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Anything wrong with breaking a buck? An empirical evaluation of NASDAQ's \$1 minimum bid price maintenance criterion ☆

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Abstract

This paper empirically evaluates the effects of NASDAQ's \$1 minimum bid price threshold (known as the *one-dollar rule*) as part of its listing maintenance criteria. Even though this controversial rule was introduced as early as September 1991, its economic impact has been largely unexplored by academics. This study suggests that implementation of the one-dollar rule is justified for the following reasons: (1) NASDAQ stocks frequently trading below \$1 during the pre-rule period are extremely vulnerable to catastrophic losses; (2) a dramatic decline in extreme loss probability is observed among low-priced (relative to \$1) stocks after the rule was introduced; and (3) the \$1 benchmark serves as an appropriate cutoff point in screening stocks listed on the exchange.

JEL classification: G10; G14; G18

Keywords: Exchange listing standards; Low-priced stocks; Extreme tail risk; NASDAQ

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1. Introduction

Major stock exchanges are exclusive ''clubs,'' each with its own listing maintenance criteria. The reputation and viability of an exchange depend on the companies it lists. Listing requirements have evolved throughout the history of stock exchanges. In the past two decades, one particular practice is setting an arbitrary minimum trading price for listed companies. Major exchanges in the United States have adopted minimum price rules. The NYSE has a $1 average closing price criterion in its continued listing standards.[1] The NASDAQ Stock Market (NASDAQ hereafter) requires a listed company's shares to close above $1 (bid price) at least once over a consecutive 30-business-day period, which is known as the minimum bid price rule (or the *one-dollar rule*). A grace period is allowed for listed issuers breaking the one-dollar rule to provide a buffer of time within which to catch up, but the stock is delisted if higher-than-$1 bids cannot be restored during the grace period. This rule applies to all three NASDAQ component markets: the Global Select Market, the Global Market, and the Capital Market. Appendix A summarizes the maintenance requirements for listed companies on these markets.[2] On the NASDAQ, security delistings due to non-compliance with the minimum bid price criterion account for almost 42% of all regulatory delistings.[3] This makes the one-dollar rule the most critical requirement among all maintenance standards. In contrast to these two U.S. exchanges, most equity markets outside the U.S. do not institute a minimum price criterion for maintaining listing.[4]

An extreme non-U.S. case happened in Hong Kong on July 25, 2002, when the Hong Kong Exchanges and Clearing Limited (HKEx) released a consultation paper that proposed the delisting of penny stocks from the Main Board if the moving average of daily volume-weighted share price was less than HK$0.5 (about US$0.065) over 30 consecutive trading days.[5] The following day, market capitalization of penny stocks collapsed by approximately HK$10.91 billion (about US$1.4 billion), with daily price dropping by as much as 88%. This forced the HKEx to withdraw the proposal two days later. On November 12, 2002, HKEx reversed its position on the minimum price criterion by announcing that it ''would like the views of a wider audience on whether there should be any minimum (price) standards for continuing listing.''[6]

[1]NYSE Listed Company Manual, Section 802.01C, from www.nyse.com. Refer to Appendix B for details.

[2]The minimum price criterion is more common in the *initial* listing standards of U.S. exchanges such as the NYSE, the NASDAQ, the former American Stock Exchange (currently known as the NYSE Amex), the former Boston Stock Exchange (currently known as the NASDAQ OMX BX), the former Philadelphia Stock Exchange (currently known as the NASDAQ OMX PHLX), and the NYSE Arca (which also has a $1 minimum price rule in its continued listing standards).

[3]These statistics are compiled during the period from September 1, 1991 to December 31, 2009. Refer to Panel A of Table 2 for details.

[4]Only two Asian exchanges in Korea and Indonesia have a minimum price requirement in their continued listing standards. The Neuer Markt in Germany also had a similar rule before its closing in 2003.

[5]Hong Kong Exchanges and Clearing Limited, 2002, ''Consultation paper on proposed amendments to the listing rules relating to initial listing and continuing listing eligibility and cancellation of listing procedures,'' from www.hkex.com.hk/news/hkexnews/020725news.htm.

[6]Hong Kong Exchanges and Clearing Limited, 2002, ''HKEx today released its revised consultation paper on Continuing Listing Criteria and Related Issues,'' from www.hkex.com.hk/news/hkexnews/021115news.htm.