

Dealership versus Continuous Auction: Evidence from the JASDAQ Market[☆]

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Summary

JASDAQ, Japan's stock market for emerging firms, used to adopt two trading methods: a quote-driven dealership system and an order-driven continuous auction system, and listed firms could choose either method. Using this unique setting, we evaluate which of these trading methods is more desirable for low liquidity stocks in terms of liquidity and price efficiency. The results of the difference in difference (DID) test show that the dealer market provides more trading opportunities than the continuous auction market and the transaction costs at the time of trading are almost the same. While the dealer market is superior in price efficiency, adverse selection costs were found to be high, suggesting that market makers have less incentive to provide liquidity because they cannot earn enough profits in such markets with low trading volume. This indicates a reason why dealer markets are disappearing from emerging securities markets with high liquidity needs.

JEL classification: G14

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

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