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Valuation in Over-the-Counter Markets

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Abstract

We provide the impact on asset prices of search-and-bargaining frictions in over-the-counter markets. Under certain conditions, illiquidity discounts are higher when counterparties are harder to find, when sellers have less bargaining power, when the fraction of qualified owners is smaller, or when risk aversion, volatility, or hedging demand is larger. Supply shocks cause prices to jump, and then "recover" over time, with a time signature that is exaggerated by search frictions: The price jump is larger and the recovery is slower in less liquid markets. We discuss a variety of empirical implications.