Massive Delisting on the Prague Stock Exchange

Governments should be careful about which privatized companies to place on the stock exchange

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The Prague Stock Exchange (PSE), established in the early 1990s, was one of the first stock exchanges in the transition countries. Under the voucher privatization scheme, shares of all privatized companies were placed on the market by an administrative decision — thus, simply "thrown" at the market. In 1993, almost 1,000 share issues from the first wave of voucher privatization were traded on the PSE, and the number further increased following the second privatization wave in 1995. Lively trading on the PSE was the result of a liberal regulatory framework and a multiplicity of trading channels.

However, after the initial boom, the PSE experienced massive delisting, i.e. exclusion of a large proportion of the listed share issues from public trading, and virtually no initial public offerings. In 1997, 75% of shares were delisted from the PSE, mostly due to insufficient liquidity. At the same time, the number of domestic and foreign companies listed on the Warsaw and Budapest Stock Exchanges was growing.

Nevertheless, delisting in the Czech Republic was a necessary step, since companies that under standard conditions would be privately owned ended up as public after the voucher privatization.

A Corrective Action?

Delisting may serve to correct wrong decisions made by privatization authorities and help make the market more transparent. However, it can also hurt minority investors, and coupled with few new listings may contribute to the shrinking size of the market, reducing investment opportunities in the home country.

Apart from the Czech Republic, massive delisting was also observed in other transition countries, which also had undertaken voucher privatization: namely, Bulgaria, Lithuania, and Slovakia. Although delisting has also occurred in developed economies, its magnitude has been much smaller in comparison to the market size than in transition countries.

Determinants of Delisting

Our analysis of the delisting process in the Czech Republic, based on data on all firms privatized during both voucher privatization waves (1,664 medium and large non-financial companies), shows that factors crucial for delisting can be grouped as follows:

- *Pre-privatization characteristics* of the company: size, financial indicators, the industry it operates in and its willingness to report results;
- *Privatization-related factors*: timing of privatization (which wave), the ownership structure before and after privatization, especially the ownership share of the National Property Fund (NPF), and the average price of shares in privatization auctions;
- *Post-privatization factors*: development of the company's financial indicators and its growth opportunities.

Possible to Identify Targets

The results of our estimation confirm that several factors could help to identify likely “delisting targets” even before the actual delisting took place. These include:

- The size of the company, with larger companies having a lower probability of delisting;
- Unwillingness to report financial results before privatization, which contributed to the increased probability of delisting;
- The proportion of shares held by the NPF, which indicated the state's future intensions towards the privatized company. An increase in the amount of shares owned by the NPF by 1% decreased the probability of delisting by 0.3%;
- The average price of shares in privatization auctions, with a higher price indicating greater expected future prospects and a lower probability of being delisted;
- The timing of privatization: the probability of delisting was 5.5% lower for companies privatized in the first privatization wave and 5.7% lower for companies privatized in both waves, which confirms that more profitable firms were privatized first;
- The future prospects of a company, with higher growth opportunities indicating an increase in the probability of delisting.

Thus, not all of the privatized companies were suitable candidates for immediate placement on the stock exchange. Massive delisting could be prevented if the above factors had been taken into account. Moreover, companies not suitable for public trading, were not suitable for voucher privatization either.

The design and implementation of a voucher privatization program involving a large number of companies thus significantly influenced the emergence and the initial development of the stock market. Governments that decide on privatization programs should be very careful when choosing which companies to privatize, what methods to use and what criteria to apply to companies to be placed on the stock exchange.

If a proper filtering of companies had been done in the Czech Republic before placing newly privatized companies on the stock exchange, a more transparent and efficient stock market would have emerged after privatization. When comparing the Czech market to more gradually evolving stock markets in Poland and Hungary, one could conclude that massive delisting in the Czech Republic was one of the decisive factors causing the virtual lack of new listings on the PSE. In general our results indicate that in the case of emerging markets less seems to be more in the sense that it is better to start with fewer listed share issues, which fulfill standard listing requirements.

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