

Minimum Trading Unit and Investor Base, Liquidity, Noise Trading, and Brokerage Promotion

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Abstract

This paper provides a comprehensive study of the impact of changes in lot size or the Minimum Trade Unit (MTU) on the Tokyo Stock Exchange (TSE). The event of the MTU changes in Japan provides an ideal setting to explore several interesting issues related to the investor base, liquidity, noise trading, brokerage commission, and stock value. From a sample of 118 TSE listed firms that reduced their MTU during the 1996-2000 period, we find a substantial increase in the number of individual investors and improvement in liquidity for small trades. Our results suggest that there is a shift in order flow from large to small trades after the MTU change: trading activity for small-size trades intensifies while activity for large trades dwindles. Our investigation of return volatility also reveals that noise trading increases as more uninformed, small investors enter the market after the MTU change. Further, MTU changes appear to attract more brokerage firms to cover the stock, possibly induced by increased commission income. Our empirical results support the idea that the expanded investor base, improved liquidity, and enhanced brokerage efforts to market the stocks are significantly associated with the rise in the stock value around the MTU change.

Key words: Minimum Trade Unit, Tokyo Stock Exchange, Liquidity, Investor Base, Noise Trading, Brokerage Promotion

JEL Classification: G10, G15, G20

This Version: October 2001