Abstract

I study the problem of an issuer (innovator) of a basket security in segmented markets. Investors do not have access to all markets so demand the basket security for risk-sharing purposes. The innovator, on the other hand, has access to all markets but no endowments. He only profits from intermediation.

I show that the introduction of a basket security either eliminates trading in the market the innovator prefers to specialized in or the basket fully replicates the market portfolio. The innovator's choice depends on how much trading volume he expects to generate in his basket security and the odds of receiving his intermediation profits.

Provided innovator's incentives, I show that the market-mediated equilibrium might not be constrained efficient. I then study how competition among innovators affects the basket structure. I show that competition increases the diversification in the basket since innovators seek to increase the trading volume to compensate their losses from the entry of new competitors. Moreover, I show that competition might generate the coexistence of different basket securities each of them serving different clienteles. Finally, I show that introducing competition is not always benefitial for investors since the change in the basket structure introduced by competition does not imply necessarily an improvement in the risk-sharing opportunities to all investors.