in minimizing insider trading, the challenge associated with this method lies in its cost as it is dependent upon legal experts and their abilities to argue for and against technicalities that may be abused within the confirms of the legal structures in place. The individual perspective allows for the use of local instruments that are cost effective in minimizing insider trading. The paper also asserts that the use of individual support mechanisms has overall benefits to economies at it allows for the stock market to become efficient at the least cost. This is a desirable state as it attracts foreign direct investment, to the stock market as compared to inefficient markets which results in firms having to acquire capital at higher costs.

FUTURE RESEARCH

This paper has proposed a framework that can be used to by developing stock exchanges to minimize insider trading. In the paper a key element that is proposed is the use of company specific methods to combat insider trading. A key element of this would be a company policy.

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