Liquidity Supply across Multiple Trading Venues

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Abstract

Recent regulatory changes have fragmented the trading of financial securities, giving rise to the emergence of "global" dealers, that is, intermediaries making the market simultaneously across more than one trading venue. We develop an inventory model in which two risk-averse global dealers compete to absorb part or the totality of an order flow that fragments between two venues. We show that fragmentation may lead to a better allocation of risks among dealers, which may result in lower transaction costs. We also show that bid-ask spreads in a venue depend on the sign and size of the order flow routed to the other venue. We test these predictions using proprietary data from Euronext on multi-listed firms. First, we document the existence of a pool of traders who split their liquidity supply across the different order books, and we find that market spreads are significantly impacted by the divergence of dealers' global inventory. Second, we show that market spreads are significantly related to the size and the direction of order flow routed to the other venue, consistently with our predictions.