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Does market maker competition affect the response to insider trading?

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Abstract

This study investigates the impact of market maker competition on the relationship between equity bid-ask spreads and informed trading risk from reported insider purchases. It is the first study to provide evidence that the relationship between inside spreads and insider purchases is stronger when there are fewer market makers or more concentrated market making shares. No evidence is found of a relationship between inside ask depth and reported insider purchases. The results are consistent with theoretical expectations that spreads will respond more to informed trading risk under less competitive market making conditions. However, the results are contrary to the DuPont (2000) prediction that market makers alter depth more than spread in response to informed trading risk.

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