Monopolistic Dealer versus Broker: Impact of Proprietary Trading with Transaction Fees[☆]

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Abstract

In this study, we consider a one-period financial market with a monopolistic dealer/broker and an infinite number of investors. While the dealer who trades on his own account (with proprietary trading) simultaneously sets both the transaction fee and the asset price, the broker who brings investors' orders to the market (with no proprietary trading) sets only the transaction fee, given that the price is determined according to the market-clearing condition among investors. We analyze the impact of proprietary trading on the asset price, transaction fee, trading volume, and the welfare of investors. Results show that proprietary trading increases both the trading volume and the transaction fee, and improves social welfare. Our study effectively demonstrates how proprietary trading affects market equilibrium and welfare

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of investors.

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