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Editor

- H Kent Baker
  University Professor of Finance
  American University
  Kogod School of Business
  Department of Finance and Real Estate
  Washington DC, 20016-8044, USA
  Tel: 202-885-1949
  Fax: 202-885-1946
Biography

• Prof. H. Kent Baker is University Professor of Finance at the Kogod School of Business, American University in Washington, DC.
• He is the author/co-editor or editor/co-editor of 24 books including several textbooks.
• Professor Baker has also published more than 250 journal articles, monographs, book chapters, and proceedings as well as 350 book reviews and abstracts.
• Much of his research is empirical and published in peer-reviewed academic journals
Journals include:

• Journal of Finance
• Journal of Financial and Quantitative Analysis
• Financial Management
• Financial Analysts Journal
• Journal of Portfolio Management
• Journal of Financial Research
• Financial Review
• Harvard Business Review
• Journal of Accountancy
• He has had consulting and training experience with more than 100 organizations.

• He currently serves on six advisory or editorial boards.

• Professor Baker received a B.S.B.A. from Georgetown University; an M.B.A., M.Ed., and D.B.A. from the University of Maryland, and M.S., M.A., and two PhDs from American University.

• He also holds CFA and CMA designations.
Research Interest

His research interests include:

• Survey research
• Investor behavior
• Financial psychology
• Market microstructure
• Dividend policy
• Mutual funds
Market Microstructure

• Market Microstructure is the process by which securities such as stocks are traded.

• For a stock market to function properly, a structure is needed to:
  1. Facilitate the placing of orders.
  2. Speed the execution of the trades ordered.
  3. Provide equal access to information for all investors.

• It is the study of the process and outcomes of exchanging assets under explicit trading rules
• Analysis of how specific trading mechanisms affect the price formation process.

• Trading mechanism: set of rules governing the exchange of financial assets (stocks, derivatives) or foreign currencies in a market.

Need for market microstructure

• Tries to answer how prices are formed in the economy.

• Market microstructure has a profound impact on the real world – on traders, broker/dealers, exchanges, regulators, and policy makers alike.
Organization of Financial Markets

• Market player
  – **Brokers:** transmit orders for customers, act as conduits for the customers’ orders. Involved only in interdealer transactions (FX market) ⇒ pure match makers (connect dealers).
  – **Dealers:** trade for their own account or also facilitate customer orders (broker/dealer).
  – **Market makers:** (specialists): quote price to buy or sell. Generally take a position in the security ⇒ dealer function.
• **Orders:**

  – Orders are instructions that traders give to the brokers and exchanges that arrange their trades.

  – They specify:
    
    • security to be traded,
    
    • how much to trade,
    
    • whether to buy or sell,
    
    • Terms

  – They may also specify:
    
    • their validity
    
    • their execution time
• whether they can be partially filled or not
• Orders affect the profit from trading, transaction costs, and the liquidity.

**Major trading issues**

• Liquidity
• Transaction Costs
• Informative Prices
• Volatility
• Trading Profits
Forces affecting the structure of markets

• Demand for trading
  – Liquidity trading
  – Information trading
  – Noise trading (Black (1991))

• Order processing costs
  – Information system
  – Order routing systems (e.g., SuperDOT)
  – Order execution system (e.g., SuperMontage)
  – Clearing and Settlement
• Technology and automated trading
  – Resistance/vested interests (e.g., NYSE floor community!)
  – Block traders
• Risk bearing
  – Inventory risk
  – Payments risk
• Institutionalization
  – 50% of volume is institutional traders
• Free trading options
  – Stale limit orders
  – Stale quotes
• Information trading
  – Liquidity traders lose
  – Informed traders need to be compensated for research
• Anonymity, Reputation, Transparency
  – Disclosure of trades and quotes
  – Delayed disclosure
  – Upstairs facilitated trade
  – Reputation through repeated trading
Market structures

• The trading rules and the trading systems define a market’s market structure.

• Call markets versus continuous markets.
  
  – Call markets allow trades only when the market is called (rotation among securities).
  
  – Continuous markets allow trades anytime during regular trading hours.
  
  – Hybrids of course exist (NYSE, the LSE and soon Nasdaq)
  
  – Which one would you prefer, and why?
• Trading hours.
  – Most markets limit their regular trading hours.
  – Should markets be open around the clock?

Market information systems
It is of utmost important that orders are not lost and that order instructions are understood.
  – Ticker symbols
  – Order routing systems
  – Order presentation systems
  – Messaging systems
– The information created by trading is valuable.

– Market data systems report trades to the public

– Broadcast services
  
  • Price and sale feeds
  
  • Ticker tapes
  
  • Quotation feeds

• Transparency is a key feature of markets.

– Ex ante vs. ex post transparency
Market maker obligations

- Provide quotes during trading hours
- Offer “best execution”
- Report trades in a timely manner
- Fair communication
- No churning
Thank You..!
Related Journals

- Journal of Accounting and Marketing
- International Journal of Accounting Research
2nd International Conference on Business Economics and Management
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