

Multimarket Contact and the Cost of Trading Corporate Bonds

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Summary

- Motivation: Corporate bond market is highly concentrated dealer-intermediated market, yet dealers have limited pricing power
- The paper's answer: Multimarket contact (MMC) disciplines corporate bond pricing
- MMC means the same dealers interact across many bonds:

$MMC_{i,b,t}$ = dealer i 's overlap with other dealers across bonds

- Example:
 - Low MMC: Dealers A and B overlap in only one bond
 - High MMC: Dealers A and B are jointly active across hundreds of bonds
- Main mechanism: a dealer who widens her quote in one bond faces retaliation in every other bond she shares with the same counterparties
- More specifically, the incentives differ
 - Case 1: Dealers A and B trade \$1 M, all in one bond
 - Case 2: Dealers A and B also trade \$1 M, but across 50 different bonds

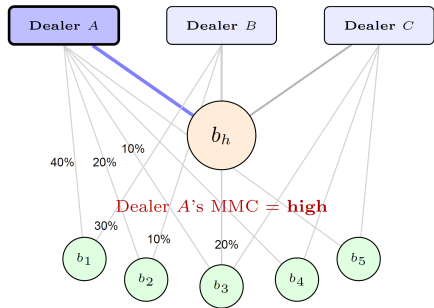
Empirical Findings

- Dealers with higher MMC charge lower transaction costs
- A one-standard-deviation increase in MMC lowers spreads by about 4–6 basis points, roughly 17–26% of the average spread
- The effect is stronger for bonds with:
 - Higher price impact, a proxy for adverse selection
 - Less frequent trading
- Lower interdealer spreads are passed through to customers
- A COVID-era issuance-based shift-share IV supports the causal interpretation
- Main takeaway: dealer networks can discipline pricing, so concentration does not necessarily imply high markups

Comment 1: Clarify MMC Construction

- The economic intuition behind MMC is clear, and Figure 7 is helpful
- However, the mapping from the network diagram to the dealer–bond–month measure is difficult to reconstruct from the formulas
- A simple numerical example could show:
 - How pairwise overlap is averaged across dealers
 - How revenue weighting changes each shared bond's contribution
- This would also explain why average unweighted overlap is around 485, while weighted overlap is around 2.02

A Simple Walkthrough



- Target bond b_h is traded by Dealers A, B, C
- Unweighted overlap:
 - A–B share 3 bonds, A–C share 3 bonds, B–C share 1 bond
 - A's MMC: $(3 + 3)/2 = 3$, while B's and C's MMC are both $(3 + 1)/2 = 2$
- Revenue-weighted overlap:
 - A–B still share 3 bonds, but the weighted overlap is $0.40 \times 0.30 + 0.20 \times 0.10 + 0.10 \times 0.20 = 0.16$, rather than the unweighted count of 3
 - A's revenue-weighted MMC is then obtained by averaging A–B's and A–C's weighted overlaps

Comment 2: IV Exclusion Restriction Concern

- Example: Bond X is an old IG industrial bond traded by Dealers A and B
- Before COVID, Dealer A had a large market share in IG industrial bonds, while Dealer B did not
- During COVID, IG industrial firms issued many new bonds
- This mechanically increased Dealer A's contact with other dealers across more bonds

Industrial issuance shock $\rightarrow$ higher MMC for A $\rightarrow$ lower spread on Bond X

- Concern: the same issuance shock may also improve A's industrial-bond business directly
- For example, A may get more customer flow, better inventory management, more information, or stronger client relationships
- So lower spreads may reflect segment-level business advantages, not only MMC

Proposed Test: Outside-Segment Shock

- Example: Bond X is still an old IG industrial bond traded by Dealers A and C
- Dealers A and C both historically trade many technology bonds
- During COVID, technology firms issue many new bonds
- A and C now meet each other in more tech bonds, so A's MMC in Bond X rises

Tech issuance shock $\rightarrow$ more A-C overlap elsewhere $\rightarrow$ higher MMC in Bond X

- This may provide a cleaner test because technology issuance is less likely to directly affect customer demand or inventory conditions for industrial Bond X
- If it strongly predicts MMC and produces similar second-stage estimates, it would strengthen the cross-market interpretation

Comment 3: Retaliation is not directly observed

- The model and empirics are well aligned
- One gap is mechanism: the model is about cross-bond retaliation, but retaliation is not directly observed

Model: A overcharges B in Bond X $\rightarrow$ B retaliates in Bond Y

Empirics: more MMC $\rightarrow$ lower spreads where retaliation should matter

- This is consistent with the model, but could also reflect relationship capital, information sharing, search efficiency, or inventory benefits
- Can the empirical MMC measure be brought closer to the model's idea of imported cooperation capacity?

Conclusion

- This paper advances our understanding of how dealer interactions affect the corporate bond transaction costs, with careful theoretical modeling and smart empirical design
- My comments:
 - Clarify the construction of MMC with simple numerical examples
 - Strengthen the IV exclusion restriction
 - Potential: test of the retaliation mechanism
- I learned a lot from reading this paper and highly recommend it!