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Volume 15, 2005 - [Issue 18](#)

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Alternative beta risk estimators in cases of extreme thin trading: Canadian evidence

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Pages 1251-1258 | Published online: 20 Aug 2006

 Cite this article  <https://doi.org/10.1080/09603100500396585>

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Abstract

In this paper, an alternative method of estimating the systematic risk for Canadian stocks is presented and empirically investigated. The method proposed is applied to a set of data impacted by censoring – the presence of zero returns, which occurs in extreme cases of thin trading. The approach used is the sample selectivity model, which is a two-step procedure: with a selectivity component and a regression component. In addition, this study compares the new beta estimate to the standard OLS beta and the Dimson Beta. The results indicate that the selectivity-corrected beta does correct the downward bias of the OLS estimates and possesses desirable statistical properties.

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Acknowledgment

This research was funded by ARC Discovery Grant DPO345680.

Notes

¹ Several other beta estimation procedures have been proposed to combat thin trading problems: for example, Marsh ([1979](#)), Cohen et al. ([1983a](#), [b](#)) and Fowler et al. ([1989](#)).

² To run the Dimson estimator with two leads and two lags of the market return with a selectivity correction requires a minimum of seven non-zero returns in the sample of 253 observations.

³ Details are available from the authors upon request.

⁴ See for example, Karpoff ([1987](#)), Gallant et al. ([1992](#)) and Hiemstra and Jones ([1994](#)).

⁵ This second step regression has heteroscedastic errors and, thus, should be estimated by generalised least squares. However, an ordinary least squares estimation will still yield consistent and unbiased estimators.

⁶ It should be noted however, that the censoring category between 80 and 90% shows a high market value (size) of C\$ 60 million and a high trading volume of 124 000 shares. This can be explained due to the fact we have only one firm falling in this category (Viventia Biotech), with a degree of censoring of 82.2% (207 zero returns).

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