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Insider Trading with Different Risk Attitudes

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ABSTRACT

This paper examines the impact of different risk attitudes on the financial decisions of two insiders trading in the stock market. We consider a static version of the Kyle (1985) model with two insiders. Insider 1 is risk neutral while insider 2 is risk averse with negative exponential utility. First, we analytically prove the existence of a unique linear equilibrium. Second, we carry out a comparative static analysis with respect to the duopoly case of risk-neutral insiders (Tighe (1989)) and with respect to the duopoly case of risk-averse insiders (Holden and Subrahmanyam(1994)) models. Our findings reveal that the market depth and the information revelation are higher in Tighe (1989) than in our model. However, compared to Holden and Subrahmanyam(1994), we find that the market depth depends crucially on the degree of risk aversion. Finally, we show that regardless of the degree of risk aversion, the stock price reveals more information in our model than the stock price in Holden and Subrahmanyam(1994).

KEYWORDS Insider trading; Risk neutrality; Risk aversion; Exponential Utility; Market structure; Kyle model

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