

## **Predatory trading: Ethics judgments, legality judgments and investment intentions**

**Daphne Sobolev and James Clunie**

### **Abstract**

**Purpose** - Predatory trading is a stock market trading technique in which certain market participants exploit information about other market participants' need to trade. Predatory trading often harms others. Hence, this paper examines the determinants and effects of financial practitioners' and lay people's judgments of predatory trading. Specifically, it investigates how the public availability and reliability of the exploited information affect their ethics and legality judgments and how the latter influence their behavioral intentions and regulation support.

**Methodology** – We conducted two scenario judgment studies. In the first study, participants were financial practitioners, and in the second - lay people.

**Findings** - Practitioners often judge predatory trading to be ethical. Practitioners and lay people incorporate in their ethics and legality judgments the public availability of the exploited information but tend to discount the legal reliability criterion. Lay people justify their ethics judgments using harm, legal, or profit maximization principles. Practitioners' intentions to engage in predatory trading and lay people's intentions to let predatory fund managers invest their money depend on their judgments, which influence their regulation support.

**Originality** – This paper is the first to explore people's judgments of predatory trading. It highlights that despite the harm that predatory trading involves, practitioners often judge it to be ethical. Although law tends to lag behind financial innovation, people base their judgments and hence also behavioral intentions on their interpretation of the regulation. Hence, it reveals a dark aspect of the relationship between ethics and legality judgments.

**Keywords:** Predatory trading; Ethics judgment; Legal judgment.

**Paper type:** Research paper.

## 1. Introduction

“Viewed from a distance, the natural world may present a vista of sublime, majestic placidity. Yet beneath the foliage and concealed from the distant eye, a continuous massacre is occurring. Virtually everywhere that there is animal life, predators are stalking, chasing, capturing, killing, and devouring their prey. The means of killing are various: dismemberment, asphyxiation, disembowelment, poison, and so on” (Chignell *et al.*, 2015).

In January 2021, hedge funds heavily shorted GameStop stocks. However, information about their investments was widely available and thus traders could exploit it. Coordinated via Reddit, retail investors bought shares in GameStop, driving its price higher. This forced many short-sellers to cover their positions in order to limit further losses. Reddit investors’ actions were highly profitable: GameStop stock price jumped by 1,600% in just a few days. However, this caused the hedge funds and their clients great losses. For instance, Melvin Capital lost 53% in the month of these events (Goodwin, 2021; Hasso *et al.*, 2021).

Predatory trading has been defined to be any trading, which exploits information about other investors’ *need* to trade (Brunnermeier and Pedersen, 2005). In line with the literature on predatory trading, we refer by ‘prey’ to the person (or institution) who needs to trade, and by ‘predator’ to the person who seeks to profit from the prey’s need to trade. Thus, the GameStop case exemplifies predatory trading, in which the predators are Reddit investors and the prey are the hedge funds. However, predators can use a wide range of methods to predate, and in other cases, short-sellers acted as predators (Clunie, 2011). Predatory trading techniques can be employed by high frequency traders (O’Hara, 2014), insiders (Kyle and Viswanathan, 2008), and fund managers (Clunie, 2011), and they are prevalent in financial markets (Takahashi and Xu, 2016).

Predatory trading is not necessarily illegal: its legality depends on the extent to which the information that it exploits is generally available and relevant (material) [1]. Only recently, following the case of GameStop, regulators have started considering the regulation of certain predatory

trading techniques (Goldstein, 2021). Nevertheless, the financial losses that it causes can harm individuals, institutions, and markets. Financial losses have been related to anxiety, depression and suicide (Barr *et al.*, 2015). Predatory trading has been shown to reduce market efficiency (Takahashi and Xu, 2016) and liquidity (Brunnermeier and Pedersen, 2005; Morelli, 2019). Thus, it is ethicality-questionable.

Seeking to further the understanding of people's engagement in ethically questionable behaviors, research on the ethicality of financial practices has theorized that inadequate regulation encourages it (Klaw and Mayer, 2021). However, only a single study has examined the ethicality of predatory trading. That study has set theoretical criteria for the evaluation of its ethicality (Clunie, 2011). Few studies have investigated the ethics judgments which underlie ethically questionable financial practices. They have found that ethics judgments are affected by individual characteristics such as age, gender, and competitiveness (e.g. Terpstra *et al.*, 1993). However, no study has examined how practitioners and lay people judge the ethicality or the legality of predatory trading.

Ethics has been defined to be the "moral-based values that an individual or group believes are good and right in a specific situation," whereas law has been defined to be the "system of rules that are created and enforced by recognized authorities" (Pearce, 2013, p. 498). Thus, throughout this paper, we conceptualize ethics judgments as the outcome of the judgmental processes which lead to people's decision, whether a behavior is good or bad. Similarly, we define legal judgment to be the outcome of the judgmental processes which lead people to decide whether an act is legal or illegal. We define 'behavioral intentions' to be people's assessments of the probability that they would behave in described ways in the future.

Understanding practitioners' ethics and legality judgments of predatory trading and their effects on practitioners' behavioral intentions could be useful for regulators and financial firms. For instance, following the case of GameStop, the US Securities and Exchange Committee (SEC) has considered additional regulation of financial practices (Goldstein, 2021). Discerning the relationship between practitioners' judgments and behavioral intentions could help formulate effective

regulations, codes of conduct, and firm rules. Furthermore, understanding lay people's ethics judgments of predatory trading could help financial firms select trading methods, which fit their clients' preferences.

Accordingly, this paper aims to characterize the determinants and the effects of people's ethics and legality judgments of predatory trading practices. The investigated determinants of people's judgments include the legal criteria of the general availability and relevance of the exploited information. As regulators determine the general availability of the information by its public availability and its relevance by its reliability (among other criteria; Financial Conduct Authority), this paper focuses on the public availability and reliability of the exploited information. The investigated effects of people's ethics and legality judgments include their behavioral intentions. In particular, this paper explores practitioners' intentions to engage in predatory trading and lay people's intentions to let predatory fund managers invest their money. Furthermore, it examines people's ethics judgments of predatory trading and support for predatory trading regulation.

In two studies [2], this paper shows that: (1) The extent to which the information exploited for the predatory trading is publicly available affects practitioners' and lay people's ethics and legality judgments more than the extent to which it is reliable; (2) Practitioners' legal judgments of predatory trading affect their intentions to engage in it; (3) Both lay people's legal and ethics judgments of predatory trading affect their intentions to let predatory fund managers invest their money, and the latter impact their support of predatory trading regulation. Additional analysis shows that although predatory trading may involve harm, financial practitioners often judge it to be ethical. Moreover, a proportion of lay people support predatory trading regulation.

This paper makes three theoretical contributions and an empirical contribution to the literature on the ethicality of financial practices. First, it investigates the ethicality of predatory trading from practitioners' and lay people's points of view and relates their judgments to their behavioral intentions. Research on the ethicality of financial practices, including insider trading (Klaw and Mayer, 2021) and short-selling (Angel and McCabe, 2009), has contributed fundamental insights

but has focused on theoretical analysis. Similarly, ethics research has theorized how predatory trading *could be* judged (Clunie, 2011) but not how *it is* judged. This paper highlights that people's judgments of predatory trading frequently diverges from ethics principles. Moreover, by relating people's judgments to their behavioral intentions, this paper furthers the understanding of the role of ethics in the financial industry.

Second, within the literature on the ethicality of financial practices, surprisingly little research has addressed legal judgments (Sobolev, 2020; Terpstra *et al.*, 1993) and no research has systematically investigated the effects of law on ethics and legality judgments. By showing that people often base their ethics judgments of predatory trading on certain legal criteria (i.e. public availability) but discount others (i.e. the reliability criterion), this study characterizes the influence of law on ethics judgments and provides it with boundary conditions. Furthermore, by showing that people often use law to justify the ethicality of financial practices which harm others, this paper suggests that law can negatively affect people's judgments. This is especially important in the financial industry, where law often lags behind innovation.

Third, this paper relates lay people's investment intentions to their support of predatory trading regulation. Business ethics research has suggested that although behavioral intentions are related to people's actual behavior, there is often a gap between people's intentions and actual behavior (Carrington *et al.*, 2010). Hence, people's intentions do not always directly translate into their behavior. By establishing that there is a significant relationship between lay people's behavioral intentions and support for predatory trading regulation, this study extends the theoretical literature on the ethicality of financial practices to the exploration of people's behavior.

Finally, this study uses both quantitative and qualitative methods for the analysis of people's judgments of financial practice ethicality. Thus, it responds to calls for the use of interpretive research methods in empirical ethics research (e.g. Crane, 1999). Furthermore, it provides converging evidence and holistic insights into people's judgments.

## 2. Literature background and hypothesis development

### 2.1. Effects of the public availability and reliability of the information on ethics and legality judgments of predatory trading practices

Regulators have defined that under certain circumstances, the use of information that is not generally available but is relevant (material), amounts to market abuse. Information is defined to be generally available if the “information has been disclosed [...] through an accepted channel for dissemination of information [...], open to inspection by the public [...] [or] can be obtained by observation” (Financial Conduct Authority). Of these factors, in this paper, we focus on the public availability of the information. The prohibition on the use of data, which is not publicly available, has been rationalized by the principle of distributive justice (Klaw and Mayer, 2021). Information is defined to be relevant if it is reliable (and satisfies additional conditions; see Financial Conduct Authority). The regulator defines ‘reliability’ as “how near the person providing the information is, or appears to be, to the original source of that information and the reliability of that source”. As the reliability of the information determines its quality and its relevance to a judged issue, it impacts the extent to which any judgment should rely on the information.

Research has suggested that people use the distributive justice principle, that underlies the public availability legal criterion, and the reliability criterion in certain judgmental tasks. For instance, it has shown that in legal court cases, mock jurors’ judgments reflect the use of the distributive fairness principle (Lenton, 2007). Similarly, research has established that reliability affects investors’ firm valuations (Lackmann *et al.*, 2011).

However, research has shown that people often do not know the law and hence do not always incorporate it in their legality judgments. For instance, studies have demonstrated that lay people exhibit low levels of legal literacy with respect to marriage law (Pleasence and Balmer, 2012), and that final year medical students exhibit low medical law literacy (Preston-Shoot and McKimm, 2013). Therefore, *a priori* – before conducting this study – it was unclear whether people used legal

criteria to judge the legality of predatory trading behaviors. Hence, in this study, we tested the hypothesis:

**Hypothesis H1.** The extent to which the information used for predatory trading is (a) publicly available and (b) reliable affects practitioners' and lay people's legality judgments.

Furthermore, research has suggested that results about the incorporation of legal criteria in people's ethics judgments may not extend to predatory trading. For example, in the related case of high frequency trading, a study has identified conflicts between practitioners' ethics and legality judgments. In particular, practitioners considered certain regulations to be unethical (Sobolev, 2020). Moreover, a study has suggested that there may be discrepancies between ethics judgments of financial practices and other practices ("business is one thing, ethics is another"; Bragues, 2005). This discrepancy has been attributed to the conflict between the self-interest and wealth creation principles, which characterize the financial industry, and the self-denial principle, which often underlies moral principles. As *a priori* it had been unclear whether people's ethics judgments of predatory trading relied on legal criteria, we investigated in this paper also the hypothesis:

**Hypothesis H2.** The extent to which the information used for predatory trading is (a) publicly available and (b) reliable affects practitioners' and lay people's ethics judgments.

## *2.2. The relationship between ethics judgments, legality judgments and behavioral intentions*

We investigate two types of behavioral intentions: practitioners' intentions to engage in predatory trading and lay people's intentions to let predatory fund managers invest their money.

Research has not examined the effects of practitioners' judgments of the legality and ethicality of predatory trading on their trading intentions. It has suggested that legal judgments *should* affect financial practitioners' behavioral intentions. In particular, a study has established that awareness of legal sanctions increases the fear of being caught and inhibits financial fraud (Yiu *et al.*, 2014). The financial industry is highly regulated, and legal punishments for financial crimes are

frequently publicized by the media (e.g. Rogers *et al.*, 2016). Hence, legal judgment should affect practitioners' behavioral intentions. However, the fact that financial crimes are indeed prevalent suggests that legal judgment *does not* always effectively influence practitioners' behavioral intentions. Hence, the effect of legal judgments on practitioners' behavioral intention was, *a priori*, unclear. Furthermore, research has not explored how financial practitioners' ethics judgments affect their behavioral intentions.

Similarly, research has not examined the influence of lay people's judgments of predatory trading on their investment intentions. Research has theorized that ethics judgments *should* affect people's behavioral intentions (O'Fallon and Butterfield, 2005). However, studies have yielded inconsistent results about these effects. For instance, research has shown that corporate ethical conduct (e.g. engagement in CSR) does not always impact investors' decisions (Malik, 2015). Therefore, it could not be inferred from previous research whether lay people's ethics judgments of predatory trading affected their investment intentions. Furthermore, research has suggested that people's legal judgments should affect their investment intentions. For example, a study has shown that stock prices decrease after announcements of corporate crimes (Song and Han, 2017). However, the same study has found that market reactions strongly depend on the type of the crimes, and predatory trading has not been investigated. Hence, we tested the hypotheses:

**Hypothesis H3.** Legality judgments of predatory trading affect (a) practitioners' intentions to engage in predatory trading and (b) lay people's intentions to let predatory fund managers invest their money.

**Hypothesis H4.** Ethics judgments of predatory trading affect (a) practitioners' intentions to engage in predatory trading and (b) lay people's intentions to let predatory fund managers invest their money.

### 2.3. *The relationship between behavioral intentions and support for regulation*

Research has theorized that intentions affect ethical behavior. In particular, cognitive models of decision making have proposed that behavioral intentions link people's moral judgments to their actions. Ethical behavior models have attracted a large body of research (O'Fallon and Butterfield, 2005). However, empirical studies have established that, in practice, there are often discrepancies between behavioral intentions and actual behavior. For example, research has identified an intention-behavior gap between consumers' ethical purchase intentions and buying behavior. This gap has been attributed to people's behavioral controls and situational contexts (Carrington *et al.*, 2010).

In the context of predatory trading, it is likely that people, who consider predatory trading unethical, would not like to let predatory fund managers invest their money and would be more likely to support predatory trading regulation. However, as the relationship between behavioral intentions and actual behavior is context-dependent and not always significant, we sought to explore whether, in the context of predatory trading, this relationship holds. Hence, we tested the hypothesis:

**Hypothesis H5.** People's intentions to let predatory fund managers invest their money are significantly related to the extent to which they are willing to support predatory trading regulation.

### 3. Study 1

Study 1 was designed to test hypotheses H1, H2, H3.a, and H4.a for practitioners. To further the understanding of predatory trading judgments, we also used Study 1 to explore whether predatory trading practices are considered ethical. In this study, participants were financial practitioners, including fund managers, who managed, in total, more than £10 billion. The study was conducted using an online questionnaire. It had a correlational part and an experimental part. Participants filled in the questionnaire individually.

### *3.1. Method*

#### *3.1.1. Participants*

We sent participation requests, including a link to an online questionnaire, to 65 fund managers, investment management professionals, and traders, working at UK-based, global, multi-asset fund management firms. For instance, one of the firms managed approximately £50 billion. Each of the fund managers, whom we invited to participate, managed a fund of at least £50 million, however, a few of them managed considerably larger funds. None of the firms had experienced any regulatory censure.

Thirty-one financial practitioners (including three women) completed the questionnaire. Their average age was 41.39 (std. dev.: 9.38 years). Twenty-one of the participants worked as fund managers and five of them managed together more than £10 billion. The rest of the participants were traders or had other professions. Fifteen participants had postgraduate degrees, two were postgraduate students, and the rest had undergraduate degrees or school education. Fourteen of the participants had finance degrees, five – management degrees, and five – economics degrees. Participants were not paid for their participation. However, they were offered a copy of any publication resulting from their participation.

#### *3.1.2. Design*

The study had two parts. Part 1 of the study had a correlational design. Participants were presented with two cases of predatory trading (case 1 and case 3) and one case of front-running (case 2). The latter was presented to mask the aim of the study. Each case comprised a description, a course of action and a scenario. For example, one of the presented cases resembled that of GameStop and was as follows:

“Case description. You think that a security is under-priced in the market. You also note that short-sellers have a large short position in that security.

Course of action. You consider buying the mis-priced security, knowing that this could cause losses for the short-sellers.

Scenario. To arrive at your conclusion about the intrinsic value of the stock you used a discount cash flow analysis. Your forecasts in this analysis involved a certain level of uncertainty. Sources of information about the stock and the other investors were publicly available.”

For each case, participants were asked to produce three responses: a legality judgment, an ethics judgment, and an assessment of the likelihood that the fund managers would behave in real life as described in the case. Research has recommended the use of single-item measures for studies which aim at high validity and reliability in many contexts (Fisher *et al.*, 2016). Furthermore, single-item measures have been used in studies about ethics judgments (e.g. Gino *et al.*, 2010). Thus, we measured legality judgments using the item ‘please rate the extent to which you are confident that the proposed course of action is legal’ on the scale ranging between ‘very confident that it is illegal’ (1) and ‘very confident that it is legal’ (7). Ethics judgments were measured using the item ‘please rate the extent to which you consider the proposed course of action ethical’ on the scale ‘strongly believe that it is not ethical’ (1) to ‘strongly believe that it is ethical’ (7). Behavioral likelihood was measured using the item ‘please rate the extent to which you consider it likely that you would act in a similar real-life situation as described in the proposed course of action’ on the scale ‘extremely unlikely (0%)’ (1) to ‘extremely likely (100%)’ (7). To avoid order effects, the order of the cases was randomized.

Part 2 of Study 1 had a 2 (public availability: low/high) x 2 (reliability: low/high) x 4 (cases: 1-4) within-participant experimental design. Each participant was presented with a sequence of four cases describing predatory trading scenarios. To manipulate the public availability and reliability of the exploited information, each case included details about the source of the used information. There were four possible sources for each combination of public availability and reliability. For each participant and for each case, a source was chosen in random from these four sets, so that each participant was presented with all four experimental conditions. We used both original fictitious sources (e.g. ‘a senior executive in the company, who had lied to you in the past, and now gave you

the information before it was published') and real news outlets (e.g. 'Financial Times'). To determine the reliability of the news outlets, we used online public trust poll web sites (Engel, 2014; Pugh, 2012). For each case, participants gave an ethics judgment and a legality judgment, using the same scales described in Part 1.

### 3.1.3. Additional questionnaires

Research has shown that individual characteristics affect ethics judgments (Terpstra *et al.*, 1993). Therefore, we asked the participants to complete a personal detail questionnaire, including their age, gender, education level, main education field, and occupation, as well as the 'ten item personality inventory' questionnaire (Gosling *et al.*, 2003). The latter was used to assess participants' big five personality traits (emotional stability, extraversion, agreeableness, conscientiousness and openness to experience).

## 3.2. Results

Descriptive statistics of the results are presented in Table I.

### 3.2.1. Hypothesis testing

The results of all ANOVAs and t-tests described in this section are presented in Table II.

To test hypothesis H1 (the public availability (a) and reliability (b) of the exploited information affect practitioners' legality judgments), we conducted a repeated measures ANOVA on the legality judgments obtained in Part 2 of the study, using public availability, reliability, and case as independent variables. The results showed that both public availability and reliability significantly affected legality judgments. T-tests confirmed that legality judgments were greater when the information was publicly available and reliable than when it was not publicly available or reliable, respectively. Therefore, the results supported hypothesis H1. However, the effect of public availability on legality judgements (partial  $\eta^2 = 0.89$ ) was greater than that of reliability (partial  $\eta^2 = 0.43$ ).

To test hypothesis H2 for practitioners (the public availability (a) and reliability (b) of the exploited information affect practitioners' ethics judgments), we conducted similar repeated measures ANOVA and t-test on the ethics judgments obtained in Part 2 of the study. The results of both tests supported hypothesis H2 (see Table II). As before, the effect of public availability on ethics judgments (partial  $\eta^2 = 0.82$ ) was greater than that of reliability (partial  $\eta^2 = 0.35$ ).

We tested hypothesis H3.a (legality judgments of predatory trading affect practitioners' intentions to engage in predatory trading) by regressing participants' behavioral likelihood judgments on the legality judgments obtained in Part 1 of the study, controlling for participants' age, education level, gender, and the big five personality traits. The regression showed that practitioners' legality judgments were positively related to their behavioral likelihood judgments (regression coefficient  $\beta = 0.35$ ,  $p = 0.02$ ) and emotional stability ( $\beta = 0.41$ ,  $p = 0.008$ ). (None of the other variables had a significant regression coefficient  $\beta$ ). Therefore, we concluded that the results supported hypothesis H3.a.

We tested hypothesis H4.a (ethics judgments of predatory trading affect practitioners' intentions to engage in predatory trading) by regressing behavioral likelihood judgments on the ethics judgments obtained in Part 1 of the study, controlling for the same variables as before. The results revealed that practitioners' ethics judgments had an insignificant effect on their behavioral likelihood judgments. Therefore, we concluded that the results did not provide sufficient evidence to support hypothesis H4.a.

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Insert Table I about here

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Insert Table II about here

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### 3.2.2. Additional analysis

*Ethics Judgments.* T-tests comparing participants' ethics judgments to the scale's midpoint value (4) revealed that when predatory trading involved reliable, publicly available information, participants judged it to be ethical (i.e., the judgments were significantly greater than 4; see Table I).

*Behavioral likelihood in the front-running case.* We regressed behavioral likelihood on ethics and legality judgments as in the analysis of Hypotheses H3.a and H4.a, using the data of the front-running case. Legality judgments ( $\beta = 0.47$ ,  $p = 0.04$ ) and ethics judgments ( $\beta = 0.54$ ,  $p = 0.01$ ) significantly affected behavioral likelihood judgments.

*Common method variance analysis.* We used Harman's one-factor test to test for common method variance. The percentages of variance of the variables, explained by a single factor were less than 60% (37.49% - 57.29%) in all study conditions. Hence, we concluded that no evidence, suggesting that common method variance had biased our results, was found (Fuller *et al.*, 2016).

### 3.3. Discussion

Research has not examined how people judge predatory trading. Complementing the literature on financial practice ethicality (Angel and McCabe, 2009; Clunie, 2011; Klaw and Mayer, 2021; Sobolev, 2020), Study 1 establishes that practitioners incorporate information about public availability and reliability in their ethics and legality judgments of predatory trading cases. Hence, Study 1 supports hypotheses H1 and H2 for practitioners. However, it shows that the effect of public availability on practitioners' judgments is greater than that of reliability. Extending research about the effect of legal factors on questionable financial behavior (Yiu *et al.*, 2014), it suggests that practitioners' legality judgments strongly influence their evaluations of the likelihood that they would engage in predatory trading. Thus, it supports hypothesis H3.a but not hypothesis H4.a. Finally, it shows that when predatory trading is legal (that is, exploits publicly available and reliable information), although it may involve harm, practitioners consider it to be ethical.

## **4. Study 2**

Study 1 investigated financial practitioners' judgments. However, it did not examine lay people's judgments. Thus, in Study 2, we tested hypotheses H1, H2, H3.b, H4.b and H5 for lay people. In addition, we explored the nature of their ethics judgments and the extent to which they considered regulation of predatory trading important. In line with calls to use interpretive research methods in empirical ethics research (Crane, 1999), we analyzed lay people's ethics judgments using quantitative and qualitative methods. The study had an experimental design with four conditions. It consisted of an online questionnaire. Participants filled it in individually.

### *4.1. Method*

#### *4.1.1. Participants*

Four hundred participants, living in the USA, were recruited for the study through Amazon Mechanical Turk (100 participants for each condition). We included in the analysis the answers of a total of 348 participants (including 145 women), who submitted usable questionnaires. Their mean age was 36.26 years (std. dev.: 10.80 years). The majority of the participants (77.59%) described their culture as Western. The minority (18.68%) described it as Asian. The rest of the participants (3.74%) described their culture as other than Western or Asian. Participants' educational backgrounds ranged between high school graduates and post-graduate degrees. They had diverse professions, including, for example, a healthcare employee, a tutor, and a mechanic. Participants were paid \$2 for their participation.

#### *4.1.2. Design*

Study 2 had a 2 (public availability: low/high) x 2 (reliability: low/high) x 2 (cases: 1-2) within-participant experimental design. Participants were asked to read two predatory trading cases and answer questions about them. The presented cases were similar to two of the cases used in Part 2 of Study 1. However, to fit the cases to non-professional participants, we reformulated them, replacing financial terms by expressions which were used in a popular book and a film (Lewis, 2010). Hence,

we replaced the term 'short-selling' by 'betting against'. Public availability and reliability were manipulated through the description of the exploited information. For example, one of the cases used in the high public availability, high reliability condition was:

"A fund suffers a severe loss. A fund manager, working at a different firm, knows that in such cases, clients tend to leave the fund, and the fund would need to return money to the clients. To do this, the fund would have to sell the stocks it holds, which is likely to lower the price of these stocks further.

The fund manager considers betting against the stocks that the fund holds. If he does so, then he would profit from the expected decrease in the stocks' prices. However, he knows that his actions are likely to cause additional losses to the fund.

Assume that the fund manager learnt about the assets that the fund holds through the fund's annual reports. Assume also that he learnt about the fund's losses from an article in the Financial Times."

The experimental manipulation was similar to the one used in Part 2 of Study 1. For each of the cases, participants were asked to make an ethics judgment and a legality judgment, using the scales described in Part 2 of Study 1. To gain qualitative insights into people's judgments, participants were asked to explain their answers. To measure participants' investment intentions, participants were asked to assess the extent to which they wanted to let the described fund manager invest their own money. Investment intentions were measured on the scale ranging between 'you would like very much to let this fund manager invest your money' (1) and 'you would not like at all to let this fund manager invest your money' (7). Participants were also asked to judge the reliability of the given information.

Finally, to assess the importance that participants attributed to predatory trading regulation, at the end of the experiment, we asked the participants whether they would like to sign a petition that asks the government to regulate predatory trading. The possible answers were: 'yes, I would like to sign the petition' (1) and 'no, I would not like to sign the petition' (2). Aiming at a high

external validity, we presented the petition as if it was not a part of the study. Thus, we asked the participants to sign the petition after thanking them for their participation. After answering this question, participants were thanked again for their participation, and were informed that the petition was a part of the study and that they would not sign any petition.

#### *4.1.3. Personal details questionnaire*

In addition to the judgmental task, participants were asked to complete a personal detail questionnaire, including their age, gender, education, nationality, occupation, and culture.

## *4.2. Results*

Descriptive statistics of the main variables are presented in Table III.

### *4.2.1. Hypothesis testing*

The results of all ANOVAs and t-tests described in this section are given in Table IV.

To test hypothesis H1 (the public availability (a) and reliability (b) of the exploited information affect lay people's legality judgments), we conducted a repeated measures ANOVA and a t-test on participants' legality judgments, as we did in Study 1. The results supported hypothesis H1.a but did not provide sufficient evidence to support hypothesis H1.b.

To test hypothesis H2 (the public availability (a) and reliability (b) of the exploited information affect lay people's ethics judgments), we conducted a repeated measures ANOVA and t-tests on participants' ethics judgments. The ANOVA showed that ethics judgments significantly depended on public availability and on reliability. T-tests, conducted over all conditions, showed that participants considered the trading significantly more ethical when the information was publicly available than when it was not, but did not show a significant main effect of reliability on ethics judgments. However, a t-test conducted over the conditions in which the information was not publicly available revealed a significant reliability effect. Therefore, we concluded that the results supported hypothesis H2. Again, the effect of public availability on ethics judgments was greater than that of reliability.

To test hypothesis H3.b (legality judgments of predatory trading affect lay people's intentions to let predatory fund managers invest their money), we regressed participants' investment intentions over their legality judgments for each case. We controlled for participants' gender, age, education level and culture. In both cases, legality significantly influenced participants' investment intentions (case 1: legality  $\beta = -0.44$ ,  $p < 0.001$ ; case 2: legality:  $\beta = -0.52$ ,  $p < 0.01$ ). Therefore, the results supported hypothesis H3.b.

We tested hypothesis H4.b (ethics judgments of predatory trading affect lay people's intentions to let predatory fund managers invest their money), by regressing participants' investment intentions over their ethics judgments, controlling for the same variables. Ethics judgments significantly affected investment intentions (case 1: ethics  $\beta = -0.52$ ,  $p < 0.001$ ; case 2: ethics:  $\beta = -0.58$ ,  $p < 0.01$ ). Thus, the results supported hypothesis H4.b.

We tested hypothesis H5 (people's investment intentions are significantly related to their support for predatory trading regulation), by calculating the correlations between participants' investment intentions and their consent to sign the predatory trading regulation petition. The results revealed that the more participants in the high public availability conditions wanted to sign the petition, the less they wanted to let the described fund managers invest their money (high reliability: case 1:  $r = -0.23$ ,  $p = 0.03$ ; case 2:  $r = -0.19$ ,  $p = 0.066$ ; low reliability: case 1:  $r = -0.25$ ,  $p = 0.02$ ; case 2:  $r = -0.29$ ;  $p = 0.006$ ). Thus, the study provided evidence supporting hypothesis H5.

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Insert Table III about here

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Insert Table IV about here

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#### 4.2.2. *Additional analysis*

*Manipulation check.* Information reliability did not significantly influence participants' legality judgments. To investigate the possibility that this happened due to manipulation ineffectiveness, we conducted a repeated measure ANOVA and a t-test on participants' reliability judgments, using availability, reliability and case as the independent variables. Information reliability judgments significantly depended on reliability ( $F(1, 78) = 193.69, p < 0.001, \text{partial } \eta^2 = 0.71, \text{observed power} = 1.00$ ) and were greater in the high reliability conditions (mean: 5.61, std. dev.: 1.24) than in the low reliability conditions (mean: 3.49, std. dev.: 1.87,  $t(694) = 17.71, p < 0.001$ ). Hence, the manipulation was effective, and manipulation ineffectiveness could not explain the lack of reliability effects on legality judgments.

*Ethics judgments.* T-tests, comparing participants' ethics judgments to the scale's midpoint value (4), showed that when predatory trading exploited information which was neither publicly available nor reliable, participants judged it to be unethical (see Table III). When the exploited information was publicly available and reliable, participants considered the trading to be either ethically neutral or unethical.

*Qualitative analysis of ethics judgment justifications.* We classified participants' ethics judgment justifications into three categories: harm-related justifications, legal justifications, and other justifications. In all conditions, a proportion of participants mentioned harm in their ethics justifications (e.g. "He's out to make gain[s] for himself by harming or losing money for the fund holders", "He knows what he is doing will cause harm") or legal criteria (e.g. "It is not illegal to profit upon publicly available information", "It is insider trading. You [are] not allowed to do that"). Many participants gave normative justifications or expressed their perceptions of the market (classified as 'other reasons'; e.g. "This sounds like common practice", "we are all doing this out of necessity", "The market is for business, not to be nice", "It's just business", "Part of the buying/selling - winning/losing game"). Participants referred also to fund managers' job requirements and to profit maximization (e.g. "It's his job as a fund manager", "They are looking out for clients['] best interest",

“If he is profiting and so is the company then his actions are ethical”, “[...] all is fair in love, war, and making money”).

*Common method variance analysis.* The percentages of variance of the variables, explained by a single factor were 37.86%-55.71%. Hence, Harman’s one-factor test suggested that common method variance had not biased our results.

#### *4.3. Discussion*

Study 2 supports hypotheses H1.a and H2, but not H1.b. Thus, it suggests that lay people use the public availability of the exploited information to judge the ethicality and legality of predatory trading, but discount information about its reliability. Qualitative analysis reveals that indeed lay people often used legal criteria, and in particular, the public availability criterion, as well as normative criteria, to judge the ethicality of predatory trading. Study 2 supports also hypotheses H3.b., H4.b., and H5. Hence, it shows that both ethics and legality judgments affect the extent to which lay people are willing to let predatory fund managers invest their money, and that the latter impacts their support of predatory trading regulation. Finally, it shows that when predatory trading uses publicly available and reliable information, lay people often consider it to be ethically neutral.

### **5. General Discussion**

This paper examines the determinants and outcomes of ethics and legality judgments of predatory trading. Study 1 shows that financial practitioners use the public availability of the exploited information and, to a lesser extent, its reliability to guide their ethics and legality judgments. It reveals that practitioners’ legality judgments affect their intentions to engage in predatory trading. Furthermore, it shows that they often consider legal predatory trading cases to be ethical even if they involve harm. Study 2 demonstrates that lay people use the public availability criterion to judge the legality of predatory trading cases, but discount the reliability criterion in their legal judgments. On the other hand, they use both criteria to guide their ethics judgments. It shows that lay people

base their judgments on legal considerations, harm considerations, and on market norms, including profit maximization. In addition, it establishes that they use both their ethics and legality judgments to guide their intentions to let predatory fund managers invest their money. Those, who intend to let predatory fund managers invest their money more than others, support predatory trading regulation less.

Our findings portray people's ethics judgments of predatory trading as highly diverse. On the one hand, they suggest that a proportion of people rely on partial knowledge of legal criteria and profit-maximization norms to make their ethics and legality judgments. Relying on these criteria, they judge predatory trading behaviors, which harm others, to be ethical. Thus, their judgments are in stark contrast to business ethics research that has established that law sometimes diverges from ethics (Klaw and Mayer, 2021), has highlighted that financial profit maximization does not capture many aspects of ethics (Kolstad, 2007), and has conceptualized ethics as harm minimization (Lindorff *et al.*, 2012). On the other hand, our results show also that a proportion of people use the harm minimization criterion in their judgments and support predatory trading regulation.

## *5.1. Applications*

### *5.1.1. Regulatory applications*

The recent case of GameStop has led the SEC to consider whether practitioners should be required to disclose their intentions to short-sell stocks (Goldstein, 2021). If such regulation is accepted, then the use of short-selling for predatory trading is likely to become less prevalent. However, many predation methods do not employ short-selling (Clunie, 2011). Our results demonstrate that financial practitioners are likely to engage in predatory trading methods if they are legal. Hence, the use of predation methods other than short-selling is unlikely to be affected by such regulation. Thus, we suggest that it could be beneficial for regulators to consider the regulation of predatory trading rather than specific predation methods.

### *5.1.2. Educational applications*

Our results show that when practitioners judge predatory trading, they rely on the public availability of the exploited information more than on its reliability. As regulators use both criteria (as well as others) for criminal convictions, practitioners' limited attention to information reliability may suggest that educational efforts are required.

### *5.1.3. Management applications*

This study reveals that lay people's intentions to let predatory fund managers invest their money are positively related to their perceptions of the ethicality of predatory trading. In addition, it shows that lay people judge certain predatory trading techniques to be unethical. Hence, this study suggests that to attract clients, financial firms could choose trading styles that fit their clients' ethical perceptions and communicate these efforts to their clients.

### *5.2. Limitations and future research*

This study is the first to characterize practitioners' and lay people's judgements of the ethicality and legality of predatory trading practices. However, it suggests paths for further research. First, our results are based on quantitative and qualitative analysis of experimental results. The contribution of experiments to behavioral finance research has been acknowledged (Muradoglu and Harvey, 2012). However, it has also been suggested that incorporation of other research methods, such as interviews, could be beneficial (Muradoglu and Harvey, 2012). Hence, we suggest that future research could explore predatory trading judgment and engagements using interviews.

Second, in our analysis, we controlled for certain participants' characteristics. However, we did not control for their emotional intelligence. A study has shown that emotional intelligence affects risk taking (Buccioli *et al.*, 2021). As predatory trading involves both risk and harm to others, emotional intelligence could influence the extent to which practitioners and lay people would engage in it. Hence, we consider it important to explore the relationship between emotional intelligence and engagement in predatory trading. Similarly, our study was not designed to examine cultural effects on ethics judgments. However, research has shown that people from different

countries make different moral judgments. For instance, they exhibit differences in their tolerance to damage resulting from morally-questionable behavior (Ahmed *et al.*, 2003). As ethics judgments depend on cultural norms, we conjecture that culture influences people's investment intentions.

Third, in our scenarios we did not explicitly refer to the profit that could be gained due to engagement in predatory trading. However, a study has shown that stake sizes affect financial decision making in risky situations (Oehler *et al.*, 2018). Future research could explore the effect of profit size on practitioners' intentions to engage in predatory trading.

Fourth, our results reveal that the effect of public availability on ethics and legality judgments is greater than that of reliability. Why might that be? The media regularly disseminates information about insider trading (Rogers *et al.*, 2016). Media stories often focus on the public availability of the information. Therefore, we hypothesize that media coverage mediates the effects of public availability and reliability on ethics and legality judgments.

Finally, our paper suggests that practitioners often judge legal predatory trading more leniently than lay people. In addition, it raises the question whether practitioners rely more on law than on ethics in their behavioral intentions compared to lay people. Discrepancies between practitioners' and lay people's judgments and corresponding behavior could negatively impact the public's trust in financial institutions. As a large proportion of people report that they do not trust banks (White, 2018), it is especially important to examine judgmental differences between lay people and financial practitioners.

## **6. Conclusion**

This paper reveals that in the financial industry, predatory behaviour is often considered to be ethical. To judge the ethicality of predatory trading, financial practitioners and lay people use the legal criterion of public availability, but discount the legal criterion of reliability. Lay people rely on norms that allow profit maximization as well as norms that forbid harming others. And their

judgments impact their behavioural intentions, which are, in turn, related to their support for predatory trading regulation.

Whereas a large body of research has contributed theoretical insights to the literature on the ethicality of financial practices, this paper contributes to it by examining the way that practitioners and lay people judge predatory trading. In addition, it extends the literature by relating people's judgments of predatory trading to their behavioural intentions. Moreover, although previous research has not investigated how law influences ethics judgments of predatory trading, this paper reveals that people sometimes use their legal judgments to justify the ethicality of financial practices which harm others.

Highlighting the ethical challenges raised by predatory trading, this paper offers regulatory applications, applications for managers and educational applications. Thus, it suggests that as the behavioural intentions of financial practitioners are often determined by their legal judgment, it would be beneficial if predatory trading regulation takes a comprehensive approach rather than the regulation of certain, specific practices. It also advises that educational efforts are required to enhance practitioners' understanding of regulation. Moreover, it recommends that financial firms offer programmes that fit their clients' ethical beliefs.

Finally, this paper offers a range of directions for future research. In particular, it suggests that it would be beneficial if future research explores the effects of emotional intelligence and culture on financial judgments and behavioural intentions. It points out that future studies could examine the role of the media in shaping people's judgments of financial practices. Furthermore, it highlights the need to explore the differences between practitioners' and lay people's judgments.

## Endnotes

1. At present, US and UK financial market regulations do not directly refer to predatory trading. However, misuse of information and insider trading are illegal. Thus, if the information used for predatory trading has been obtained illegally (e.g. through insider trading), then that trading would be illegal due to the information that it exploits rather than due to its predatory nature.
2. Two additional studies, which are not reported here, further supported the relationship between investment intentions and regulation support. Moreover, they replicated the finding that people judge certain legal predatory trading cases to be ethical. In one of these studies, participants were 103 USA-based practitioners working in finance and accountancy, and in the second – 332 lay people.

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## Tables

**Table I.** Study 1: Means (and standard deviations) of the main variables and the results of t-tests comparing ethics judgments to the scale midpoint (4). The legality judgment scale ranged between ‘very confident that it is illegal’ (1) and ‘very confident that it is legal’ (7). The ethics judgment scale ranged between ‘strongly believe that it is not ethical’ (1) and ‘strongly believe that it is ethical’ (7). The behavioral likelihood scale ranged between ‘extremely unlikely (0%)’ (1) and ‘extremely likely (100%)’ (7). Thirty-one financial practitioners participated in this study.

Notations: \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$ , NS: not statistically significant.

Part	Case / condition	Legality judgment	Ethics judgment	T-test comparing ethics judgments to the scale midpoint	Behavioral likelihood judgments
Part 1	Case 1  (predatory trading)	6.77 (0.56)	6.32 (1.32)	$t(30) = 9.75^{***}$	5.31 (2.11)
	Case 2  (front running)	5.55 (2.19)	4.97 (2.32)	$t(30) = 2.33^*$	3.67 (2.40)
	Case 3  (predatory trading)	7.00  (0.00; all practitioners agreed)	6.94 (0.25)	$t(30) = 64.45^{***}$	6.34 (1.37)
Part 2 (all cases involved predatory trading)	High public availability, high reliability	6.36 (1.06)	5.50 (1.78)	$t(120) = 9.24^{***}$	
	High public availability, low reliability	5.10 (2.20)	4.28 (2.25)	$t(120) = 1.38^{NS}$	

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Low public availability, 2.00 (1.89) 1.79 (1.52)  $t(123) = 16.24^{***}$

high reliability

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Low public availability, 2.06 (1.96) 1.95 (1.75)  $t(122) = 13.02^{***}$

low reliability

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**Table II.** Study 1: Hypothesis testing results. In both ANOVAs, the independent variables were public availability (low/high), reliability (low/high), and case (1-4). The legality judgment scale ranged between ‘very confident that it is illegal’ (1) and ‘very confident that it is legal’ (7). The ethics judgment scale ranged between ‘strongly believe that it is not ethical’ (1) and ‘strongly believe that it is ethical’ (7). Thirty-one financial practitioners participated in this study.

Tested hypothesis	Dependent variable	ANOVA results	T-tests results
H1 (The extent to which the information used for predatory trading is (a) publicly available and (b) reliable affects practitioners’ legality judgments)	Legality judgments	Legality judgments significantly depended on public availability (F (1, 26) = 207.16, $p < 0.001$ , partial $\eta^2 = 0.89$ , observed power = 1.000) and reliability (F (1, 26) = 19.45, $p < 0.001$ , partial $\eta^2 = 0.43$ , observed power = 0.99)	Legality judgments were greater when the information was publicly available (mean: 5.73, std. dev.: 1.84) and reliable (mean: 4.16, std. dev.: 2.67) than when it was not publicly available (mean: 2.03, std. dev.: 1.92, $t(486) = 21.77$ , $p < 0.001$ ) and unreliable (mean: 3.57, std. dev.: 2.58, $t(486) = 2.45$ , $p = 0.01$ ), respectively
H2 (The extent to which the information used for predatory trading is (a) publicly available and (b) reliable affects practitioners’ ethics judgments)	Ethics judgments	Ethics judgments significantly depended on public availability (F (1, 27) = 126.14, $p < 0.001$ , partial $\eta^2 = 0.82$ , observed power = 1.000) and reliability (F (1, 27) = 14.55, $p = 0.001$ , partial $\eta^2 = 0.35$ , observed power = 0.96)	Ethics judgments were greater when the information was publicly available (mean: 4.89, std. dev.: 2.11) and reliable (mean: 3.63, std. dev.: 2.48) than when it was not publicly available (mean: 1.87, std. dev.: 1.63, $t(487) = 17.69$ , $p < 0.001$ ) and unreliable (mean: 3.11, std. dev.: 2.32, $t(487) = 2.36$ , $p = 0.02$ ), respectively

**Table III.** Study 2: Means (and standard deviations) of the main variables and the results of t-tests comparing ethics judgments to the scale midpoint (4). The legality judgment scale ranged between ‘very confident that it is illegal’ (1) and ‘very confident that it is legal’ (7). The ethics judgment scale ranged between ‘strongly believe that it is not ethical’ (1) and ‘strongly believe that it is ethical’ (7). The investment intention scale ranged between ‘you would like very much to let this fund manager invest your money’ (1) and ‘you would not like at all to let this fund manager invest your money’ (7). Regulatory support was measured using the items: ‘yes, I would like to sign the petition’ (1) and ‘no, I would not like to sign the petition’ (2). Standard deviations are given in the brackets. A total of 348 lay people participated in the study.

Notations: \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$ , NS: not statistically significant.

Condition	Case	Legality judgment	Ethics Judgment	T-test comparing ethics judgments to the scale midpoint	Investment intention	Regulation support
High public availability,	1	4.65 (1.94)	3.48 (2.11)	t (91) = 2.37*	4.72 (2.08)	1.57 (0.50)
high reliability	2	5.08 (1.75)	4.17 (2.03)	t (91) = 0.82NS	4.47 (2.17)	
High public availability,	1	4.33 (2.06)	3.28 (2.02)	t (88) = 3.35**	5.24 (1.95)	1.65 (0.48)
low reliability	2	4.81 (1.78)	4.30 (2.11)	t (88) = 1.36NS	4.91 (1.97)	
low public availability,	1	3.47 (1.91)	3.11 (2.10)	t (87) = 3.96***	4.91 (2.13)	1.55 (0.50)
high	2	3.60	3.63 (2.24)	t (87) = 1.57NS	4.95 (2.07)	

reliability		(2.03)				
low public	1	3.38	2.61 (1.67)	t (78) = 7.42***	5.52 (1.81)	1.53 (0.50)
availability,		(1.84)				
low	2	3.32	2.95 (1.97)	t (78) = 4.75***	5.59 (1.75)	
reliability		(1.88)				

**Table IV.** Study 2: Hypothesis testing results. In both ANOVAs, the independent variables were public availability (low/high), reliability (low/high), and case (1-2). The legality judgment scale ranged between ‘very confident that it is illegal’ (1) and ‘very confident that it is legal’ (7). The ethics judgment scale ranged between ‘strongly believe that it is not ethical’ (1) and ‘strongly believe that it is ethical’ (7). A total of 348 lay people participated in the study.

Tested hypothesis	Dependent variable	ANOVA results	T-test results
H1 (The extent to which the information used for predatory trading is (a) publicly available and (b) reliable affects lay people’s legality judgments)	Legality judgments	Legality judgments significantly depended on public availability (F (1, 78) = 44.66, p < 0.001, partial $\eta^2$ = 0.36, observed power = 1.00) but not on reliability	Legality judgments were greater when the information was publicly available (mean: 4.72, std. dev.: 1.90) than when it was not (mean: 3.45, std. dev.: 1.91, t (694) = 8.82, p < 0.001)
H2 (The extent to which the information used for predatory trading is (a) publicly available and (b) reliable affects lay people’s ethics judgments)	Ethics judgments	Ethics judgments significantly depended on public availability (F (1, 78) = 8.33, p = 0.005, partial $\eta^2$ = 0.10, observed power = 0.81) and reliability (F (1, 78) = 5.34, p = 0.02, partial $\eta^2$ = 0.06, observed power = 0.63)	Ethics judgments were greater when the information was publicly available (mean: 3.91, std. dev.: 2.11) than when it was not (mean: 3.09, std. dev.: 2.04, t (694) = 4.58, p < 0.001). When the information was not publicly available, ethics judgments were greater when the information was reliable (mean: 3.63, std. dev.: 2.24) than when it was not (mean: 2.95, std. dev.: 1.97, t (165) = 2.06, p = 0.04)