Informed Trading around Accelerated Share Repurchase: A Pitch

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Introduction

I am a first year student in Masters by Research program. Currently, I am working on my first project. While writing my initial draft for the first project, I found Faff's (2014) 'Pitching Research' template quite helpful for me to develop the complete structure using "cocktail glass" "IDioTs, "3-2-1" and "mickey mouse" format.

Every research student knows how difficult it is to come up with a research topic. However, once the topic is ready, Faff (2014) helps to overcome the other hurdles by giving a structured guide. The most crucial parts are taking off and landing as demonstrated in Faff (2014). It is a big hurdle for everyone to choose a research topic with purpose. Thus, the better start will help to accomplish a better finish. I would like to acknowledge that I have greatly benefitted from using the pitching template of Faff (2014) to develop this pitch paper.

Motivation

Accelerated share repurchase (hereafter, ASR) is a recent innovation to repurchase shares immediately without incurring major costs like tender offer repurchases or Dutch Auctions. Indeed, ASR has become a daily vernacular of share repurchase announcements, which shows its growing popularity among US corporations. Recent literature documents that equity market reacts positively to ASR announcements (see for example, Bargeron, Kulchania and Thomas (2011) and Bonaime (2012)). Bargeron et al. (2011) show that announcements of ASRs subsequent to open market repurchase programs are associated with positive and significant abnormal returns and assert that shareholders view these transactions as incrementally wealth increasing relative to repurchase programs comprised entirely of open market repurchase (OMR) programs.

Easley, O'Hara and Srinivas (1998) show that in incomplete markets, options trading contain private information incremental to that available in the equity market. Since ASR announcements convey positive information to the equity market, traders who have private information would be keen to exploit their information advantage and trade prior to the public announcements. However, it will be interesting to examine if informed traders are attracted to the ASR announcements and trade in the options market based on the positive information.

Furthermore, prior studies document significant insider trading activity around share repurchases. Lee et al. (1992) document that managers sell fewer and buy more shares prior to self-tender offers but that insider trading returns to normal levels after the tender offer. Louis et al. (2010) find abnormally high net insider selling during the quarter of fixed-price and Dutch-auction self-tender offer announcements. Babenko et al. (2012) identify more insider open market purchases in the year before an open market repurchase announcement, and more top level insider purchases in the year after the announcement. There is a lack of research on insider trading activity around ASR announcements. Cohen et al. (2012) highlight that trading activity by "opportunistic" insiders, whose trades do not follow any particular pattern, is informative about future returns. I extend the prior research to investigate the abnormal behaviour of corporate insiders around ASR announcements.

Three: IDioTs

Idea

Bargeron et al. (2011) posit that firms choose ASR over other repurchase methods, specially open market repurchase (OMR) due to the benefits derived from increased credibility of commitment and immediate execution. Unlike OMR, once ASR announcement is made the company is bound by the contract to implement the repurchase as specified. Therefore, ASR contributes credibility to the announcing company, however, at the same time it forgoes the flexibility to alter the size of the program compared to OMRs. Bonaime (2012) shows that the probability of announcing an ASR is greater for firms likely to be concerned about reputation because of their low past completion rates. She suggests that market devalues firms' reputation when they fail to follow through an OMR announcement and those firms announce ASR in order to regain their reputation.

Easely et al. (1998) posit that option market is attractive to informed traders, resulting in option trades being informative for the future movement of stock prices. Roll, Schwartz and Subrahmanyam, (2010) show that the ratio of options to stock trading volume (O/S ratio) is a better proxy for informed trading. They find evidence of increased options trading (O/S) around earnings announcements. They urge further research on the impact of O/S on market reaction around other corporate news announcements. Johnson and So (2012) find that abnormal O/S is negatively related to price reaction to earnings announcements. Easely, et al (1998) conjecture that informed traders' buy call (put) and sell put (call) if the news is positive (negative). Therefore, this study further partitions the O/S into call O/S and put O/S in our analysis.

Extant literature also examine insider trading prior to other share repurchase announcements (see Lee et al. (1992), Louis et al. (2010) Babenko et al. (2012)). However, lack of research on the how insiders behave around ASR announcements. This study fills this gap.

Data

I hand collected ASR announcements from 2004 to 2012 from Factiva and Edgar Security Filings. I searched in Factiva using words such as "Accelerated share (stock) repurchase (buyback)" and "overnight share (stock) repurchase (buyback)". I identified 340 samples which had available data on COMPUSTAT, CRSP and OPTION METRICS.

Tools

I use STATA software, which my university hold the license for it. I am on the learning curve to use best or appropriate statistical/ econometric tests. I used standard event study methodology to calculate abnormal return. I use OLS regressions to examine the impact of informed trading on price reaction.

What's New?

This paper is the first to examine the impact abnormal option trading and insiders' abnormal behaviour on market reaction to ASR announcements. Idea is the driver of our project and Data and Tools are passengers. I also have an edge for data since it is hand collected and it is a very tedious process. We use OLS regressions in our models and Pseudo Analysis for robustness check in examining the impact of abnormal informed trading on market reaction to ASR announcements. Pseudo Analysis is also performed by randomly selecting a date within [5,45] range and treating it as a dummy event date and doing the regression analysis 1000 times to examine the robustness of our results.

So What?

Finding answers for the above questions will enlighten us to predict the news by observing option market and insiders behaviour. If insiders use their trading to communicate their private information to the market, the speed of reporting of these transactions has important implications on how the market interprets ASR announcements.

Contribution

We contribute to options literature by showing evidence that informed traders have information advantage and use option market as their trading platform around a new phenomenon of repurchase called ASR. We also contribute to ASR literature by observing abnormal option trading only in shorter time period [-5,-2] prior to the event which shows that ASR announcement is a highly

unexpected event. This study will also identify "routine" and "opportunistic" insiders and examine the information content of ASR announcements for firms dominated by "routine" insiders versus those dominated by "opportunistic" insiders. If insiders' trades provide signal to the market, the influence of concurrent insider trading on the information content of ASR announcement should be stronger for firms with higher levels of "opportunistic" insider trading.

Other Considerations

I need collaboration for data and tools. Dr. Huu Duong from Monash University helped me to download option measures data from Option Metrics. He also helped me to program and to execute the Pseudo Analysis for robustness check. We assume we have "HIGH/MEDUIUM" "competitor risk" since the literature for ASR is evolving rapidly.

Figure 1:
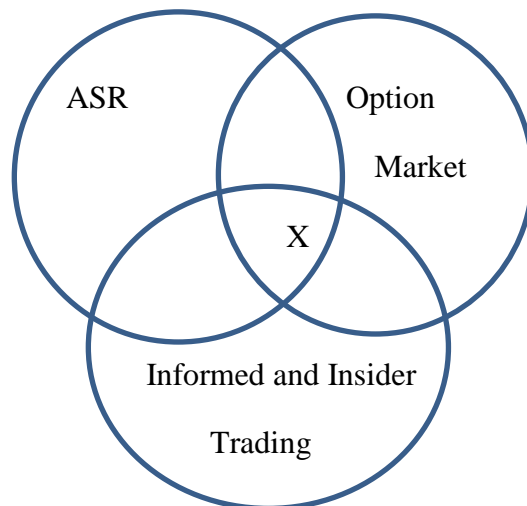
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Table 1: Pitching Template: Informed Trading Around Accelerated Share Repurchase

Pitcher's Name	Ladshiya Atisoothanan	Date Completed	15.10.2014
(A) Working Title	Informed Trading around Accelerated share repurchase(ASR)		
(B) Basic Research Question	Any evidence of trading activity on private information prior to unscheduled event like accelerated share repurchase? Any significant difference between call option and put option when evaluating informed trading activity? How insiders behave prior to ASR announcement?		
(C) Key paper(s)	Babenko, I., Tserlukevich, Y., Vedrashko, A., 2012. The credibility of open market share repurchase signalling. J. Financ. Quant. Anal. 47, 1059–1088. Bargeron, L., Kulchania, M., Thomas, S., (2011), Accelerated Share Repurchases, Journal of Financial Economics, 101, 69-89. Cohen, L., Malloy, M., Pomorski, L., 2012. Decoding inside information. Journal of Finance. 67, 1009-1043. Easley, D., O'Hara, M., Srinivas, P. S., (1998). Option volume and stock prices: Evidence on where informed traders trade. Journal of Finance 53, 431–465 Lee, S., Mikkelson, W., Partch, M., 1992. Managers' trading around stock repurchases. Journal of Finance 47, 1947–1961. Louis, H., Sun, A., White, H., 2010. Insider trading after repurchase tender offers: timing versus informed trading. Financial Management. 39, 301–322. Roll, R., Schwartz, E., Subrahmanyam, A., (2010), O/S: The relative trading activity in options and stock. Journal of Financial Economics, 96, 1-17.		
(D) Motivation/Puzzle	Prior literature shows that equity market reacts positively to ASR announcements. Lack of understanding on how informed traders and insiders behave immediately prior to these good news announcements. My study provides insights on this aspect. **Puzzle:** If there is informed trading prior to ASR announcements, does it influence the price reaction of actual ASR announcements?		
THREE	**Three** core aspects of any empirical research project i.e. the "**ID**io**T**s" guide		
(E) Idea?	Roll et al. (2010) demonstrate a new measure (O/S ratio) for informed trading and urge further research on the impact O/S ratio around corporate news announcements. Therefore, we examine the abnormal O/S ratio around announcement of accelerated share repurchase, which is a recent innovation of repurchase mechanism. According to Easley et al, (1998), we partition option measures into call and put options and examine them around ASR. Also, we examine insiders' trading behaviour around ASR.		
(F) Data?	(1) **Country**: US firms (2) **Sample size:** Identified 340 announcements which had availability of stock data and accounting data **Sample period:** 2004-2012; (3) Cross sectional data		

	(4) **Data Sources?** Factiva & Edgar: ASR announcements; Option Metrics: option measures; COMPUSTAT: Accounting data; CRSP: Stock data; I/B/E/S: Institutional holdings (5) Hand collected data, lot of time spent to verify the information content in each announcement in Factiva and Edgar
(G) Tools?	B**asic empirical framework:** Regression model approach **Econometric software needed:** STATA- La Trobe University has license. **Knowledge of implementation of appropriate or best statistical/econometric tests?** Using OLS and willing to learn and develop my statistical and econometric knowledge.
TWO	**Two** key questions
(H) What's New?	Driver: Idea; Passengers: Data and Tools; Data: hand collected, tedious process and a few people will be willing to spend time on it; Tools; OLS regression using STATA and pseudo analysis as a robustness check. Both data and tools are very strong
(I) So What?	Finding answers for the above questions will enlighten us to predict the news by observing option market.
ONE	**One** bottom line
(J) Contribution?	Informed traders have information advantage and use option market as their trading platform prior to ASR announcements. Also, we observe abnormal option trading only in short period [-5,-2] prior to the event which shows that ASR announcement is a highly unexpected event.
(K) Other Considerations	Is **Collaboration** needed/desirable? – idea/data/tools? (either internal or external to your institution) Idea: No Data: Yes, Option Metrics Data was given by Dr. Huu Duong from Monash University. Huu also serve as an external supervisor. Tools: robustness test, Pseudo Analysis was programmed and executed by Dr. Huu Duong. "**Risk**" assessment: **"no result"** risk: LOW; **"competitor"** risk: HIGH; risk of **"obsolescence":** LOW; other risks? Not aware Is the **scope** appropriate? Not too narrow, not too broad.