

# DELISTING AND ITS IMPACT ON SHAREHOLDERS WEALTH: EVIDENCE FROM INDIA

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## ABSTRACT

*This study examines the impact of the delisting of shares from the stock exchanges on shareholders' wealth. We study a sample of 127 stocks delisted from the National Stock Exchange (NSE), India, during the period 2002 to 2018. We find that shareholders of delisted stocks get a negative return of 13.89 % over the car window (-30,-1). O'Donnell (1969) and Jarrell (1984) and Sanger and Peterson (1990) found an average decline of 9% and 8.5% on the stock returns around delisting. Our results are consistent with the existing literature, which show a significant loss of shareholders' wealth. The study's finding points out the decline in shareholders' wealth and provides an evidence from the Indian Capital markets. The study's seeks the attention of regulators, policy makers and stock exchanges to manage or come out with better regulations and policies in delisting of Stocks. It also help to provide suggestions to regulators to reduce the losses incurred to the minority shareholders.*

**Key words:** Employability skills, graduates, education.

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## 1. INTRODUCTION

### 1.1. Delisting Reasons in India

The listing of securities of a company provides free transferability of securities and makes them readily marketable. Listing of securities is ensured by the listing agreement, which is entered by the stock exchange and the issuing company. The listing regulations have been designed to safeguard investors' interests and ensure transparency through disclosures, control, and proper supervision over the dealings in listed companies' conduct. In India, securities can freely be traded through the Securities and Exchange Board of India (SEBI).

Delisting of shares means excluding the listed entity's stocks from the stock exchange, which means the delisted stocks are no longer available on the stock exchanges – National

Stock Exchange (NSE) and Bombay Stock Exchange (BSE). There are various reasons for delisting namely: 1. Market capitalization insufficiency 2. Under-priced stock price 3. Filing for bankruptcy by the company 4. Non-compliance with exchange regulatory requirements 5. Merger and acquisitions

Delisting has a significant negative impact on the shareholders, the firm, and other parties' interests involved in it. The most negatively impacted are minority interest investors. This study looks at the delisting of shares from the national stock exchange of India (NSE) and includes both voluntary and involuntary delisting.

## 1.2. Delisting Internationally

In the Issuer-Initiated(voluntary) delisting, listed companies opt to go private by permanently removing the shares from the stock exchange due to merger, acquisition, or non-performance. Voluntarily delisted companies allow the investors to either offload the shares by reverse book building or hold the shares until they find a buyer. For voluntary delisting, the significant causes may be: 1. A listed company evaluates the listing fees payable to the stock exchange disproportionate to the benefits to the company or its security holders. 2. The minimum number of public shareholders of the listed securities (due to private placement issue or otherwise) does not justify the securities to continue to be listed. 3. Regional imbalance for any reason of the holders of the securities. 4. Negligible or total absence of trading for a considerable long period. 5. The company is under closure or has suspended its business. 6. Small capital base or failure to comply for increasing the capital, not justifying listing to be continued. 7. Mergers, amalgamations or takeovers.

In Exchange-Initiated(involuntary) delisting specifically has been a subject of increasing attention recently. Exchanges require compliance for specific qualitative and quantitative criteria to continue listing in the stock market. These criteria may include minimum stock prices, minimum trading volumes, restrictions on the minimum number of stockholders, adequate financial disclosures, and satisfactory economic conditions. For involuntary delisting, the significant causes may be: 1. Non-payment of listing fees 2. Non-compliance with listing requirements 3. Non-compliance with the provisions in the listing agreement 4. Absence of trading or negligible trading 5. Non-redressal of investors' complaints despite repeated reminders 6. Unfair trading practices on behalf of the promoters/management 7. Other malpractices such as fake or duplicate share certificates deliberately issued by the management 8. Whereabouts of the company /its promoters/directors not known 9. Significant reduction in the number of public holders of securities than required level.

An exchange may also delist a firm based on any other event that renders continued listing of a stock inappropriate. Stock exchanges impose such requirements because their reputations hinge on the quality of stocks traded on their floor. Fidanza, B. (2018) also discussed the more likely delisting of small firms, firms with poor ex-ante performance, and young firms. Chaiyawat, T. and Samranruen, P. (2016) suggest that there are many ratios representing risks, statistically affecting delisting. Risks that are likely to affect firm delisting are liquidity risk, operating efficiency risk, profitability risk, leverage risk, credit risk, and financial insolvency risk.

Khort, J. (2014) mentions about evidence which suggests that agency cost and insiders' interests play into the decision to go private, and for some firms, cost-saving is not the only reason to consider. For minority investors, once the stocks are no longer publicly traded, the shares become worthless. Many investors argued that this rule is detrimental to shareholders since it is too easy for companies to withhold financial information.

## 2. LITERATURE REVIEW

Delisting has drawn significant attention because of its negative impact directly or indirectly on the shareholders, firms, employees, and other stakeholders. O'Donnell (1969) and Jarrell (1984) found a decline of 9% on an average in the market value of the delisted stock, mentioned in the paper by Edelman and Baker (1989). This is the case for both voluntary or involuntary delisting. The causes of voluntary delisting were the firm's financial distress or the firm being merged or acquired. One of the crucial factors associated with financial distress was a corporate governance issue. Sanger and Peterson (1990), analyse common stock delisting, and describe the study of price movements around the period of delisting. They find that that equity value declines by 8.5 percent on the day of announcement if there is a prior announcement of delisting else; a similar adjustment happens over a subsequent non-trading interval.

The literature on delisted lists four hypotheses explain the decline in value: liquidity hypothesis, management signalling hypothesis, exchange certification hypothesis, and downward sloping demand curve hypothesis. All the four hypothesis predict a decline in stock returns due to delisting. The liquidity hypothesis considers the assumption that liquidity has an important effect on financial assets' prices. Amihud and Mendelson(1986) (1988) assume exogenous trading frequencies and conclude that less liquid securities yield higher expected returns, which benefits investors with long trading horizons.

Though not the same as bankruptcy, delisting has a significant negative impact both for the shareholders and the firm. Among other things, Sanger and Peterson (1990) confirmed the average abnormal returns of -8.5% around delisting. Panchapagesan and Werner (2004) noted a 50% decline after delisting in the median share price along with a threefold increase in bid-ask spread and a two-thirds reduction in trading volumes.

Macey, O'Hara, and Pompillo (2005) estimated that the stocks' price reduces to half, volatility, and percentage bid-ask spread increases. Similarly, Harris, Panchapagesan, and Werner (2008) found that the spreads increases and the trading volumes decline with increased intraday volatility in delisting due to governance-related issues.

To summarize, voluntary and involuntary delisting events impose high costs on shareholders, making it an area for investigation, but there is scant literature and little empirical evidence of the same in both the developed markets and emerging markets like India. This paper analyses the impact of voluntary and involuntary delisting on the shareholder's wealth and looks at the wealth effects on shareholders of delisted stocks.

## 3. METHODOLOGY

The price effects of the delisting are measured using a standard event study methodology as described in Brown and Warner (1985). Consistent with Brown and Warner (1985) we rely on the market model to measure abnormal returns in the short run. First the parameters alpha and beta for the sample firm are estimated over the event period by running an OLS regression of the security returns on the reference portfolio using return data from the pre-event period (between  $\tau-31$  and  $\tau-230$  where  $\tau$  is the event date) as follows:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it} \quad (1)$$

$$E(\varepsilon_{it}) = 0 ; Var((\varepsilon_{it})) = \sigma_{\varepsilon_i}^2$$

where  $R_{it}$  and  $R_{mt}$  are the period  $t$  return on security  $i$  and the market portfolio  $m$  respectively.  $\alpha_i$  and  $\beta_i$  are the parameters of market model. NSE CNX S&P 500 index has been used as the benchmark market portfolio return to control for the broad market movements while measuring price effects. Also, the market model assumes the error term to be a white noise.

For estimating the market model, we use a 200-day estimation window starting from  $t = -230$  to  $t = -31$ . In order to investigate if delisting generate any abnormal returns for a stock on

each day  $t$  in the event period, the actual returns in the event window are compared with the market model predicted returns of that stock in the event window. The excess return for each stock is found by subtracting the benchmark return from the market model computed returns. Therefore, it is computed as:

$$AR_{it} = R_{it} - (\hat{\alpha}_i + \hat{\beta}_i R_{mt}) \tag{2}$$

In the above equation  $\hat{\alpha}_i$  and  $\hat{\beta}_i$  are ordinary least squares estimates from the estimation period using the market model.  $R_{it}$  and  $R_{mt}$  are the returns (ex post returns) of the security  $i$  and the market portfolio  $m$  respectively for period  $t$  in the event window. In order to make statistical inferences average abnormal returns (AAR) and cumulative average abnormal returns (CAAR) are calculated as follows.

$$AAR_t = \frac{1}{N} \sum_{i=1}^N AR_{it} \tag{3}$$

where  $N$  is the number of stocks whose abnormal returns are available on day  $t$  in the event window. By cumulating the periodic average abnormal return over a particular time interval ( $t$  period around the event date), we obtain the cumulative average abnormal returns (CAAR):

$$CAAR_k = \sum_{t=1}^k AAR_t \tag{4}$$

where  $k$  is the number of days we want to cumulate over the event window. It is important to examine whether the average cumulative abnormal returns are statistically different from zero. The standard cross-sectional  $t$ -test assumes there is no cross-sectional dependence in abnormal returns but allows for event induced variance changes.

#### 4. RESULTS

**Table 1** Average abnormal returns of the Delisted Shares 30 days prior to listing

Rel day	N	AAR	T-Stat		Rel day	N	AAR	T-Stat
(-30,-30)	127	0.03%	0.04		(-15,-15)	127	0.79%	1.18
(-29,-29)	127	-1.28%	-1.53		(-14,-14)	127	-0.57%	-0.81
(-28,-28)	127	-0.71%	-0.74		(-13,-13)	127	-0.27%	-0.30
(-27,-27)	127	-1.37%	-1.36		(-12,-12)	127	0.07%	0.07
(-26,-26)	127	-0.86%	-0.94		(-11,-11)	127	-0.71%	-0.92
(-25,-25)	127	0.67%	0.72		(-10,-10)	127	0.52%	0.59
(-24,-24)	127	0.28%	0.33		(-9,-9)	127	-0.59%	-1.11
(-23,-23)	127	0.02%	0.03		(-8,-8)	127	-0.23%	-0.35
(-22,-22)	127	1.28%	1.45		(-7,-7)	127	-0.54%	-0.63
(-21,-21)	127	-0.38%	-0.63		(-6,-6)	127	0.38%	0.50
(-20,-20)	127	-0.79%	-0.88		(-5,-5)	127	-0.89%	-1.15
(-19,-19)	127	0.79%	1.45		(-4,-4)	127	-1.17%	-1.94
(-18,-18)	127	-1.22%	-0.99		(-3,-3)	127	-1.55%	-2.11
(-17,-17)	127	-0.46%	-0.47		(-2,-2)	127	-1.43%	-1.86
(-16,-16)	127	-1.58%	-2.58		(-1,-1)	127	-2.08%	-2.25

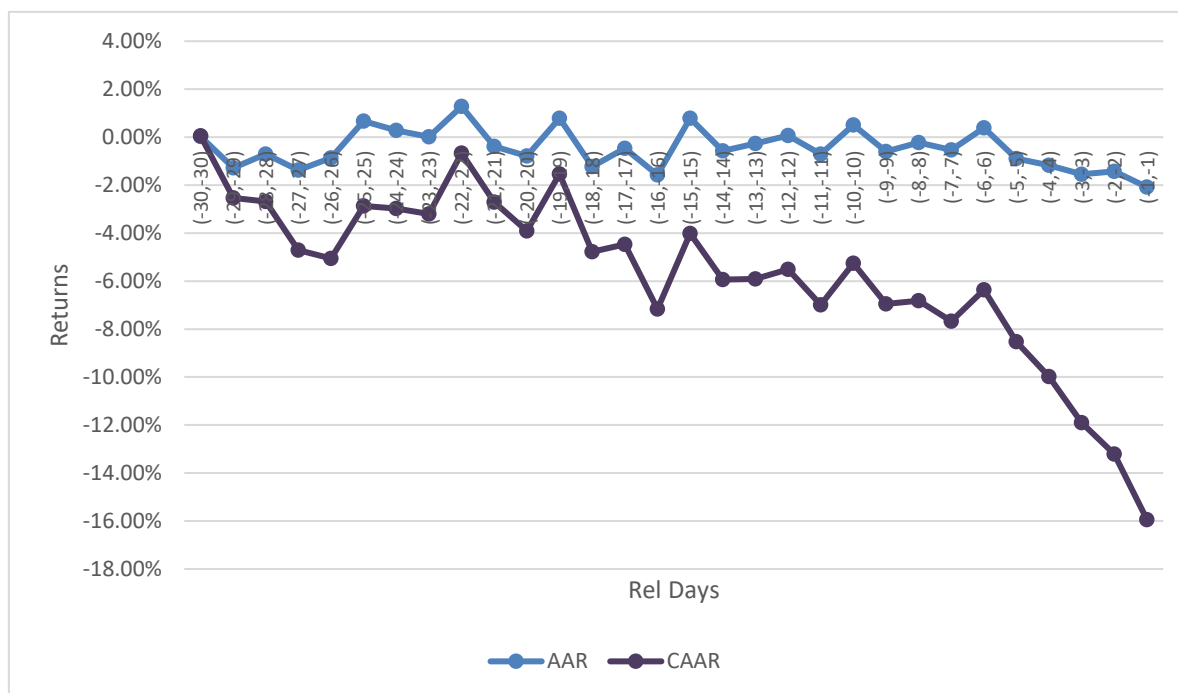
*Note: The table presents the 30 days data of average abnormal returns(AAR) of the stocks being delisted. N is the number of observations, T-stat is the t-statistics for the significance of returns and Rel days represents the days before the actual delisting day.*

Table 1 presents the average abnormal returns (AAR) prior to delisting starting from day – 30 to Day –1 and Figure 1 plots the average abnormal returns and cumulative average abnormal returns (CAAR) starting 30 days before delisting. Table 2 presents the Cumulative average abnormal returns on different windows and we find that the CAAR’s for all the windows are negative and statistically significant at 1% level. Overall shareholders wealth reduced by 13.68 % in 30 days prior to delisting and by 7.58 over the CAAR window of (-10,-1). Our results are consistent with studies in the developed markets like O'Donnell (1969) and Jarrell (1984), Sanger and Peterson (1990). Raza, Hussin and Majid (2019) also mention the poor financial performance in relevance with firms' delisting from the Bursa Malaysia. The finding complied with India's study that delisting companies show a negative return and minority shareholders incur significant loss of wealth due to delisting.

**Table 2** Cumulative average abnormal returns of delisted shares prior to delisting

Rel Day	N	CAAR	T-Stat
(-30, -1)	127	-13.86%	-2.99
(-20, -1)	127	-11.53%	-3.42
(-10, -1)	127	-7.58%	-3.34
(-5, -1)	127	-7.12%	-4.12
(-4, -1)	127	-6.23%	-4.04
(-1, 1)	127	-2.08%	-2.25

*Note: The table presents the cumulative average abnormal returns data for 30 days before the delisting of the share. N is the number of observations, T-stat is the t-statistics for the significance of returns and Rel days represents the days before the actual delisting day.*



**Figure 1** Average Abnormal Returns and Cumulative Average Abnormal Returns of Delisting of Shares

*Note: The plot shows the average abnormal returns(AAR) and cumulative average abnormal returns(CAAR) plotted against the relative days to listing(Rel Days). The data is plotted for 30 days before delisting and is represented as (-30,-30) till one day before the delisting date represented as (-1,-1). The plot shows the abnormal returns of the stock prior to being delisted. The CAAR show decline as it approaches the day of delisting.*

## 5. DISCUSSION

This study looks at the delisting of both voluntary and involuntary shares listed in the National Stock Exchange of India. Using an event study methodology we find significant reduction in shareholders wealth due to delisting of shares. Our results support the findings of O'Donnell (1969) , Jarrell (1984) and Panchapagesan and Werner (2004).

The study looks at both voluntary and involuntary delisting of stocks in the National Stock Exchange of India. However, due to limited sample size we could not analyse it separately. Analysing delisting separately for both voluntary and involuntary listing would have provided more insights and offer more meaningful answers. However, future research could extend our study which could help in fine tuning the regulations and policy making. Our research would provide directions for regulators like the Securities and Exchange Board of India(SEBI) and the exchanges like National Stock Exchange of India to frame delisting regulations such that minority shareholders interest are protected

## 6. CONCLUSION

There are no significant benefits to investors from delisting of stock from the exchange, and the companies also do not have any incentives to delist a share. The regulators provide the reason for delisting shares in the compulsory listing, but the involuntary listing could be either because of a merger or non-performance. As per Sethuram(2019), so long as 90% of shareholders agree to a fair acquisition price, the delisting can still be successful. The Securities and Exchange Board of India (SEBI)(Delisting of Equity Shares) (Second Amendment) Regulations, 2018 ("Amendment Regulations") attempts to ensure that market speculations do not inflate the floor price. Small groups of shareholders can no longer defeat the offers for delisting with vested interests by quoting exorbitant prices in the reverse book building process.

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