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Designated Sponsors and Bid-Ask Spreads on Xetra

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Abstract

In order to enhance liquidity, Deutsche Börse AG postulates that non-actively traded stocks on the electronic limit order platform Xetra contract services of a designated sponsor. Interestingly, a lot of stocks opt for trading with more than one designated liquidity provider. In a first step, this paper provides a panel data assessment of the influence of designated sponsors on quoted and effective spreads. We find that while spreads narrow when trading with one or two designated sponsors, further increases in the number of specialists do not necessarily pay out in terms of higher liquidity. Results are shown to differ both across market segments and across different sponsor firms with spreads being lower for firms contracting brokers. In a second step, the variation in the number of liquidity providers is used to test predictions that link the number of market makers to theoretic components of the bid-ask spread. We provide evidence that the observed spread decline is related to inter-dealer competition and risk sharing, but not necessarily to a decrease in adverse selection costs.

Keywords: Liquidity, Bid-Ask Spread, Spread Decomposition, Trade Indicator Models, Designated Sponsors, Designated Market Makers**JEL Classification:** G10[Suggested Citation](#) >[Show Contact Information](#) >

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