Insider Information and Its Role in Security Markets

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Dispersed Nature of Information

Information is naturally dispersed among members of a group. Whether the group is a family, organization, market, or society, it is rare that any individual, or subset of individuals, possesses all information relevant to the functioning of that group. Each member has unique access to information that is special to him. This could be information about his or her tastes, endowments, expectations, and state of circumstances in his or her immediate neighborhood. Dispersal of such information across members of a group is a norm, not an exception.

If it were possible to gather all this information in one place or in a single mind, one could utilize the techniques of optimization (e.g., mathematical programming) to arrive at a plan for the group to satisfy some specified criterion of efficiency or desirability. There are three barriers to centralized compilation of information dispersed among members of a group. First, a great deal of such information exists in forms that do not permit such information to be easily codified and transmitted to a central store. Information about one’s tastes and expectations is an example of this. Individual’s judgements about their own preferences do not necessarily correspond to the choices they make in exercising those preferences (see Lichtenstein and Slovic 1971, and Grether 1991). Second, even for small groups, such relevant information that can be codified and transmitted is far too voluminous. Third, and equally important, there are no dependable means of persuading the individuals who hold information to share it with others in its entirety and in a timely manner.