

An Industrial Organization Approach to Finance

By David Ong

Class time: Monday and Thursday 3:30-5:20 pm 231.

Office hours: by appointments Mondays, Wednesdays, Fridays 4-5pm.

Introduction

Financial institutions in emerging markets are generally far from meeting the assumptions of most standard models in finance. In emerging markets, institutions are underdeveloped, participants are strategic and information is scarce. As a consequence, participants trade on insider information and try to learn from and manipulate each other. Government tends to dominate these markets. Political connections are crucial for financing through formal channels like banks. Family and friend networks are often necessary for small firms and individuals who cannot get financing through formal channels which tend to favor SOEs. A growing body of financial research has begun to take these factors into account. This course will explore that new literature and seek out applications in emerging markets, in particular, China.

This will be a research orientated course. The goal will be a preliminary research project. I will lecture for the first third of the course to motivate topics for the presentations. Students will make two presentations for the second two thirds of the course. While I lecture on these topics, the student's role is to find an issue of particular interest. The student may choose any area of finance not covered in a traditional finance course and related to emerging markets. The student is required to make two presentations. For the 1st literature review presentation, the student with my guidance should find a paper(s) which is (are) closest to their interest which they will present in a ½ hr presentation. See my suggested list below. They will then adapt the methodology of the paper to address an issue of particular interest to the student for the 2nd research proposal presentation (½) hr.

Students often gather data and do preliminary analysis for the extension presentation. However, the analysis of actual data is not necessary, though certainly does improve the presentation.

The lectures will be based on Wong and Piotroski (2010) "Institutions and Information Environment of Chinese Listed Firms" which describes the effects on market performance of the

two features which define the Chinese financial market: implicit bureaucratic control and scarcity of reliable information. Once the Chinese context is established, I will discuss Putniņš (2010) “Market Manipulation: a Survey,” which goes into specific strategies of market manipulation found in empirical studies. This will be followed by Hu & Noe (1997) “The Insider Trading Debate” which surveys the literature on insider trading. I will discuss my field experiment on detecting and punishing insider trading using market forces without government intervention.

Grading

Grading will be based upon class participation, a midterm quiz, and 2 presentations:

25% literature review presentation:

45% research proposal presentation and defense, and finding data, data analysis:

15% from midterm quiz on lecture materials.

15% class participation

Menu of Possible Presentation Topics

Market Manipulation

Allen, F. & Gale, D. (1992), 'Stock-price manipulation', *Review of Financial Studies* **5**(3), 503--529.

Chakraborty, A. & Yilmaz, B. (2008), 'Microstructure bluffing with nested information', *The American Economic Review* **98**(2), 280--284.

Chakraborty, A. & Yilmaz, B. (2004), 'Informed manipulation', *Journal of Economic Theory* **114**(1), 132--152.

Bettman, J.; Hallett, A. & Sault, S. (2007), 'The Impact of Electronic Message Board Takeover Rumors on the US Equity Market', Technical report, Working Paper.

Benabou, R. & Laroque, G. (1992), 'Using privileged information to manipulate markets: Insiders, gurus, and credibility', *The Quarterly Journal of Economics* **107**(3), 921--958.

Barbosa, António M.R.G., Manipulation and Information Acquisition (August 27, 2011). Midwest Finance Association 2012 Annual Meetings

Chakraborty, A. & Yilmaz, B. (2004), 'Informed manipulation', *Journal of Economic Theory* **114**(1), 132--152.

Charness, G. & Garoupa, N. (2000), 'Reputation, honesty, and efficiency with insider information: An experiment', *Journal of Economics & Management Strategy* **9**(3), 425--451.

Clarkson, P.; Joyce, D. & Tutticci, I. (2006), 'Market reaction to takeover rumour in Internet Discussion Sites', *Accounting & Finance* **46**(1), 31--52.

Chou, H.; Tian, G. & Yin, X. (2010), 'Rumors of Mergers and Acquisitions: Market Efficiency and Markup Pricing', .

Fotak, Veljko, The Impact of Blog Recommendations on Security Prices and Trading Volumes (September 15, 2007).

Huber, J.; Angerer, M. & Kirchler, M. (2011), 'Experimental asset markets with endogenous choice of costly asymmetric information', *Experimental Economics* **14**(2), 223--240.

Indjejikian, Raffi J., Lu, Hai and Yang, Liyan, Rational Information Leakage (August 1, 2011).

Iori, G. & Tedeschi, G. (2010), 'Herding Effects in Order Driven Markets: The Rise and Fall of Gurus', *City University Economics Discussion Papers*.

Jouini, E. & Napp, C. (2011), 'Gurus and beliefs manipulation', .

Kong, Dongmin and Wang, Maobin, The Manipulator's Poker: Order-Based Manipulation in the Chinese Stock Market (May 29, 2011).

Khwaja, A. & Mian, A. (2005), 'Unchecked intermediaries: Price manipulation in an emerging stock market', *Journal of Financial Economics* **78**(1), 203--241.

Kimmel, A. (2004), 'Rumors and the financial marketplace', *The Journal of Behavioral Finance* **5**(3), 134--141.

Kyle, A. & Viswanathan, S. (2008), 'How to define illegal price manipulation', *The American Economic Review* **98**(2), 274--279.

Lerman, Alina, Individual Investors' Attention to Accounting Information: Message Board Discussions (April 2011).

Smith, N. (2011), 'Herding and Speculation in Experimental Asset Markets',

Tālis J. Putniņš, Market Manipulation: A Survey,

Veiga, H. & Vorsatz, M. (2010), 'Information aggregation in experimental asset markets in the presence of a manipulator', *Experimental Economics* **13**(4), 379--398.

Veiga, H. & Vorsatz, M. (2009), 'Price manipulation in an experimental asset market', *European Economic Review* **53**(3), 327--342.

Insider Trading

Bruno Biais, Larry Glosten, Chester Spatt, Market microstructure: A survey of microfoundations, empirical results, and policy implications, *Journal of Financial Markets* **8** (2005) 217--264

Choi, J.; Jin, L. & Yan, H. (2012), 'Informed Trading and Expected Returns', .

Jie Hu, Thomas H. Noe 1997 "The insider trading debate" Federal Reserve Bank of Atlanta in its journal *Economic Review*.

Glosten, L., and P. Milgrom. 1985. "Bid, Ask, and Transaction Prices in a Specialist Market with Heterogeneously Informed Agents." *Journal of Financial Economics*, vol. 14, no. 1 (March): 71--100.

Kyle, A. 1985. "Continuous Auctions and Insider Trading." *Econometrica*, vol. 53, no. 6 (November): 1315--35.

Ananth Madhavan 2002, *Market Microstructure: A Practitioner's Guide*, AIMR

Agrawal, A. & Nasser, T. (2012), 'Insider trading in takeover targets', .

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- Bhattacharya, U. & Daouk, H. (2009), 'When No Law is Better Than a Good Law*', *Review of Finance* **13**(4), 577--627.
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- Chen, H. & others (2011), 'Insider trading law enforcement and gross spreads of ADR IPOs', *Journal of Banking & Finance* **35**(8), 1907--1917.
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- Frijns, B.; Gilbert, A. & Tourani-Rad, A. (2009), 'Elements of Effective Insider Trading Laws', *working paper*.
- Frijns, B.; Gilbert, A. & Tourani-Rad, A. (2008), 'INSIDER TRADING, REGULATION, AND THE COMPONENTS OF THE BID-ASK SPREAD', *Journal of Financial Research* **31**(3), 225--246.
- Gilbert, A. & Tourani-Rad, A. (2008), 'The Impact of Regulations on the Informational Basis of Insider Trading', *Australian Journal of Management* **33**(2), 407--435.
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- Jiang, H. (2009), 'Three essays on ownership concentration in New Zealand', .
- Jiang, H.; Habib, A. & Hu, B. (2011), 'Ownership concentration, voluntary disclosures and information asymmetry in New Zealand', *The British Accounting Review* **43**(1), 39--53.
- Korczak, A.; Korczak, P. & Lasfer, M. (2010), 'To trade or not to trade: the strategic trading of insiders around news announcements', *Journal of Business Finance & Accounting* **37**(3-4), 369--407.
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Zhang, X. (2011), Empirical analysis of the insider trading's characteristics in China stock market, in 'Artificial Intelligence, Management Science and Electronic Commerce (AIMSEC), 2011 2nd International Conference on', pp. 6628--6631.

Government manipulation of the stock market

Allen Jun, Franklin et al. "Explaining the Disconnection between China's Economic Growth and Stock Market Performance."

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Political Connections

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Chan, Kam C, Qinyuan Chen, and Nianhang Xu. "Political Uncertainty and Cash Holdings: Evidence from China."

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- King, Irwin, Joseph Piotroski, T J Wong, and Tianyu Zhang. 2014. "Mixing Business with Politics: The Value of Business and Political Elites to Chinese Firms."
- Lee, Wei, and Lihong Wang. 2016. "Do Political Connections Affect Stock Price Crash Risk? Firm-Level Evidence from China." *Review of Quantitative Finance and Accounting*: 1-34.
- Li, Guoping, and Hong Zhou. 2015. "Political Connections and Access to IPO Markets in China." *China Economic Review* 33: 76-93.
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Informal Finance

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Family Finance

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