An Industrial Organization Approach to Finance

By David Ong

**Class time:** Monday and Thursday 3:30-5:20 pm 231.
**Office hours:** by appointments Mondays, Wednesdays, Fridays 4-5pm.

**Introduction**

Financial institutions in emerging markets are generally far from meeting the assumptions of most standard models in finance. In emerging markets, institutions are underdeveloped, participants are strategic and information is scarce. As a consequence, participants trade on insider information and try to learn from and manipulate each other. Government tends to dominate these markets. Political connections are crucial for financing through formal channels like banks. Family and friend networks are often necessary for small firms and individuals who cannot get financing through formal channels which tend to favor SOEs. A growing body of financial research has begun to take these factors into account. This course will explore that new literature and seek out applications in emerging markets, in particular, China.

This will be a research orientated course. The goal will be a preliminary research project. I will lecture for the first third of the course to motivate topics for the presentations. Students will make two presentations for the second two thirds of the course. While I lecture on these topics, the student’s role is to find an issue of particular interest. The student may choose any area of finance not covered in a traditional finance course and related to emerging markets. The student is required to make two presentations. For the 1st literature review presentation, the student with my guidance should find a paper(s) which is (are) closest to their interest which they will present in a ½ hr presentation. See my suggested list below. They will then adapt the methodology of the paper to address an issue of particular interest to the student for the 2nd research proposal presentation (½) hr.

Students often gather data and do preliminary analysis for the extension presentation. However, the analysis of actual data is not necessary, though certainly does improve the presentation.

The lectures will be based on Wong and Piotroski (2010) “Institutions and Information Environment of Chinese Listed Firms” which describes the effects on market performance of the
two features which define the Chinese financial market: implicit bureaucratic control and scarcity of reliable information. Once the Chinese context is established, I will discuss Putniņš (2010) “Market Manipulation: a Survey,” which goes into specific strategies of market manipulation found in empirical studies. This will be followed by Hu & Noe (1997) “The Insider Trading Debate” which surveys the literature on insider trading. I will discuss my field experiment on detecting and punishing insider trading using market forces without government intervention.

**Grading**

Grading will be based upon class participation, a midterm quiz, and 2 presentations:
- 25% literature review presentation:
- 45% research proposal presentation and defense, and finding data, data analysis:
- 15% from midterm quiz on lecture materials.
- 15% class participation

**Menu of Possible Presentation Topics**

**Market Manipulation**


Clarkson, P.; Joyce, D. & Tutticci, I. (2006), 'Market reaction to takeover rumour in Internet Discussion Sites', *Accounting & Finance* 46(1), 31--52.


Indjejikian, Raffi J., Lu, Hai and Yang, Liyan, Rational Information Leakage (August 1, 2011).


Smith, N. (2011), 'Herding and Speculation in Experimental Asset Markets',

Tālis J. Putniņš, Market Manipulation: A Survey,


Insider Trading


Beny, L. N. (2005), 'Directors' Dealings, Market Efficiency, and Strategic Insider Trading in the German Stock Market',.


Chang, M. & Wee, M. (2012), 'How Do Insider Trading Policies Affect the Information Content of Insider Trades?',


Collin-Dufresne, P. & Fos, V. (2012), 'Do Prices Reveal the Presence of Informed Trading?',


Denis, D. & Xu, J. (2011), 'Insider Trading Restrictions and Top Executive Compensation',


Jiang, H. (2009), 'Three essays on ownership concentration in New Zealand'.


Lebedeva, O.; Maug, E. & Schneider, C. (2012), 'Trading Strategies of Corporate Insiders',

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Prevoo, T. & Ter Weel, B. (2010), 'The Effects of a Change in Market Abuse Regulation on Abnormal Returns and Volumes: Evidence from the Amsterdam Stock Market', *De Economist* 158(3), 237--293.

Sureda Gomila, A. & others (2010), 'Essays on the behavior and regulation of insiders'.

Tonks, I. (2010), 'Discussion of To Trade or Not To Trade: The Strategic Trading of Insiders around News Announcements', *Journal of Business Finance & Accounting* 37(3–4), 408--421.


Government manipulation of the stock market

Allen Jun, Franklin et al. "Explaining the Disconnection between China’s Economic Growth and Stock Market Performance."


Political Connections


Chan, Kam C, Qinyuan Chen, and Nianhang Xu. “Political Uncertainty and Cash Holdings: Evidence from China.”

Chen, Tain-Jy, and Ying-Hua Ku. “Rent Seeking and Entrepreneurship: Internet Startups in China.”


Tsai, Lily, and Yiqing Xu. 2015. “Outspoken Insiders: Political Connections and Citizen Participation in Authoritarian China.”


Informal Finance


Allen, Franklin, Meijun Qian, and Jing Xie. 2013. “Understanding Informal Financing.”


DeFond, Mark L., Xinzi Gao, Oliver Zhen Li, and Lijun Xia. 2014. “Did China’s Adoption of IFRS Attract More Foreign Institutional Investment?” *SSRN Electronic Journal*.


Dumas, Christelle, and Hong Kong. 2016. “The Great Famine and Household Saving in China.”


*Family Finance*


DeFond, Mark L., Xinzi Gao, Oliver Zhen Li, and Lijun Xia. 2014. “Did China’s Adoption of IFRS Attract More Foreign Institutional Investment?” SSRN Electronic Journal.

Dumas, Christelle, and Hong Kong. 2016. “The Great Famine and Household Saving in China.”


