Andreas Krause

Chapter 4.2

Quality of securities issued

Outline

- Problem and model assumptions
- Direct trade
- Investment bank intermediation
- Comparing direct trade and investment banks
- Summary

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Problem and model assumptions

Direct trade

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Summary

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Issuers affecting security quality

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- Issuers can affect the value of their securities

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- Increasing the value (quality) will be costly to issuers

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Model assumptions

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- Buyers can obtain the security directly

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- The expected profits are $\hat{\Pi}_S = p\hat{P}_H$

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- The expected profits are $\hat{\Pi}_S = p\hat{P}_H + (1-p)\left(p_B\hat{P}_L\right.$

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Reduced security quality with high marginal costs

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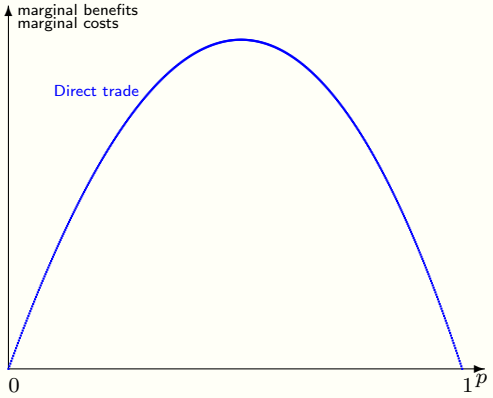
Reduced security quality with high marginal costs



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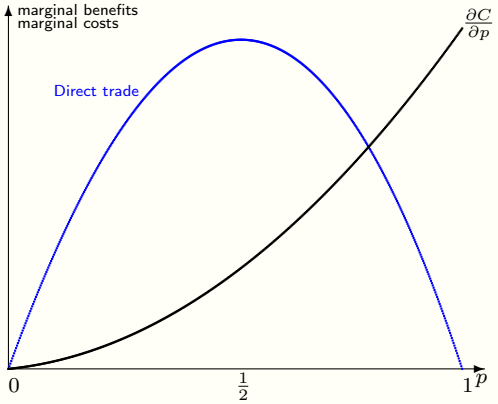
Reduced security quality with high marginal costs



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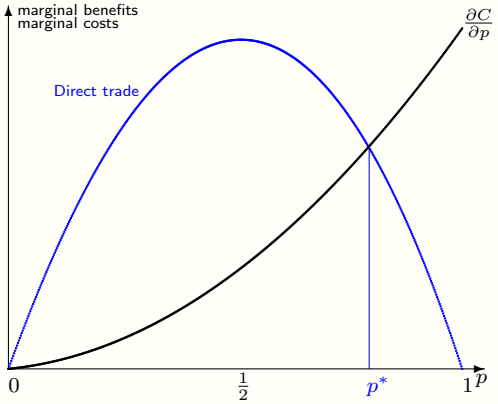

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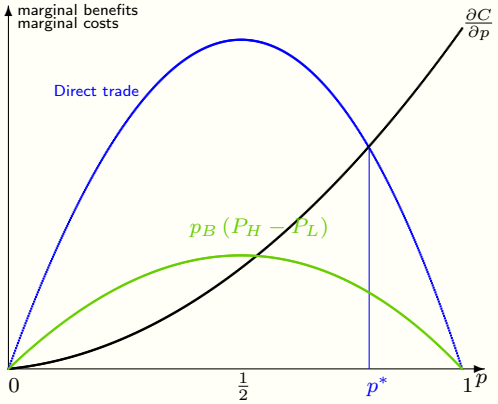

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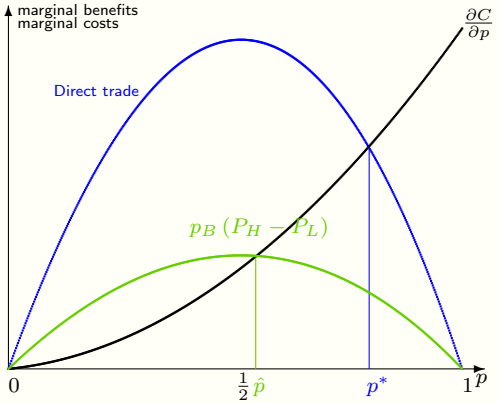

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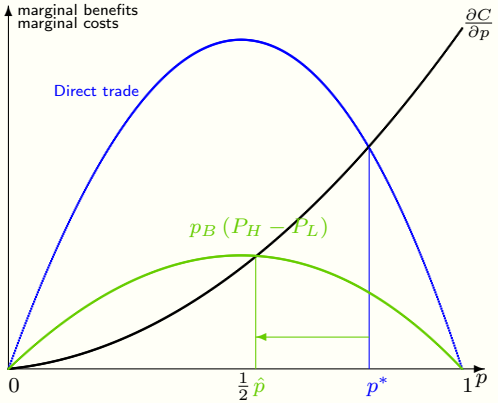

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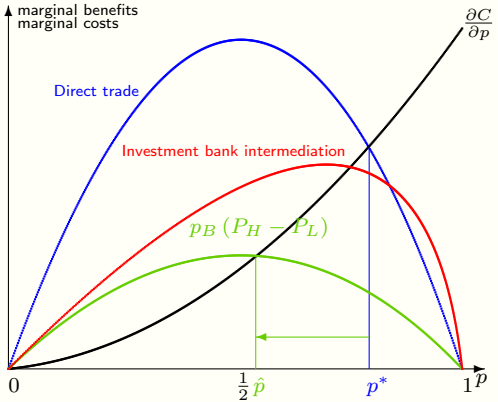
Reduced security quality with high marginal costs



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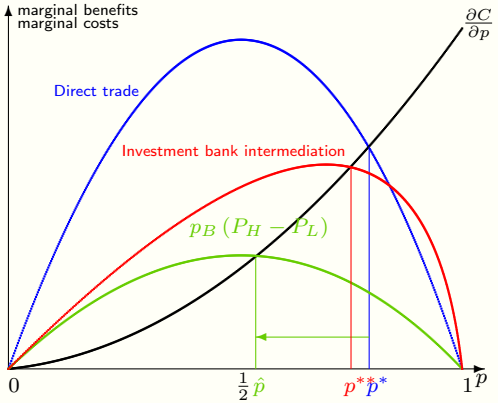

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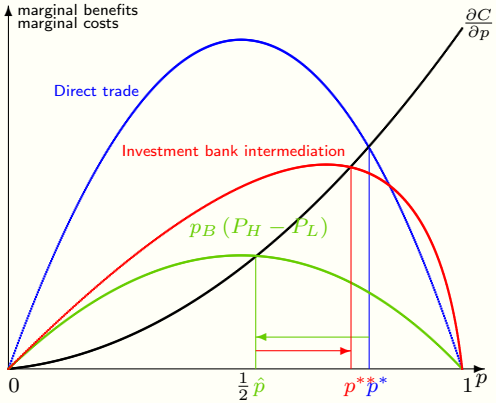

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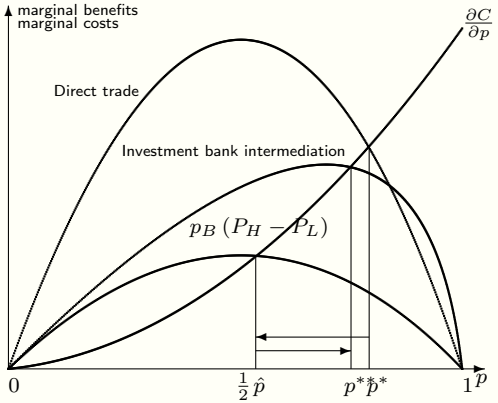

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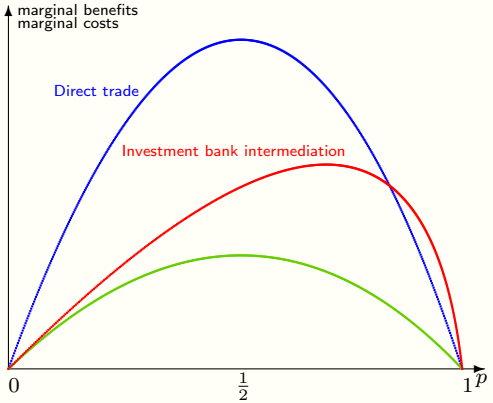

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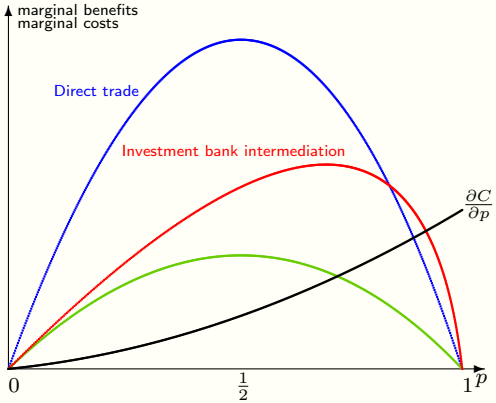

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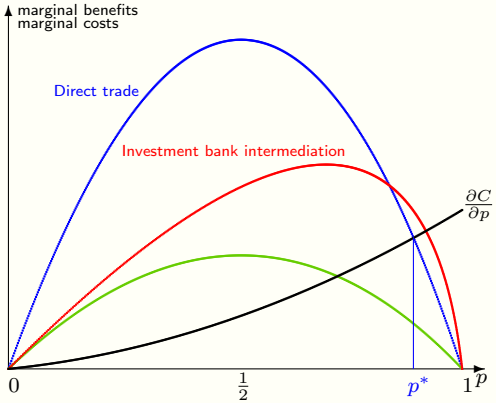

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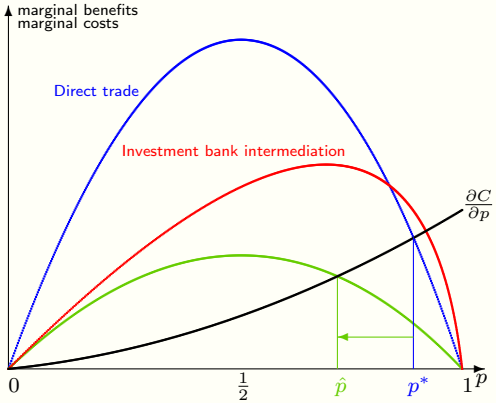

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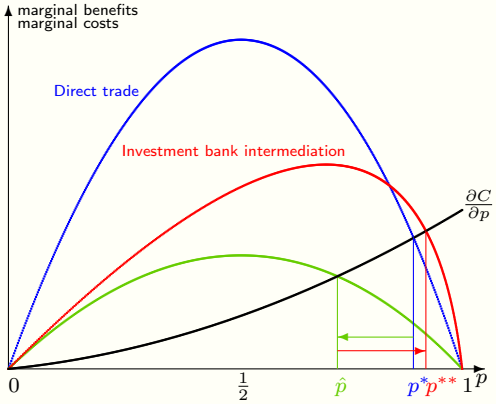

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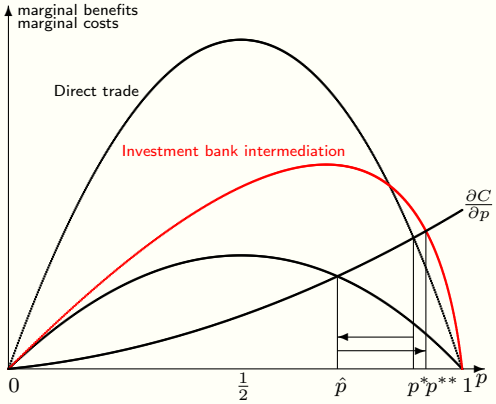

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Analysing the effects

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Analysing the effects

- Focus only on the first terms of the first order condition and take the difference: $(P_H - P_L) - p_B \left(\hat{P}_H - \hat{P}_L \right)$

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Problem and model assumptions

Direct trade

Investment bank intermediation

Comparing direct trade and investment banks

Summary

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Investment banks do not always increase security quality

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