

553 LECTURE NOTES IN ECONOMICS
AND MATHEMATICAL SYSTEMS

Burkart Mönch

Strategic Trading in Illiquid Markets



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553

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Burkart Mönch

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Author

Burkart Mönch
Goethe University Frankfurt
School of Economics and Business Administration
Finance Department, Derivatives Group
Uni-PF 77
60054 Frankfurt am Main
Germany
E-mail: b.moench@econ.uni-frankfurt.de

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Introduction

The Area of Research and the Object of Investigation

In this thesis we will investigate trading strategies in illiquid markets from a market microstructure perspective. Market microstructure is the academic term for the branch of financial economics that investigates trading and the organization of security markets, see, e.g., Harris (2002).

Historically, exchanges evolved as a location, where those interested in buying or selling securities could meet physically to transact. Thus, traditionally security trading was organized on exchange floors, where so-called dealers arranged all trades and provided liquidity by quoting prices at which they were willing buy or sell. Consequently, the initial surge of the market microstructure literature focused predominantly on this type of market design, which is often referred to as quote-driven.

Nowadays, the interest is shifting towards order-driven markets. Beginning with the Toronto Stock Exchange in the mid 1970s and increasing in frequency and scope, this market structure has emerged as the preeminent form of security trading worldwide. In order-driven markets, exchanges arrange trades by matching public orders, often by employing automatic execution systems.