Paul Schultz is feeling vindicated these days. Two weeks ago, the U.S. Securities and Exchange Commission imposed $27.1 million in penalties on 28 stock brokerages and 51 of their traders as part of a settlement to wind up an investigation of Nasdaq Stock Market trading abuses. The multimillion-dollar fine was the cherry atop a big sundae - last year's record $1.03 billion settlement of a federal class action lawsuit by investors who had accused 37 brokerages of various trading violations involving Nasdaq. Key to both the SEC and civil actions was the allegation of a price-rigging conspiracy, brought by Schultz, a former Ohio State University associate professor, and William Christie, a professor at Vanderbilt University. In their 1994 article, "Why Do Nasdaq Market Makers Avoid Odd Eighth Quotes," published in The Journal of Finance, the professors alleged "tacit collusion" among brokers making a market in certain Nasdaq stocks. The piece became known - due to the large settlement - as the first billion-dollar economics article. Schultz and Christie questioned the widespread practice of quoting stocks for customers to the nearest quarter of a dollar, rather than the nearest eighth, giving market makers considerable extra profits. Market makers are the individuals and companies that make up Nasdaq's backbone. They buy and sell a company's stock from their own accounts and execute customers' orders through the market's national computer network. The authors found that in 71 of 100 actively traded Nasdaq stocks, market makers rarely quoted stocks in "odd eighths" - 1/8, 3/8, 5/8 and 7/8. That didn't occur with similar stocks on the New York Stock Exchange. A follow-up study by Schultz and Jeff Harris, then an Ohio State doctoral student, found that market makers suddenly began quoting some stocks in eighths - equal to 12.5 cents - the day stories appeared about the original report. The challenge to market makers created a virtual firestorm. "We were shocked by the interest in this," said Schultz, whose newfound visibility helped him land a professorship and chair at the University of Notre Dame. It "was like throwing a match on gasoline." The term that caught everyone's attention was "tacit collusion." It was enough to cause Nasdaq to finance two academic studies - one co-authored by Nobel-prize winning economist Merton Miller - that tried to refute the charge. While the word "collusion" may have been strong, it's clear that the academic articles prodded the SEC. After all, the American Stock Exchange had complained about similar problems two years earlier, but no action was taken. The Schultz-Christie research also resulted in a Department of Justice investigation and a series of changes by Nasdaq. Schultz said the most gratifying part of his work was not his sudden fame, but that "it demonstrated to students and to others that the research we do really does matter." One Notre Dame publication noted that Schultz - the John W. and Maude Clarke Chair in Finance - had made "an impact" in finance. "We consider Paul Schultz a great addition to our college," said Carolyn Y. Woo, dean of Notre Dame's College of Business Administration. Although Schultz is no longer at Ohio State, the university still reaps some gains from the "odd eighths" article and The Journal of Finance, which is edited by Rene Stulz, an OSU finance professor. Nasdaq made Ohio State its "premier partner," and provided the business school with several awards, such as a $15,000 scholarship. A larger gift is being considered. "They credit us for reshaping the market," said Stephen A. Buser, chairman of the Department of Finance at OSU and former co-editor of The Journal of Finance. Although the previous Nasdaq administration had fought to disprove the Schultz-Christie articles, Buser said the current leaders realize "it was right on point," and "that type of research" is needed. For his part, Schultz feels he was "pretty lucky that I stumbled across" the odd-eighths pricing. "I'm always aware of that. But as Steve Buser said, a lot of people stumble across something but most pick themselves up and keep going.
without noticing” what they tripped over. Before the "odd-eighths" research, the biggest publicity coup by Ohio State's finance department came from its 9-year-old Student Investment Management class, which Buser helped launch. The first SIM class of finance students was given $5 million from the OSU’s endowment fund in 1990, becoming the first group of American college students to officially manage a multimillion-dollar university account. The student managed account not including dividends and interest, which is paid out as endowment money is now worth $16 million. The performance of the OSU account is slightly below that of the Standard & Poor’s 500 during the same period. The SIM program has spawned similar ones at other universities, but OSU continues to be a leader. Just this month, William Batten, an OSU business school grad and former chairman of the New York Stock Exchange, committed $500,000 to Ohio State's Fisher College of Business to fund the Batten Investment Laboratory. The lab will include video conferencing equipment to link students with financial analysts and executives scattered around the world. The facility also will have a digital stock monitoring system and other state of the art technology. As Ohio State struggles to make its mark among the nation's elite business schools, the loss of Schultz was a step backward. Perhaps the gifts by Nasdaq and Batten will be two steps forward.