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Finance
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The Financial Review 34 (1999) 75–94

The
Financial
Review

FR

Changing the Size of a Futures Contract: Liquidity and Microstructure Effects

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Abstract

We analyze the relation between contract size and liquidity using data from the respecification of Sydney Future Exchange's (SFE) Share Price Index (SPI) and 90-day Bank Accepted Bill (BAB) futures contracts. Respecification of SPI and BAB contracts presents a unique opportunity to investigate the effects of a change in futures contract size. SFE decreased the size of SPI futures by a factor of four while increasing its minimum tick. The BAB contract was doubled in size with the minimum tick size left unchanged. We find, after controlling for market factors, that the respecification of the SPI futures resulted in higher trading volume, while that of BAB futures decreased trading volume. The results regarding spreads are ambiguous. Based on two cases investigated, we conclude that decreasing the futures contract size was effective in terms of enhancing liquidity while increasing the size resulted in a reduction in liquidity.

Keywords: contract size, tick size, bid-ask spreads, trading volume, liquidity

JEL Classification: G15

1. Introduction

The issue of contract size in optimal contract design requires a careful consideration of the tradeoff between volume and transaction costs. Too small a contract

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Authors wish to thank the editor Kuldeep Shastri, two anonymous referees, Linda Allen, Amber Anand, Anthony Collins, Peter Locke, Susan Mangiero, Ashok Vora, George H.K. Wang, as well as the seminar participants at Hofstra University, Commodity Futures Trading Commission, and at the 1999 Eastern Finance Association Meetings for helpful comments