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The Impact of Market Maker Competition on Nasdaq Spreads

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Abstract

This study utilizes a comprehensive database containing monthly information on the number of market makers for about 5,288 Nasdaq securities over an eight-year period to investigate the impact of competition on spreads. A variety of models are estimated in order to demonstrate the robustness of the results that include four specific findings: (1) the number of market makers has a negative and highly significant impact on spreads; (2) the relation is nonlinear with a decreasing impact by the marginal market maker; (3) Nasdaq spreads have been declining over time; and (4) structural changes in Nasdaq are associated with significant changes in the relationship between spread and the number of market makers. One improvement over the literature includes allowing endogenous competition through the use of instrumental variables.

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