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MARKET MICROSTRUCTURE IN PRACTICE

Market Microstructure in Practice by Charles-Albert Lehalle and Sophie Laruelle is a unique piece in the financial literature about microstructure. This book is not a practitioners book, nor a book about regulation, nor a statistics, economics or econophysics book. It is a mix of all these viewpoints and that is why it is intended to anyone interested in modern market microstructure.

As market participants and top quantitative analysts, the authors describe their experience of the evolution of the markets in the last years, in the context of the fragmentation due to the new regulatory frameworks (Reg NMS, MIFID...). They also provide their thoughts, comments and opinions about these changes in regulation, together with the quantitative tools which are necessary to analyse them. Both academics and practitioners will definitely learn a lot from this book.

Charles-Albert Lehalle and Sophie Laruelle have three main goals in this work:
- Describing, with an historical perspective, the recent regulatory changes (mainly the fragmentation) and analysing their consequences for each type of agent (in particular the emergence of new agents such as the high frequency traders).
- Assessing the impact of these changes on market quality (essentially on the «liquidity»).
- Providing to market participants the scientific approaches enabling them to design their trading strategies in this new environment.

The authors address these issues in depth, with the constant will to give actual examples based on market data (for instance on the way regulation was enforced and how the various platforms behaved) and to validate their claims by sound statistical methods. Hence the book is a remarkable balance between explanations of new regulations, descriptions of market participants, sharp statistical analyses from practitioners viewpoints of market data stylized facts (for example about liquidity, volatility, volume, turnover...), and simple mathematical models enabling to explain these empirical features and to take them into account in the trading practices.

The regulatory perspective is very present in the book. Indeed, Charles-Albert Lehalle and Sophie Laruelle provide a very frank and thorough analysis of the consequences of the new regulations on the price formation process and their opinion about them. They describe in a scientific manner the pros and cons and consider many regulatory tools enabling to fix some observed failures of the regulation (tick size, make-take fees, status of exchanges and market participants...). All the sensitive points related to the fragmentation of the markets are developed and commented: dark pools, emergence of high frequency traders, best execution obligations... Furthermore specific market events such as the Flash Crash are discussed in details.

From a quantitative point of view, the way trading has to take place in the post regulation context is also addressed in the book. The reader can very precisely understand what the different market participants are actually doing everyday and why a quantitative approach is necessary, in particular to fulfill the regulatory constraints such as the best execution policy. All the steps of the market participants tasks are meticulously described. Also, many technical tools are provided, explaining for example how to design a smart order router or the way to optimize between trade scheduling strategies. In particular the authors give a very original view of the central concept of market impact which will be of great interest for any broker or large investor.

It is likely that Charles-Albert Lehalle’s group in CA-Cheuvreux was probably one of the only teams in the world able to write such an impressive piece and luckily they did it.

The analyses which can be found in this work will probably remain as references on the topic. This book is definitely a gold mine for academics or practitioners who wish to get a scientific view on how markets are now operating and understand what trading nowadays means.

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The Paulson Plan: Who Are the Winners?

Eric DE BODT, Frédéric LÖBEZ and Junyao ZHANG, University Lille Nord de France – SKEMA

The joint plan by the U.S. Treasury and the Federal Deposit Insurance Corporation (called the Paulson plan), announced on October 13, 2008, represented the largest financial transfer from taxpayers to financial institutions in U.S. history. Existing research has analyzed whether this massive state intervention improved the recipients’ financial health, and thus in this study, we focus on its competitive distortion effects. Our investigation reveals that the Paulson plan was anything but neutral with respect to competition among industry participants. Both short- and long-term results confirm that the winners were the largest banks.

JEL Codes: TARP; The Paulson plan; Value Effect; Event Study; Distance to Default.

A Partial Equilibrium Model of the Convenience Yield Risk Premium of Storable Commodities

Sami ATTAOUI, Vincent LACOSTE and Pierre SIX, Neoma Business School

This paper develops a partial equilibrium model of the convenience yield risk premium when commodities are storable. Contrary to the previous literature, the risk premium is computed explicitly and endogenously. We provide a decomposition of the convenience yield risk premium in terms of the volatility of the convenience yield as well as in terms of the sensitivity of the marginal utility of investors to the movements of the convenience yield. This decomposition enables us to assess the impact of the risk aversion and investment horizon of investors on the futures contracts’ basis and on the term structure of volatility. Our illustrations are carried out in the case of copper, gold, and oil markets.

JEL Codes: G13; G17.

Keywords: Convenience Yield Risk Premium; Commodity Futures Markets; Commodity Risk Management; Commodity Derivatives Pricing; Samuelson Effect; Commodity Futures Basis; Risk Aversion.

Raising Companies’ Profile with Corporate Social Performance

Philippe BERTRAND, Aix-Marseille Université, IAE-aix-en-Provence, Cergam and AMSE, and Kedge Business School, Marseille, France, Alexis GUYOT, Audencia Nantes School of Management, Centre for Financial and Risk Management (CFRM), Vincent LAPOINTE, Aix-Marseille Université (Aix-Marseille School of Economics), CNRS & EHESS, France

This paper examines whether the initiation of Vigeo Corporate Social Performance (CSP) rating impacts company profiles. Using a sample of European listed firms, we confirm that there is a positive and significant relationship between CSP rating and a firm’s liquidity and investor base. Consistent with the neglected stock effect, this relationship is sensitive to firm size. Our results have important implications for practitioners. Firstly, investment in Corporate Social Responsibility (CSR) could represent an alternative method of improving a company’s stock market quality alongside liquidity provider contracting or market listing transfer. Secondly, when a firm’s board investigates the opportunity to invest in CSR, it should consider the benefits of lowering the company’s cost of capital through the aforementioned effects. Finally, from an asset manager’s perspective, any change in CSP should be taken into account, as it can affect company valuation and therefore portfolio performance.

JEL Codes: G32; G34; M14.

Keywords: Corporate Social Performance; Corporate Social Responsibility; Liquidity; Investor Base; Cost of Equity Capital.

Does Employee Ownership Really Boost Performance? Evidence from France

Amel BELANES, University of Tunis, and Malek SAIHI, Institute of High Commercial Studies (IHEC) Carthage- University of Carthage

This paper uses a representative sample of French companies to investigate how employee ownership influences business performance. A key focus is to determine whether the impact is linear and whether it varies with the proxy used for company outcomes. Empirical results unanimously point to a significant non-linear influence by employee shareholding on company performance, which declines when employee ownership is low or high, but rises when it is in the mid range. Accordingly, companies should consider implementing plans that promote employee shareholding as a way to enhance motivation and commitment and so improve performance, while bearing in mind that ownership should not exceed a certain threshold to avoid potential drawbacks. Investors should target companies with medium levels of employee ownership as they are likely to be more profitable. The paper’s findings are consistent with Herzberg’s two-factor theory of hygiene and motivator factors, suggesting that share ownership plans alone are not sufficient to promote employee satisfaction, commitment and motivation, but should be combined with other factors to build success. Companies and investors alike can draw useful insights from this research.

JEL Codes: G2; G31; G34.

Keywords: Corporate Governance; Employee Ownership; Performance; Panel Data.

Islamic Equity Indices: Insight and Comparison with Conventional Counterparts

Abdelbari EL KHAMLICHI, LERSEM, ENCG, Chouaib Doukkali University, El Jadida, Morocco, Aurélie SANNAJUST, University of Saint-Étienne, France, and Humayun Kabir SARKAR, Taylor’s Business School, Taylor’s University, Malaysia.

The principles of Islamic indices are similar to those of other ethical indices in terms of the screening process; both of them are also characterized by their short histories. So, after Islamic indices were introduced in the late nineties, many financial markets and index providers launched their own Islamic indices for investors looking for investment opportunities without compromising their beliefs. In terms of academic research, many papers have scrutinized this subject, but neither the over performance nor the underperformance of Islamic indices was able to win the researchers’ unanimous backing. The purpose of this paper is to provide an overview of Islamic equity indices. This will be done by a) studying the current status of this category of indices; b) analyzing the screening process and surveying current literature focusing on Islamic indices; and c) graphically comparing the evolution of major global Islamic indices with their benchmarks. Findings of the study suggested that in most of the cases, Islamic indices are moving almost together with their conventional counterpart (except a few cases) over the observation period.

JEL Codes: G10; G15.

Keywords: Islamic Finance; Shariah; Equity indices; Screening Process; Performance.
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