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Dealership versus Continuous Auction: Evidence from the JASDAQ Market

Summary

The Japan Association of Securities Dealers Automated Quotation (JASDAQ) market for emerging firms employed two trading methods during the 1998 to 2008 period: a quote-driven dealership system and an order-driven continuous auction system. Using the unique setting in which listed firms were able to choose their preferred trading method, we evaluate which of these trading methods is more desirable in improving liquidity and price efficiency. A difference-in-differences (DID) test with matched samples indicates that the dealership system provides better trading opportunities than the continuous auction system while the transaction costs are about the same. The dealership market is superior in price efficiency, but associated adverse selection costs are high. As a result, market makers have less incentive to provide liquidity because they cannot make enough profits when trading volume is low. These findings explain why the dealership market was phased out from the JASDAQ market after March 2008.

JEL classification: G14

Keywords: Dealer market; Continuous auction; Adverse selection cost; Price discovery; Liquidity.