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# Prague Stock Exchange (1993-1997)

| Vladislav Pavlát

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**PRAGUE STOCK EXCHANGE  
(1993–1997)**

Vysoká škola finanční a správní, a.s.

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## Preface

*Motto:*

*To all who still have not lost*

*Courage to learn the Past*

*To be able to change the Future*

I started to write this book about a not too distant past events related to the Stock Exchange as of a new symbol of the emerging Czech capital market. One of my friends surprised me, as he asked me a very strange question: “Do you really think that your excursion to the past will be of some interest to people? They don’t care whether it was all correct or incorrect, good or bad!” At first I was very surprised and I owe him my answer until today. He might be willing to read my book where he can find not only the answer to this question, but much more.

However, the main reason why I wrote my book is my strive to contribute to a true, objective and independent analysis of one partial economic and financial task which was necessary to solve as a part of the Czech period of transition in the nineties of the last century.

In writing this monograph, the author has done his best to base it on Objectively existing documents and not to surpass the boundary of objectivity necessary for scientific research. It was very seducing to refer to the author’s personal experience as well, but the author decided not to do so. Every historical event has its roots in motives and behavior of actors involved in it, and they are responsible for their actions. When artificial taboos are invented, it is researchers’ duty to analyze the facts and to prove their true meaning.

At the same time, it would not be wise not to disclose the ideological base of historical events, as political and economic decisions often are not based so much on scientific theories than on ideologically based fictions. This applies to the period of transition to the market economy in the Czech Republic as well. Based on correct and verified data, it is researchers right and to disclose and to present a reasonable explanation of events, be it pleasant or unpleasant for anybody. There is, of course, the question of limits of objectivity in play, as every researcher is limited by his own education, experience etc. as well, but by this well-known fact the right to present his explanation (based on verified data), should not be denied to him.

This book does not present an all-embracing, comprehensive view of the Czech capital market and its creation. Its main goal is to highlight the important role played by the Prague Stock Exchange in the whole process of transition with all ups and downs, positive and negative effects. The author attempted to concentrate as much information as it has been possible to squeeze in some 200 pages to illustrate manifold aspects of the PSE impact on the growth of financial sector and Czech Capital Market development, and to present selected partial analyses. The authors’ goal was to point out the potential orientation of future research as well.

The book follows two parallel lines: first, the line of the PSE focusing on historical events, and secondly, the line of the PSE focusing on selected topics. Last, but not least, let me sincerely thank to all who have helped me to finalize this monograph.

Prague, May 14, 2018.

*Vladislav Pavlát*

# 1

## Introduction

*1.1 Concept of monograph, its purpose, and contents*

*1.2 Sources*

*1.3 Methodology*

The elaboration of the concept, sources, and methodology in this introductory Chapter 1 was prepared according to the Czech regulatory requirements valid for specialized monographs.

### **1.1 Concept of monograph, its purpose, and contents**

The period of 1993–1997 was a decisive time for creation of the Czech financial sector with its markets and infrastructure. Within this period, the Prague Stock Exchange was founded and securities' trading started. This period is important due to two main reasons: firstly, all barriers that prevented the establishment of the PSE were eliminated, and securities' trading has been started; secondly, it has been recognized very soon that the emerging Czech capital market will have to be – as soon as possible – reformed and regulated according to international standards.

The purpose of this monograph is to describe the main events of the given period and – with a distance of two decades – to analyze the positive and negative sides of PSE activities “*sine ira et studio*”.

*The subject matter of the analysis*

The object of analysis is divided into the following three parts: 1. Trading of shares, parameters of the trading system, trading rules and supervision of trading. 2. The behavior of PSE members (a comparison of banks and other members behavior included), the activities of Ministry of Finance (MF) as a supervisor and regulator, and mutual relations between both institutions. 3. The PSE international position (in comparison with comparable Stock Exchanges in Central European countries), and its development.

The analysis is based on public sources and on selected unpublished sources from the author's private archive. The author used to be one of the Prague Stock Exchange Chamber members and Chairman of the Committee for trading.



## Block 1

### **Prague Stock Exchange (PSE) and its role in the emerging Czech capital market**

The PSE Founding Contract was signed by 12 Czechoslovak banks and 5 securities' traders on July, 17 1992. On April 6, 1993, securities' trading was started. Securities only of 7 companies were traded. However, in 1993 and in 1995, up to 2000 issues of privatized companies' shares originated by coupon privatization were traded.

Until November 1993, there was only one trading session weekly. Since November 1993, there were 2 sessions weekly and since March 1994, 5 sessions were organized. The trade volume has been growing.

The PSE was interested in the liquidity growth, therefore several markets were formed and low-quality shares were removed from the market. In 1994 the PSE became a dominant „market organizer“; RM-S and SCP market share was falling.

Source: Burza. <http://www.miras.cz/akcie/burza-praha-historie.php> 7.8.2017; author's archive

### *Contents*

The Czech Research Authority published the definition of a monograph. All research works titled as “monograph” have to correspond to the valid regulation issued by the above Authority.

The demands are strict; a minimum and maximum number of pages, the authorship definition, application of standard research methods', academic research ethics etc.

The readers interested in reading this book (may be) will be disappointed by the authors' style; the author was obliged to write according to the standard rules which was – in many cases – rather boring for him, because the described, analyzed and explained facts about the transition period from “socialist” to “capitalist” economic structure may resemble criminal stories. The academic neutral and “correct” language is very different from the dramatic “storytelling” style.

The choice of monograph contents was highly dependent on available sources and their quality which had a serious impact on the level of selected questions' description, analysis and solutions. Legislative questions were not included into the analysis. The PSE environment *per se* represents an external (exogenous) factor; this is why character of the transition period in the Czech Republic with its perception of ethics, corruption, and similar questions was not directly included into the research focus. These questions are dealt through the PSE lenses.

The scope of the monograph corresponds to given technical and editorial limits of our University.

The book has 14 parts: 13 chapters (Introduction included) and Conclusion. Every chapter has a different number of sub-chapters. Three-digit numbering of sub-chapters is used only by exception. As usual, at the beginning of every chapter, its role in the structure of the monograph is explained. At the end of selected chapters, there is a short summary or a comment.

Every chapter has a distinct place in the structure of the book.

Without any basic information on political, social, and economic events in the former Czechoslovakia and in the Czech Republic in the given period of 1993–1997 it would be rather

difficult to understand the development of PSE and the Czech capital market. This is why Chapters 1 and 2 were included. Chapter 3 deals with the events that have preceded the setting up the PSE during the years 1990–1992.

In the next three chapters (Chapters 4, 5 and 6) the first two years of the PSE trading are described in more detail. For PSE these years were vitally important: it was a fight for its existence. PSE survived and proved that – in spite of many barriers – it succeeded in concentrating the bulk of trading. The events described and analyzed in this part of the monograph refer to the first development phase of the Czech capital market.

The following four chapters contain the description and analysis of PSE activities and its role in important areas: the PSE role on the field of privatization funds (Chapter 7), PSE governance (Chapter 8), PSE role in professional education (Chapter 9) and PSE relations with the Press (Chapter 10). This part of the monograph is based on original sources and original approaches. The above analyses deal mainly with the second phase of the Czech capital market.

Chapter 11 describes and analyzes available sources; as far as it is known, it is a first basic attempt to analyze the relations between the PSE and the Czech Press.

Chapter 12 deals with different aspects of the reform ideas in the years 1995 and 1996.

The Chapter 13 (which is the last chapter of the monograph) tries to identify the positive and negative aspects of the PSE existence, its policy, and role in the given period of the Czech Republic transition period. It is an attempt to explain whether and to extent the PSE contributed to the economic development of the Czech Republic and to the financial sector and financial market growth in the given period. Conclusion highlights the partial findings

## **1.2 Sources**

The author had a difficult task: to select – from a very large number – the most reliable and most important sources.

It is useful to categorize these sources according to the following list:

1. *The PSE official documents* (legal, international agreements, internal, memos etc.)
2. *Czech legislation related to the PSE* (valid during the researched period)
3. *Publications issued by the PSE* (mimeographed, printed)
4. *Official statistics* (CR, EU, international)
5. *Academic and professional literature* (books, articles) related to the analysis of the PSE activities
6. *Periodicals* (Czech and foreign)
7. *Daily press* (Czech and international)
8. *Other* (selected documents, inquiries, interviews)

All items are cited in the text and in References as well; selected items are cited in the Annexes.

## **Ad 1. PSE official documents**

### **1.2.1 Czech documents**

- The PSE Memorandum of Association (“zakladatelská smlouva”)
- The PSE documents deposited in the Commercial Register of the Prague Municipal Court

### **1.2.2 PSE International agreements**

Memorandum of Understanding, LSE 1991

Memorandum of Understanding with the Berlin Stock Exchange (1991)

Protocole d'accord – Projet d'installation de la Bourse de Prague (1992)

Protocole Financier – signed on February 10, 1992

Contract with SBF – signed on July, 9, 1992

### **1.2.3 Foreign consultants', consulting companies and Stock Exchanges' recommendations**

Paris Bourse selected documents

Lybrand Deloitte selected documents

## **Ad 2. Czech legislation related to the PSE**

PSE Rules and Regulations (issued during the analyzed period, i.e. 1992–1997).

## **Ad 3. Publications published by the PSE**

### **a) THE PRAGUE STOCK EXCHANGE ANNUAL REPORTS:**

THE PRAGUE STOCK EXCHANGE ANNUAL REPORT 1993

<http://ftp.pse.cz/info.bas/eng/ar93-en-pse.pdf>

THE PRAGUE STOCK EXCHANGE ANNUAL REPORT 1994.

<http://ftp.pse.cz/info.bas/eng/ar94-en-pse.pdf>

THE PRAGUE STOCK EXCHANGE ANNUAL REPORT 1995

<http://ftp.pse.cz/info.bas/eng/ar95-en-pse.pdf>

THE PRAGUE STOCK EXCHANGE ANNUAL REPORT 1996

<http://ftp.pse.cz/info.bas/eng/ar96-en-pse.pdf>

THE PRAGUE STOCK EXCHANGE ANNUAL REPORT 1997

<http://ftp.pse.cz/info.bas/eng/ar97-en-pse.pdf>

### **b) BURZA (Stock Exchange), vol. 1994, 1995, 1996:**

Burza. Edited by PSE. Registration Number of Ministry of Culture: MK 6785. ISSN 1210 – 7808. Chief Editor: Štefan Babiak. Published daily (Tuesday–Friday); 8 pages, format A4.

### **c) ROČENKA BCPP, A. S./FACT BOOK PSE, vol. 1995, 1996, 1997:**

- Ročenka/Fact Book 1995. Burza cenných papírů Praha, a.s., Prague Stock Exchange. Praha, 1996. 60 pp. Sine ISIN.

- Ročenka/Fact Book 1996. Burza cenných papírů Praha, a.s., Prague Stock Exchange. Praha, 1996. 60 pp. Sine ISIN.

- Ročenka/Fact Book 1997. Burza cenných papírů Praha, a.s., Prague Stock Exchange. Praha, 1996. 60 pp. Sine ISIN.

**d) PSE Monitor (Věstník. Burza cenných papírů Praha, a. s.) Vol. 1994, 1995, 1996, 1997:** Official PSE Monitor issued by PSE Secretary General on behalf of the Stock Exchange Chamber.

Internal printed bulletin for use of PSE members; since January 1994, published occasionally several times per month in Czech language. (Each issue: 12 pages minimum.)

Contents: 1. Information on activities of the Stock Exchange Chamber;  
2. Information on activities of the three Stock Exchange Committees;  
3. Information on PSE activities;  
4. Information on activities of the Stock Exchange Registry.

**e) Information from periodical press, 1994** (Informace z periodického tisku). Internal PSE bulletin in Czech language for use of selected persons; mimeographed. Contents: copies of selected articles from Czech press.

**f) SE Chamber Memos** (Zápisy ze zasedání Burzovní komory, 1993–1997).

**g) Trading Committee Memos** (Zápisy ze zasedání výboru pro burzovní obchody BCCP, 1993–1996).

#### **Ad 4. Official Statistics** (CR, EU, international)

Czech Statistical Office. Statistical Yearbook of the Czech Republic – 2016.  
Statistical Yearbook of the Czech Republic.

<https://www.czso.cz/csu/czso/statistical-yearbook-of-the-czech-republic-2016>

#### **Ad 5. Academic and professional literature**

(See the list of References)

#### **Ad 6. Periodicals (Czech and foreign)**

Selected items from Czech and foreign periodicals.

##### **a) Czech periodicals:**

- ABK (Akcie, Burza, Kapitál), Vol.1993, 1994, 1995, 1996.
- ABK. The Capital Market in the Czech Republic, vol. 1994, 1995.
- Burzovní analýzy (Stock Exchange Analyses), vol. 1994.
- Selected articles published by Ekonom, Profit, Respekt and Reflex.

##### **b) Foreign periodicals:**

- Banque Stratégie (selected articles).

#### **Ad 7. Daily press**

Selected articles from Czech and foreign press.

##### *a) Czech press:*

České noviny; Hospodářské noviny; Lidové noviny; Mladá fronta dnes, Právo, Český deník, Burzovní noviny, Zemědělské noviny.

##### *b) Foreign press:*

- Financial Times (selected articles).

**Ad 8. Other** (selected documents, inquiries, interviews etc.)

- Selected documents of FESE.
- Selected documents of the IPRFT and CMI Ltd. Companies.

## **1.3 Methodology**

This sub-chapter reflects the differences between the research methodology and the research interpretation methodology.

### **1.3.1 Research methodology**

Research methodology presented in this paragraph corresponds to the purpose of the monograph defined above (sub 1.1). The selection of sources (in 1.2) corresponds to the monograph purpose as well. Some of the cited sources, especially statistical data of 1993, represent non-public sources. However, they are cited from the PSE publications (see above 1.2) and/or from the author's private archive.

The Exchange Chamber or Trading Committee' minutes (1993) are incomplete (See: Evaluation, Chapter 9); the analysis includes only selected minutes.

The original disposable sources have been analyzed and classified according to the following criteria: 1. Credibility of information (a. original, b. copies); 2. Information completeness (a. complete, b. incomplete); 3. Information compatibility of analogous or similar information from different PSE sources (a. information match, b. no match); it has been found that Statistical Yearbooks for 1993 and 1994 could not have been published *ex post* in Yearbooks for the following three years (1995, 1995, 1995) because of a low compatibility. 4. Information publishing capability (a. open public information, b. partially modified – anonymous information, c. excluded from publication).

As a next step, suitable calculations were prepared (for example, see Chapter 8) for better understanding of presented findings.

The following thesis was formulated as a basic research hypothesis: *“during the period of 1992–1997, the PSE activities showed an upward trend, and the implemented measures' impact on the PSE results was positive”* (except for situations when the PSE could not surpass the barriers given by the legislation).

Comparative (verbal) analysis of selective legal regulations and measures taken by the PSE (inclusive sanctions against the PSE members) has been applied for a basic verification of the performed analysis results.

The analyses' results and the hypotheses' verification are discussed in the Chapter 13.

A microeconomic analysis was not included into the monograph. Economic results were not analyzed because of incomplete information/data and/or a lack of necessary data. The monograph does not contain an analysis of legal documents; they are used only for illustration of the legal *status quo*.

### **1.3.2 Research interpretation methodology**

Research interpretation methodology, firstly, is based on the assumption that the interpretation of the published findings has to correspond to the monograph's purpose; secondly, the interpretation should be understandable and comprehensible so that the analysis' results could be interpreted in a clear and unequivocal way; thirdly, the interpretation has to go from simple one to a more complex interpretation.

There is an assumption that the majority of potential foreign readers of this monograph (except for capital markets professionals) are not fully acquainted with the political and economic development of the former Czechoslovakia and actual economic and political events in the Czech Republic in the nineties. Therefore, the first chapters present a survey of important events. After the introductory part of monograph, chapters analyzing special questions of the Czech capital market follow. Chapter 13 summarizes the PSE pros and cons and explains the main results of partial analyses.

# 2

## **A brief survey of political and economic development in the Czech Republic (1993–1997)**

- 2.1 The first government of the Czech Republic*
- 2.2 Ideological dispute over the character of economic transformation*
- 2.3 A note on the coupon privatization*
- 2.4 Reorientation of the Czech economy from East to the West*
- 2.5 Czech legislative election in 1996*
- 2.6 Attempts to save the rule of coalition*

For a better understanding of the political and economic development in the Czech Republic in the period of 1993–1997, it is useful to mention that the results of the preceding two – three years decided about the basic line of this development.

On December 19, 1989 the new Czechoslovak government – called the “Government of national mutual understanding” – published a government declaration, formulating the main directions of the next political, and economic development of Czechoslovakia.

The government had to fulfill three main and very difficult tasks: First, to maintain a macro-economic relative stability as a precondition for preventing economic chaos. Second, liberalization of prices was a precondition for economic transformation of the “socialist planned economy” into a standard market economy. Third, privatization of the state ownership and restitution of the property expropriated after the year 1948.

The idea of privatization was declared (for the first time) in a memorandum of Czechoslovak government on April 6, 1990.

In July 1990, Federal Assembly on its 2nd and 4th common meeting which was held for three days (July 3, 4 and 5) the Program declaration of governments of the Czecho-Slovak Federative Republic was approved and a resolution (No. 31) was adopted.

The Program declaration explicitly enumerated the main groups of problems: a definition of ownership; privatization; de-monopolization; budget rules; transition to a new system of taxation; price liberalization and its inflationary impact; social impact of the economic reform and the role of the National Property Fund.

### **2.1 The first government of the Czech Republic**

After the split of Czechoslovakia into two independent separate states – the Czech Republic and the Slovak Republic – ruled the government headed by *Václav Klaus*, elected in the 1992 elections for a four-year term.

At midnight from December 31, 1992, the common Czech and Slovak Federative Republic ceased to exist. The Constitution of the *Czech Republic* (in Czech: *Ústava České republiky*) was adopted by the Czech National Council 16 December 1992. It entered into force on 1 January 1993.

This government ruled from July 2, 1992 to July 4, 1996. It was formed by the ODS, KDS, KDU-CSL and ODA coalition. The prime minister was Václav Klaus.

The result was a victory for the [Civic Democratic Party-Christian Democratic Party](#) alliance, which won 76 of the 200 seats. The voter turnout was 85.0%.

Klaus and his ODS were the big winners of the post-forum elections in 1992. In the vote for the Czech National Council, the body which would become the all-important Lower House of Parliament in the nascent Czech Republic, the ODS gained 29.7% of the votes, in the coalition with the Christian Democratic Party (KDS), with which it later merged. The Civic Democratic Party held a dominant position in government. Klaus's government continued in the baseline since 1989.

“For much of the time when Klaus was in office, most of the Czech media followed his line slavishly. There was little unencumbered public debate. The Czech public was happy to have what they saw as a strong, competent and confident leader, who would solve all their problems for them and lead them into Paradise”. (Stroehlein et al., 1999.)

In the economic sphere, the Klaus government's activity was determined by the so-called “Great Privatization Act” (January 1, 1991) and by a number of other laws approved by the first Czechoslovak government.

*Inter alia*, it was the Act No. 91/1991 Coll., the Act No. 513/1991 Coll., the Act No. 328/1991 Coll., the Act No. 563/1991 Coll., the Act No. 21/1992 Coll., the Act No. 124/1992 Coll., the Act No. 286/1992 Coll.

In the Program Statement of the Government of the Czech Republic of July 13, 1992, which fully followed the decision of the first governments on economic reform, this was stated:

*„The basic goals of the Czech government's work include the successful completion of the transformation of our economy into a world-proven standard market economy...”* (FS ČSFR, 1992).

## **2.2 Ideological dispute over the character of economic transformation**

The characteristics of political and economic development in the Czech Republic in 1993–1997/8 are important for understanding the nature of the dispute between supporters of non-standard procedures for building the foundations of the capital market with those who wanted to build this market in such a way as to be credible to all its participants, investors.



In fact, however, some laws adopted after 1990, which diverged in many ways from the generally accepted international principles of the functioning of the capital market, stood in the way.

Discussion about the strategy, methods, and forms of privatization was very heated. It took almost one year, before it was feasible (in January 1991) to vote the so-called law on transformation (Act No. 92/1991 Coll.). Discussion about privatization was almost endless – it continued for a couple of years. The most important objections against the very idea of privatization raised the “fundamentalist followers” of the other idea, i.e. the so-called restitution, which was supported from western countries where many of those people spent years as emigrants. At the same time, socialist economists from almost all post-socialist countries raised objections against the so-called Coupon Privatization. As for Czechoslovakia, two different scenarios of privatization existed. The first scenario prepared the Czechoslovak Economic Council (headed by *František Vlasák*) in the period of March 3 and April 2, 1990. This scenario proposed to divide the process of transition into two stages: the stage one would consist in a total change of structure of the big Czechoslovak state-owned enterprises; only after the implementation of the first stage, stage two, i. e. a standard privatization, should be started. The second scenario was prepared by the Federal Ministry of Finance (headed by *Václav Klaus*) and announced on April 20, 1990. According to this second scenario, the strategy of the Czechoslovak economic reform also consisted of two stages, but in a reverse way: the first step should consist in privatization, and the second step would be the re-organization.

The difference between the two scenarios was very deep: the first scenario was much time-consuming than the second one. Nevertheless, the second scenario was more attractive, as it proposed to give the new owners of the privatized enterprises more freedom to re-organize these enterprises in the sense of the free market economy. In addition to this, as a new and very attractive privatization method, the so-called coupon-privatization was proposed. The authorship of this method claimed two Czech economists – *Tomáš Ježek* and *Dušan Tříška*. The result of the discussion between followers of the two scenarios was a formal compromise. In fact, the followers of the coupon privatization were the real winners. (Mlčoch, Machonin, Sojka. *Ekonomické a společenské změny v české společnosti po r. 1989*, 2000; Fungáčová, Z. *Building a castle on sand: effects of mass privatization on capital market creation in transition economies*, 2005.)

### **2.3 A note on the coupon privatization**

Klaus's top priority after becoming Prime Minister was, to quickly privatize the public sector. Speed was so important that he was lukewarm to moral arguments favoring restitution of state property to its former owners. This would – allegedly – slow down the privatization process.

The main instrument for privatization was to be the voucher system.

At first, there was very little interest in this privatization scheme, and it looked like it would be a flop. Then, *Viktor Kožený* stepped into the picture.

Kožený founded the firm Harvard Capital and Consulting, an investment fund provider that promised a 1,000% return to those who would sign their vouchers over to the firm.

## **2.4 Reorientation of the Czech economy from East to the West**

After the collapse of the Communist régime in 1989, the Czech Republic had to re-orient its trade from the East to the West as soon as possible. In the eighties, the highly industrialized market economies accounted for around 15% of Czechoslovak foreign trade. By 1995, Western countries accounted for 60% of Czech exports. The role of exports significantly changed in the Czech economy: exports in 1994 amounted to 52.4% of Czech GDP. (Myant, M. et al. 1996, pp. 119–120; Vintrová 1998, pp. 294–5.)

This seemed to be a very good result, however, it was more than outweighed by the development of other important indicators. One of these indicators was the development of the Czech trade balance.

The Czech Republic began the decade with a positive trade balance. However, by 1994, the surplus changed into a deficit and has remained negative since then. While exports decreased from 1990 to 1995, imports increased. (Pavlík, P., 1998.)

The decrease of exports mainly caused a lack of financial means on the side of Czech export-oriented industries necessary for modernization.

In the period of 1990 to 1996, 7,1 billion US dollars were invested in the Czech Republic from outside sources. EU countries accounted for 69.1% of that total. Germany was the most important investor, accounting for 27% of all foreign direct investment. The other most important EU countries were the Netherlands (14.5%), France (7.8%), Austria (7.3%) and Belgium (3.9%).

On the one hand, from macroeconomic view, the inflow of foreign capital had a positive effect on the development of the Czech economy and demonstrated the positive trend of economic transformation. On the other hand, this “first-sight effect” was more than compensated by negative effects of coupon privatization.

The need of financial means on the side of the Czech privatized firms was partially satisfied by uncontrolled credits granted by banks without reasonable limits. The system was very “simple”: majority of the “new banks” (set up after 1990) borrowed money from the “old” big banks (exempt from privatization) under favorable terms (without satisfactory guarantee) to help to finance the privatization projects of the enterprises privatized in the second “wave of privatization”. In many cases, a great part of the money was embezzled either by management of the privatized enterprises, or by bank corrupt managers. This “model” – tacitly developed and tolerated by the leading political parties – caused a series of defaults of a number of new banks. Some of these banks (Kreditní banka, Agrobanka etc.) were saved by the Czech National Bank which helped them to borrow money from the still state owned 4 big banks (under the ČNB guarantee).

Another source of growing criticism was the situation on the capital market caused by lack of control. Ministry of Finance failed to punish a growing number of tress-passers for circumvention of capital market legislation, for direct thefts of shares etc. It was only the ODA Party that was trying to fight these “diseases”, and to prepare a significant reform. (See: Chapter 12.)

In 1995, the ČSSD’s popularity rose continually in the public opinion polls. At the beginning of the year, the ODS still led by 10%, but by July, that advantage shrunk to 4-5%. (Mitrofanov, A. *Za fasádou lidového domu*, 1998.)

The center-right coalition of ODS, ODA and KDU-CSL ruled until 1996 without any attempt to change its policy.

## **2.5 Czech legislative election in 1996**

Parliamentary elections were held in the Czech Republic on 31st May and 1st June 1996, the first after independence. The result was a victory for the Civic Democratic Party, which *won* 68 of the 200 seats. Voter turnout this time was 76.3%.

In the 1996 elections, however, the coalition failed by one seat to gain an absolute majority. The ODS received 68 seats; the ODA, 13 seats; the KDU-CSL, 18 seats: together only 99 of 200 seats. The Social Democrats under *Miloš Zeman* became the second largest party in Parliament. (Nohlen, D., Stöver, F., 2010.)

As four parties (ODS, ODA, KDU-CSL and ČSSD) refused to talk to Republicans and Communists about future coalitions, no clear center-right or center-left coalition was immediately based on the election results.

However, after difficult negotiations, a deal between ODS and ČSSD parties’ was struck: *Miloš Zeman* became the Chairman of Parliament, in return for agreeing not to vote against the installation of the *Václav Klaus* government.

Because of 1996 elections, the number of parties in Parliament fell from 12 to 6 parties. With the decrease in the number of parties, the political spectrum came close to the traditional Western system with class-based voting and political contention centered on economic policy.

This change corresponded to the social structure of the Czech population: the ODS and ODA were dependent on managers, the self-employed, technicians and “intellectuals”, while the Social Democrats received most of their votes from blue-collar workers. (Machonin, S. et al., 1996.)

The main political conflicts in society were over the economy, the role of the state in the economy and social inequality, i.e. “the conflict between redistribution and the market”. (Vlachová, 1997, p. 50.)

## 2.6 Attempts to save the rule of coalition

During the 1996, investment funds started to go bust. The scandal of the Harvard Capital and Consulting owned by *Viktor Kožený* started the series of investment funds bankruptcies.

In March 1997, over 75,000 shareholders lost investments totaling 79 million US dollars in two investment funds alone: Trend and CS Fondy. (The Economist, March 1997.)

Similar stories were to follow, and by April 1997, it was estimated that 750,000 Czechs, 7% of the population, had lost their investments in shadowy investment firms governed by inadequate legislation. (The Economist, April 1997.)

As late as on 16 April 1997, the Czech government approved minor changes of the Czech Republic state budget.

In the second half of April and throughout May 1997, the possibility of the Czech crown devaluation against Western currencies was under discussion. At the end of April Czech National Bank was forced to allow the Czech crown to float freely on the currency market. This resulted in 10% devaluation of the Czech crown.

The devaluation had an immediate effect on the political scene: in May 1997, calls for Klaus resignation appeared, and the government (under the pressure of ČSSD), and ODS Government reconstruction followed. (ODS). Education Minister *Ivan Pilip* replaced Finance Minister *Ivan Kočárník*; Ambassador to London, *Karel Kuehnl*, replaced Trade Industry Minister *Vladimír Dlouhý* (ODS).

In summer 1997, enormous floods devastated Moravia (a part of the Czech Republic). The total damage surpassed 60 billion Czech crowns, i.e. 1.76 billion US dollars, but other estimates were as high as three billion US dollars. By this natural disaster – which made the media very busy – political pressures and tension were partially put aside for a couple of weeks.

When in November 1997 a big financial scandal of ODS burst out, Christian Democratic Party left the coalition (On Friday, 28th November). On 9 December, President *Václav Havel* gave a speech to the Parliament and asked *Václav Klaus* to resign. However, on December 14, on the ODS Party Conference, Klaus (supported by regional ODS leaders) was re-elected an ODS leader. Klaus received 227 votes, and his rival *Jan Ruml* (ODS) only 72 votes.

After the government collapse at the end of 1997, President Havel nominated the Governor of the Czech National bank *Josef Tošovský* to form a new government.

On 2 January 1998, Havel officially nominated Tošovský's 17-member cabinet. The final cabinet included nine non-party members (two of which had left the ODA shortly after being nominated to the government), five from the Freedom Union US and three from KDU-CSL.

The election of the president took place on January 20. *Václav Havel* was re-elected during the first joint session of both houses in the second round of voting (by a majority of 1 vote).

Tošovský's government passed a confidence vote on January 28, but it was limited to last six months. Although Communists, Republicans and most of the ODS voted against him, Tošovský had enough support from the ODA, KDU-CSL, Freedom Union and Social Democrats.

In April 1998, the Lower House of Parliament approved the ratification of the country's entry into NATO. The entry into NATO definitely petrified the pro-western orientation of the Czech Republic.

During the 1998, the economic situation of the Czech Republic was deteriorating, and economy was on the verge of a collapse. (Stroehlein, A. 1999.)

The pre-election campaign was – in comparison to the preceding general election campaigns – heated and emotional.

This time, the Czech press played a negative role, as both corruption scandals (in which both ODS and ČSSD were involved).

In 1998 election, 74.03% of eligible voters turned out to vote, 2.4% less than in the 1996 elections.

After the June 1998 elections, only five parties remained in Parliament. This time, Zeman's ČSSD had won, but Klaus's ODS was not far behind. Neither party could rule alone. This situation was – after difficult negotiations – solved by the so called “opposition agreement”. This agreement enabled the survival of ODS and Václav Klaus. Majority of the Czech public was shocked by the term “opposition agreement” which had not been generally known by then.

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At this moment, we are closing the description of turbulent events in the period since 1993 to the June election 1998 that opened a new phase of political and economic development, leading the Czech Republic to the entry into the European Union in 2004.

# 3

## The Founding of the PSE

*3.1 The beginnings of beginnings*

*3.2 The Founding Contract*

*3.3 Tender offer 1991*

*3.4 Contract on putting the Exchange into operation*

*3.5 The Franco-Czech team and its activity*

*3.6 The rise of brokers' firms*

*3.7 Preparative Committee's transformation into a joint-stock company*

*3.8 The dissolution of the Association*

The process of setting up the PSE was not an easy one. Although the Czech government recognized a Stock Exchange as a necessary constituent of the emerging Czech capital market (CzCM), the founding of this important market institution was not considered to be a priority task. There was only one priority: the coupon privatization.

To be able to understand the difficult questions that arose after the PSE came to existence, it is necessary to reveal and comment on important events from the history of the PSE.

### 3.1 The beginnings of beginnings

The leading role in the task of setting up the PSE was primarily played by the Czechoslovak State Bank. Already in 1990, this institution (as an institution responsible for banking and the total emerging financial sector reconstruction), namely its Governor *Josef Tošovský*, initiated the creation of a so-called Preparatory Committee. Its exclusive role consisted in preparing the founding of the PSE. Later on, the Preparatory Committee became an Association. Several state owned banks (later transformed into stock companies (akciová společnost - a.s.) financed the Association. This fact was in many aspects crucial for the behavior of the interested banks during the process of setting up the PSE and for the dominance of the banks on the Czech capital market.

NOTE: For a detailed survey and evaluation of the first actions and attempts of setting up the Prague Stock Exchange, see: Pavlát, V., 2016.

In the first half of the year 1992, the activity of the Association was concentrated on the tender offer and technical problems connected with it, further on agenda of companies interested to become the Association's members, and finally, on the agenda of transforming the existing Association into a joint-stock company The Prague Stock Exchange (Burza cenných papírů Praha, a.s.).

In the second half of 1992, after having closed the tender offer, the final preparative works connected with trading system and other tasks, went on. The start of the Stock Exchange was expected in the first months of 1993.

Unfortunately, the Stock Exchange Act still was not approved, and nobody knew, what the final version of this Act would look like. This was the reason, why the transformation of the Association “Preparative Committee” into the joint-stock company Prague Stock Exchange, was postponed until the last quarter of 1991.

The following text describes the agenda of the Preparative Committee meetings during the year 1992.

At the January session of the Preparative Committee (January 9, 1992), two companies – Creditanstalt, a.s. and Ekoagrobanka, a.s. – became members of the Association.

At the meeting held on January 23, 1992, the membership agenda dominated. The Preparative Committee elected a special commission that was in charge to prepare a list of potential new members. The Preparative Committee approved the following new members of the Association: Efekta, a.s., Eastbrokers, a.s., Crown Banking Corporation, a.s., and Consus (a co-operative).

At the following session held on February 13, 1992, the Associations decided to prepare a new schedule. The key item on the agenda was the discussion on the intern Stock Exchange regulations, on the latest version of the Stock Exchange Act and the Draft Securities Act. The Association decided to address a comment to the Federal Ministry of Finance and to the Government Legislative Council.

On February 27, 1992, the Association approved the Annual Report, a Report prepared by the Control Commission, the budget for the first half of the year 1992 and a new schedule. Agrobanka, a.s. (a joint stock company with the seat in Olomouc) was approved as a new Association member.

At the session of April 1992, the Association approved the activities related to the Agreement between the Association and SBF (Société des Bourses Francaises) and the Agreement that was signed by the *Chairman Miroslav Kučera* and *Vice-Chairman Vladislav Pavlát*. A discussion about question problems of clearing and settlement followed.

At the session on June 17, 1992, Association discussed the French offer of delivery of SW for securities clearing and settlement. The Association approved The Stock Exchange Statute.

At the session of June 26, 1992, SBF representatives presented a report on the SW for trading and for the Stock Exchange Depositary. Association agreed to install the settlement system in two stages. The SBF proposed to extend the scope of its aid, to establish a daughter-company for securities' settlement, and to establish a Guarantee Fund for settlement.

The Banks that were Association members, agreed to sign a credit contract in a value of 65 million CZK to be able to finance the technical installations necessary for securities trading in the Stock exchange building. Finally, the Association members discussed the last disposable version of the Securities Act.

At the session of July 8, 1992, discussion on the way how to present comments on the Draft Securities Act took place. The company Creditanstalt, a.s. became a new member.

### **3.2 The Founding Contract**

On July 24, the meeting of founders of the joint-stock company Stock Exchange Prague (Burza cenných papírů, a. s.) took place. The founding contract (zakladatelská smlouva) was signed, Stock Exchange Statute was approved, the Stock Exchange Chamber and a Control Council (dozorčí rada) were elected.

The Stock Exchange Chamber approved a draft request to the Ministry of Finance of the Czech Republic concerning the licence necessary for securities trading. On August 13, 1992, an extraordinary session on the credit took place. Contracts (of value more than 2 million CZK) had to be preliminary approved by a special commission, the members of which were the representatives nominated by Komerční banka, Agrobanka, Živnostenská banka, Interbanka and by the Prague Stock Exchange. This session was the last session of the Association. Its activities ended. Since this session, all following activities related to the Stock Exchange have been taken over by the new joint-stock company Burza cenných papírů, a. s.

Nevertheless, from the formal point of view, the Association “Burza cenných papírů” (originally called Association “Preparative Committee”) was dismissed on November 24, 1992, by the approval of the Final Report for the whole period of its existence, i.e. since 21<sup>st</sup> of May, 1991 to 24<sup>th</sup> November, 1992.

### **3.3 Tender offer 1991**

On December 19, 1991, the Technical Commission of the Preparative Committee that was in charge of preparing the tender offer approved the draft of the offer. The tender offer defined technical and economic conditions, and the delivery schedule. On January 3, 1992, ten interested companies presented their bids. On January 31, 1992, they took part in a conference that the Technical Committee organized for them. The offer closed on February 28, 1992. On March 4, 1994, the Technical Commission invited all its members to study the documents and to take part in the selection procedure. However, not all Commission members really studied the documents. Several employees of the Preparative Committee evaluated the offer, and evaluated the documents of the following firms: APP System Praha, The Alberta Stock Exchange, Digital Equipment CSFR, Mitsui and Co. UK PLC, IBM CSFR, Tandem-Logica Finance, Olivetti, TCAM, Société des Bourses Francaises, and Midwest Stock Exchange Chicago.

After all, the Preparative Committee finally decided to select the French company Société des Bourses Francaises (SBF) that offered to deliver the SW payless, using the existing agreement on technical aid between the government of the Czech Republic and the French government.

The negotiations with the tender participants were very difficult. Some of the participants were interested in delivering HW, but there were doubts whether they would be able to deliver a compatible SW. Some of tender participants tried to solve this problem in a specific way – they put together the individual offers of two companies into one offer. Olivetti company presented a joint offer together with the Japanese Mitsui company.



There was a different problem as well: the SW offered by some participants was evidently of a high quality, but most probably its use was not possible, because of a poor state of telecommunication network in Czechoslovakia. The Stock Exchange had to be interconnected not only with member firms, but also with other institutions. However, the views of Czechoslovak telecommunication experts widely differed. Discussion had to continue.

Some Association members strongly recommended to buy the top-level HW and SW, however, as soon as they were informed on the price, they did not insist any more. Prices of HW and SW were very high, and they substantially surpassed financial possibilities of Association's members. Just to illustrate the price level: the price of HW offered by company Digital Equipment Company or by Tandem Company was 60–90 million CZK.

Technical Committee expected that the Exchange would have to administer a very high information volume. This was the reason, why computers able to master a big volume of data were preferred to computers with higher speed and lower capacity. This was the reason why to buy IBM computers, which were very reliable. Czechoslovak banks frequently used IBM computers. As for SW, the situation was different: majority of the Association members did not have any idea what the requirements on SW for a Stock Exchange should look like. Endless and unnecessary discussions lasted for a long time. One part of the Association members' demanded to introduce a fully automated trading from the very beginning; the other part of members preferred to start with a manual system with a computer support. Finally, the second approach – fortunately – prevailed. The main reason for this decision was a rational one: the fully computerized system would be very costly, and its capacity probably was too high for its exploitation in the next future, *inter alia* because of no skills and no experience of its users.

In the course of discussions on advantages and disadvantages of different trading systems, it was frequently pointed out that floor trading speed (under certain circumstances) could be higher than speed of electronic trading. During the first half of nineties, floor trading continued to be used by a majority of European Exchanges (for example London, Frankfurt, Berlin, Vienna, Zurich etc.). The floor trading existed on the NYSE as well. At the beginning of preparative works in Prague, many foreign advisors (for example by *H. Cleland*), recommended floor trading; only a computer support gradually should have been introduced step by step. One of the main arguments was that on a standard and reliable Stock Exchange, brokers, and dealers daily – on trading days – should meet; this would contribute to a sense of mutual trust within the emerging Czechoslovak financial community. Given that in Czechoslovakia the capital market had not existed for a period of more than 40 years, it was a very strong argument.

Under the existing situation, the only trading system that met the final demands was the system offered by the French SBF. This system was successfully working at the Stock Exchange in Lyon in France for a couple of years, i. e. it was verified and reliable. There was no risk that existed with other offered systems: the user had to verify and modify the system according to the undeveloped capital market infrastructure in Czechoslovakia. SBF informed the Preparative Committee that the Lyon system was in process of installation in Warsaw. Czech technicians had the opportunity to get more information on the system directly in Warsaw.

Some Association members refused the French system, pointing out that the system was “old-fashioned”, “unreliable” etc. However, they were unable to present any rational argument in support to their view, and they refused to answer the question, who would be able to pay for another, more “modern” system.

One of the important moments supporting the final decision, was the fact that SBF successfully installed the French system in Warsaw. After one year of preparative works only, on The Warsaw Stock Exchange, securities’ trading started in October 1991.<sup>1</sup> SBF had a good experience from Warsaw that it could exploit in Prague to shorten the period of installation.

After all, the Association decided to accept the French offer. Unfortunately, a new problem arose: the problem of financing. Some of the Association members were reluctant to pay for the system, as they expected that Czechoslovak (or Czech) government would pay the cost. At the last moment, *Vice-Chairman Vladislav Pavlát*, found the possibility to negotiate an agreement on financing. It was possible to finance the supply of French equipment (HW and SW) in the framework of the technical aid of French Government to the government of the Czech Republic.<sup>2</sup>

It is necessary to point out the generous attitude of the French Government, of the French Ministry of Finance and of SBF, because the value of the aid for Prague Stock exchange finally was 10 million CZK. But the real value of the aid was much higher, and what was very important – it was possible to shorten the time necessary to start trading. The Preparative Committee members received a gift: a verified, reliable trading and settlement system without any obligation to pay anything by their own.

The negotiation with the French institutions was supported by *Karel Dyba*, the minister of the Czech government, and by *Karel Purkyně*, deputy-minister of the Czech Ministry of Finance, which helped to minimize the imminent bureaucratic obstacles and delays.

### **3.4 Contract on putting the Exchange into operation**

In March 1992, the Contract on putting the Prague Stock Exchange into operation signed by the Chairman of the Paris Exchange *Jean-Francois Théodore* (SBF) and Vice-Chairman of the Preparative Committee, *Assoc. Prof. Vladislav Pavlát*. The official ceremony took place in the building Na Můstku in Prague. *Karel Purkyně*, vice-minister of the Czech Ministry of Finance held a speech; he wished the emerging Stock Exchange all the best. The endless discussions and obstructions ended.

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<sup>1</sup> In October 1990, a contract on SW delivery to the Warsaw Stock Exchange between the SBF and the Polish Ministry for Privatization was signed. On July 2, 1991, securities’ trading at the Warsaw Stock Exchange started.

<sup>2</sup> See: Financial protocole (Protocole Financier), signed on February 10, 1992.

Let us briefly describe the contents of the Contract. The first paragraph defined the subject of the Contract.<sup>3</sup>

First, a working document (a Feasibility Study) had to be prepared. The document had to contain the following main items: intern Stock Exchange regulations, choice of market types, quotation procedure, the first quotation of shares of privatized companies, the role of privatization funds (in the process of trading – V.P.), order routing, the securities forms and their compatibility with the Group of 30 recommendations, the organization and settlement systems.

According to the paragraph 1.2 of the protocol, the French aid would concentrate on technical conditions and regulations leading to creation of the Stock Exchange market, working according to the principle of fixing. During the second stage of technical aid, the SW (originally using the computer AS-400) had to follow.

Paragraph 2 defined the time schedule. SBF had to present The Feasibility Study within one month. In October 1992, SBF had to deliver the SW. In the future, the Prague Stock Exchange would be responsible for SW maintenance.

Paragraphs 3 and 4 defined the responsibilities for the project management. The joint Franco-Czech Pilot Committee will have to control implementation of the project. The Czech employees were expected to take care of the following activities: verification of partial task fulfillment, users' training, translation of French texts into Czech language, testing of individual modules (together with French technicians) etc. The French team promised to co-ordinate the project, to control the delivered SW etc. The guaranty of delivered SW was limited to 3 months. Any change of the program would be under the control of the French team. The Czech contracting partner had the obligation to inform the French contracting partner on all legislative, political, and other changes that would possibly have an impact on the implementation of the Project. The Czech contracting partner had to take care of homologation of the equipment installed by the IBM company.

According to the paragraph 5 of the Contract, SBF (as an owner of SW) would cede the use of SW to the Prague SE and the right to upgrade it. A cession to other companies (paid or payless) was not possible without a permission of the SBF. The SW use was limited only to Prague.

According to the paragraph 9, the value of the aid (gift) of the French government was fixed to 2 million French francs, i.e. approx. 10 million CZK.

### **3.5 The Franco-Czech team and its activity**

On the French side, the project was managed by *Paul-Francois Dubreucque*, director of a SBF Department, *Catherine Coffin* and *Stéphane Rémus*. Other French technicians, for example *Lionel Cuenca*, *Jérémy Vasek* etc. prepared several partial parts of the project. On the Czech

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<sup>3</sup> See: Protocole d'accord – Projet d'installation de la Bourse de Prague.

side of the project, the Project *Vladislav Pavlát*, Vice-Chairman, and other managers took part as well – for example *Ing. Jiří Franc*, *Ing. Prokeš*, *Ing. J. Pícek*, *Ing. Kohút*, *Ing. J. Bér* etc.

At the end of June 1992, *Stéphane Rémus* finalized the Feasibility Study. The analysis showed the necessity of buying the SW not only for securities trading, but for the Stock Exchange depositary as well. This change was due to the announcement of the Ministry of Finance that the Securities Centre (Středisko cenných papírů – SCP) will register dematerialized shares. In that case, the Stock Exchange should have a link to the Securities Centre.

As a result, a new Contract with SBF (on July 9, 1992) was signed which provided for the delivery of the Depositary SW. SBF agreed a consortium with SICOVAM<sup>4</sup> the task of which was the installation of the Stock Exchange Securities Depositary. The value of this additional contract was 5 million French francs. Financial means provided for in the framework of the French government agreement on technical aid to the Czech Republic had to be used for funding.

### **3.6 The rise of brokers' firms**

During the first half of 1991, a greater number of new commercial companies were established. These companies were interested in securities trading as an additional source of their income. The Preparative Committee did not object to this initiative and supported the proposal to find an interim solution before the approval of capital market laws – i.e. the Stock Exchange Act and the Securities Act. The Czechoslovak State Bank set up a list of conditions that a Stock Exchange has to fulfill, before the permission for securities trading is issued. According to one of these conditions, a SE is responsible for brokers' education. Brokers will have to attend a basic course of brokers, and to pass a brokers' examination.

Some of the brokers' companies were interested in joining the Association. In January 1992, the following companies became the Association members: Efekta, Ekoinvest, Eastbrokers, Crown Banking Corporation, and Consus.<sup>5</sup>

Representatives of several bank objected to it, as they were afraid of the brokers' companies potential competition. During a long discussion on the so called "broker firms", preceding their membership, a deep mistrust towards these firms was formally pronounced; however, the efforts to prevent these firms to become the Association members failed. Later, the official name of the so-called "brokers' firm by Securities Act was changed: they were called "securities dealers". The advantage of the new non-bank security dealers was that they were able to act

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<sup>4</sup> SICOVAM, la Société Interprofessionnelle de Compensation des Valeurs Mobilières, located in Paris.

<sup>5</sup> After the transformation of the Association, some of these companies became Stock Exchange members.

quickly and in a flexible way, without any bureaucratic obstacles. But most of these firms were handicapped by a lack of own financial means.

### **3.7 Preparative Committee's transformation into a joint-stock company**

In May 1992, an ad hoc working group for legislation was set up, members of which were representatives of the Association member firms; the head of this group was *JUDr. Vyroubal*.

The only task of the working group was to prepare drafts of documents necessary for setting up the joint-stock company Stock Exchange Prague (*Burza cenných papírů, a.s.*). PSE had to present the documents to the Ministry of Finance that was responsible for licensing. There was a serious problem, as the Parliament did not approve the Stock Exchange Act by that time. The only possible solution was to prepare the documents according to the Draft Stock Exchange Act. In June 1992, a working group prepared the documents. The group passed several drafts to the Association, namely the Draft Memorandum of Association.

On July 24, 1992, the meeting of the Stock Exchange so-called “founders” took place. There were 17 companies interested in buying the shares of the Stock exchange. Representatives of these companies signed the Memorandum of Association on setting up the joint stock company Stock Exchange Prague (*Burza cenných papírů, a.s.*), and approved the Stock Exchange Statute. Then they elected members of the Exchange Chamber and members of the Arbitration Court.

*JUDr. Richard Salzmann* (Director General of the *Komerční banka, a.s.*, the biggest Czechoslovak bank) was elected Chairman of the Stock Exchange Chamber. Participants approved a draft letter to the Czech Ministry of Finance (a request for the permission of securities trading).

In spite of the fact that the PSE representatives discussed the content of the above request with the Ministry of Finance in before, the Ministry rejected the request. On September 21, 1992 (i.e. more than three weeks later), The Ministry of Finance addressed a letter to PSE. *Ing. Miroslav Purkyně*, first vice-minister of the Ministry of Finance of the Czech Republic, wrote: “...having carefully studied the documents ... we cannot grant the permission for setting up the Stock Exchange Prague, a.s.”. The main reason of rejecting the request was the low basic capital of the joint-stock company Stock Exchange Prague. The Ministry of Finance insisted the originally proposed equity of 5,3 million CZK to be increased up to 50–70 million CZK. This was the main comment, however, the Ministry of Finance commented, for example, on the Stock Exchange structure of organization, on the competence of Stock Exchange authorities, comments on insider information regulation etc.

The cause of these comments was, on one side, the fact that the Draft Stock Exchange Act was changed several times, and different problems remained unsolved, and – on the other side – the fact that Draft Securities Act was not approved by that time, but some rules regulated by this Act, were expected to be included into the Stock Exchange regulations.<sup>6</sup>

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<sup>6</sup> See: a letter addressed to the Ministry of Finance.

On September 30, 1992, a meeting of Mr. Salzmann with the representatives of the Czech Ministry of Finance was held. Then the Stock Exchange sent a letter to the Ministry of Finance. The Stock Exchange declared its readiness to increase its equity capital; however, it did not respond to the other comments received from the Ministry. PSE implemented some changes of the intern Stock Exchange rules proposed by the Ministry of Finance later on, but neglected other ones changes (to the detriment of the Stock Exchange).

In a short time, the Ministry of Finance granted the permission for setting up the Stock Exchange with no further condition or comments.

### **3.8 The dissolution of the Association**

On the dissolution day, the Association had 22 member companies, 14 of which were the original “founders”. Every company paid an amount of 200.000 CZK as a share on the Association capital; 800.000 CZK, as a contribution to the Association’s operation. The founding Association members had a privilege in voting: they disposed of the so-called decisive votes. During the process of constituting the Association, further 7 founding members were approved: Interbanka, a.s., Poštovní banka, a.s., Banka Bohemia, a.s., Ekoagrobanka, a.s., Creditanstalt Praha, a.s., and Credit Swiss First Boston Czechoslovakia, a.s. Additional members (i.e. non-founders) paid the amount of 100.000 CZK. They disposed only of a consulting vote. The following companies became members in January 1992: Crown Banking Corporation, a.s., Efekta, s.r.o., Eastbrokers, a.s., Equinvest, a.s., Consus, a cooperative, and Agrobanka, a.s.

The Association “Preparative Committee” had its seat in Prague 1, Školská 16 (where 3 rooms were rented); it later moved to Prague 1, Michalská 16, where (thanks to the director *Ing. Stanislav Kubeš*) 3 rooms and a big meeting room were rented.<sup>7</sup> In November 1991, the Association signed a contract with Bytový podnik Praha 1 and moved to Praha 1, Na Můstku 3. In this building, Stock Exchange trading started (in April 1993) and this building remained the Stock Exchange until the Stock Exchange moved to the so-called Stock Exchange Palace (Burzovní palác), Prague 1, Rybná Street.

The Final Report presented by Chairman *Ing. M. Kučera* evaluated the activities of all working groups of the Association – the group for legislation, the group for education, the members’ group, the technical group and the ad hoc group.

The Legislative Group, headed by *Vice-Chairman Vladislav Pavlát*, was composed of the following representatives of member companies: *Dr. Durčák* (Czechoslovak State Bank), *Dr. M. Kryl* (Živnostenská banka), *Ing. A. Barabas* (Živnostenská banka), and *Ing. Vohlmüt* (Československá obchodní banka, later Creditanstalt). This group prepared a short draft of the

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<sup>7</sup> All negotiations with local Authorities (Bytový podnik Praha 1) were successfully finalized by *Ing. Jiří Franc*, Executive Director of the Association.

Securities Act; the Group of the Stock Exchange prepared the Rules of the Prague Stock Exchange, a.s., and several other intern regulations.

The Members' Group headed *Ing. J. Klapal* (Česká spořitelna); the task of this group was to prepare documents related to companies which applied for membership, and (in the autumn 1992) to evaluate the applications to buy shares of the Stock Exchange Prague.

In November 1992, applications of 63 companies were registered. Approximately 25 companies applied for membership. The applicants had to present 16 different documents; they had to answer the question whether they would like to become shareholders, members, or shareholders and members.

The Technical Group was responsible for preparing the technical conditions for the Stock exchange activities. In 1992, the group was in charge of the tender offer. The final report briefly commented on the result of the tender offer: "...Having evaluated all criteria, the SBF was selected by the Association. One of the main reasons leading to this decision was the offer of a free-of-charge SW delivery and the French Government support during the implementation into the Czechoslovak environment."<sup>8</sup>

The final report evaluated the activities of the Association during the whole period of its existence. Inter alia, the Report appreciated the quality of management: "...the management ... was seeking for a positive and - when possible – non-conflict solution of extremely difficult tasks."<sup>9</sup> This evaluation refers to the efforts to achieve a successful protection of members' interest in several difficult cases, such as the preparative works on the Stock Exchange Act, the Investment Companies' Act, and Securities' Act. The Chairman and Vice-Chairman enjoyed a full support from Association members, and they were very active. They took part in different government committees and/or commissions (for example, the Capital Markets Commission of the Federal Ministry of Finance, the Legislative Commission of the Federal government, several Parliamentary Committees etc.). They took part in many conferences, seminars etc. in Czechoslovakia and abroad.

The final report highly appreciated the activities of the *Vice-Chairman Vladislav Pavlát*, for example his positive role during the process of preparing and signing the two Agreements – one with the International London Stock Exchange, and the other one with the Berlin Stock Exchange which opened the door to the Federation of European Stock Exchanges. (FESE accepted the Association, and later the Prague Stock Exchange as an "observer", with the right to take part in different meetings, seminars etc. organized by FESE.) Vice-Chairman fulfilled the task of establishing the Association's Secretariat. He was in charge of negotiations with the Paris Bourse, with the company Cooper and Lybrand, regular meetings with the British Know-How Fund, and with foreign embassies interested in the creation of the Czechoslovak capital market and the Prague Stock Exchange. The Report stated that the present management would

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<sup>8</sup> Ibidem, p. 12.

<sup>9</sup> Ibidem, p. 13.

continue its work until the registration of the joint-stock company Stock Exchange Prague in the Czechoslovak Company Register.

The final report evaluated the international relations and management trainee stays abroad in detail. During the years 1990 and 1991, contacts with 35 foreign Stock Exchanges were established. The report explained the role of the Agreement with the International Stock Exchange London and with the Berlin Stock Exchange – without having signed these Agreements, “...it would not be possible to organize the stays for 30 Czech trainees for free. The value of these stays was estimated as high as 6–7 million CZK. The majority of these management trainee stays were initiated and negotiated by the Vice-Chairman.”<sup>10</sup>

The International Stock Exchange in London organized the management trainee stays from October 1991 to November 1991 for a group of 11 trainees from Czechoslovak banks. One place was reserved for the Association, one for Československá obchodní banka, one for Živnobanka, one for Komerční banka, two for Agrobanka and three for Investiční banka. There were strict conditions for the management trainee stay. All candidates had to pass final examination at the end of a special course that was organized by the Preparative Committee, and they had to pass an interview with a representative of the London Stock Exchange. During this interview, LSE verified the knowledge of English language and basic knowledge of capital market. Implementation of management trainee stays in London had two stages: the first stage took place at the London Stock Exchange; the second stage with different securities’ dealers companies (for example James Capel, Daiwa etc.).

During the years 1991 and 1992, several management trainee stays at the Berlin Stock Exchange for 11 Czech trainees took place. The British Know-How Fund financed management trainee stays in London. The cost for one participant was approx. 5 thousand British Pounds. The management trainee stays in Berlin were financed by German banks. The International Stock Exchange and Berlin Stock Exchange evaluated the results of these trainee stays positively.<sup>11</sup> The Final Report reminded the fact that successful negotiations about the technical aid for the Association made it possible to acquire a modern information system free-of-charge, the value of which – the modification for the Czechoslovak market included – was higher than 80 million CZK.<sup>12</sup> The Report positively evaluated the activity of the Secretariat. The Report contained information on the budget and accountancy. As of September 30, 1992, the value of members’ contributions was 14, 6 million CZK. The total cost was equal to 8,578 million CZK.

The Association approved the final report at its final meeting: “The main tasks defined by the Memorandum of Association were fulfilled, so that the Association transformation into the joint-stock company was possible.”<sup>13</sup> At the same time, the Association members approved the activity of the Association during the period of May 21, 1991 until November 24, 1992.

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<sup>10</sup> The Report, p. 19.

<sup>11</sup> See: Final Report, p. 20–21

<sup>12</sup> See: Final Report, p. 20–21.

<sup>13</sup> Final Report, p. 2.



# 4

## The Czech capital market at the beginning of the economic transformation

*4.1 Selected data about the Czech Republic*

*4.2. A survey of important events in 1990–1994*

*4.3 Three phases of the Czech capital market evolution*

*4.4 Phase 1*

*4.5 Phase 2*

*4.6 The regulatory framework of the Czech capital market*

*4.7 Clearing and settlement systems*

*4.8 Multiple trading channels*

This is a survey of the main features of the emerging Czech capital market, as it really existed at the beginning of the period of the transition from the planned socialist economy to the capitalist market economy. The first and second paragraphs present a description of the general situation of the Czech Republic and the events decisive for the birth of the Czech Capital Market. The third paragraph presents a timeline of the Czech capital market evolution (for years 1990–1997). A brief characteristic of its first two phases (4.3, 4.4, and 4.5) follows. Then the three next parts present the characteristics of regulatory framework of the Czech capital market (4.6), clearing and settlement (4.7) and the multiplicity of trading channels (4.8).

### 4.1 Selected data about the Czech Republic

The Czech Republic belongs among the industrially developed countries in Central Europe. It has existed as an independent state since the split of Czechoslovakia (as of January 1, 1993) into two countries – the Czech Republic (capital Prague) and the Slovak Republic (capital Bratislava).

The Czech Republic is a democratic state headed by the president elected by parliament. In 1993, the president of the Czech Republic was *Václav Havel*. In the 1992 parliamentary elections, the majority of votes were cast in favor of right-wing parties which then formed a coalition government led by *Václav Klaus*.

The Czech Republic, with an area of 78, 864 km<sup>2</sup> and a population of 10.3 million, belongs among the mid-sized countries of Central Europe. Population density (131 people/km<sup>2</sup>) is higher than in surrounding Central European countries. In 1993, the level of economic activity of the population (52.6%) was higher than in neighboring states. (The Czech Statistical Office. Statistical Yearbook of the Czech Republic, 2016.)

The education level of the Czech population is above average in comparison with other countries in the region. The support shown for economic reform by the majority of the

population has facilitated a rapid transformation via economic reforms (see 4.2) while maintaining social harmony. Religious tolerance exists. The Authorities use non-conflict methods to solve ethnic problems connected with the Romany population (about 300,000). The Czech Republic has no significant natural resources (except for uranium ore and residual coal deposits). Its greatest asset is a skilled and qualified labor force.

Until recently, heavy industry (in particular engineering) dominated the national economy. After 1990, however, the emphasis on heavy industry has somewhat lessened. Services (including those in the financial sector) have grown significantly.

The country's Gross National Product lagged behind the average of the European Union member states. Production fell significantly after 1990, largely in response to the structural economic reforms. The principal aim of these reforms was a transformation to a market economy aided by the mass privatization program. In this regard, voucher privatization played an important role and laid the foundations upon which the capital market could exist.

In 1994 and for the first time since 1990, there was a restoration of economic growth and a significant real increase in industrial and building production. The positive sides of economic development in the Czech Republic include relatively low rate of inflation (10.4%) in 1994, a stable currency and a balanced state budget, low indebtedness (lowest of all post-communist countries), high currency reserves and a very low rate of unemployment (lowest of all post-communist countries).

Among the negative points, there are the following: the growing trade deficit, a slowing down in the reduction of inflation (partly as a result of partial rent deregulation), an increase in earnings exceeding gains in labor productivity, a high level of indebtedness and the inability of many companies to pay their debts, thus impeding the modernization of Czech industry.

## **4.2 A survey of important events in 1990–1994**

At the beginning of the nineties the economic reform in the Czech Republic started: its aim was to transform the so-called socialist planned economy into a market economy. Key measures included price liberalization, devaluation (necessary for stabilization of the exchange rate), the mass privatization program and preparative works for creation of the Czech capital market.

Economic reform proceeded successfully and its main goals were fulfilled in the years 1993–1994; by then, the role of the private sector had already significantly increased. Although the state continues to play a significant role in the Czech economy, the transition to a market economy appeared permanent. Amongst other factors, this was due to the marked support of most of the population, which had no wish to return to the so-called “socialism”. However, the population frequently criticized the government measures. For example, sensitive issues included the future of social security, health care, rent deregulation etc.

The creation of the capital market in the Czech Republic was a part of the economic reform. The success of the voucher privatization decisively accelerated the creation of the Czech capital market.

### 4.3 Three phases of the Czech capital market evolution

Phase 1 (1990–1992): the legislative basis for capital market was set up, the foundations for capital market institutions were ready, and the start of securities trading was possible.

Phase 2 (April 1993 to mid–1995): the securities trading started;

Phase 3 (mid–1995 till 1997/8): correction of the identified anomalies was discussed and prepared.

### 4.4 Phase 1

State Czechoslovak Bank (SBCS) played an important role; in 1990–1991, its governor, *Josef Tošovský* took the first steps towards establishing a securities exchange in Prague. A major trigger for these preparations was the visit to Prague in June 1990 by a delegation comprising presidents of securities exchanges in member states of the European Union and a meeting between the delegation and selected representatives of the financial sector (which was just emerging) at Koloděje Castle near Prague.

The author of this monograph had the opportunity to meet with the representatives of the European Stock Exchange Federation (FESE) as well as those from principal European Stock Exchanges. Shortly after this meeting, the “Preparatory Committee for the establishment of the securities exchange” was set up with *Miroslav Kučera* (head of department the SBCS) and *Vladislav Pavlát* (the then consultant to the SBCS on stock exchange questions) at its head. The members of the Preparatory Committee were banks; they were the founder members of the PSE.

An invaluable contribution to the preparations to establish the stock exchange was Fuse’s willingness to support the creation of a separate securities exchange in the former Czechoslovakia and in the Czech Republic (in Prague). The Preparatory Committee’s contacts with FESE enabled its leading members to visit many European stock exchanges. With selected stock exchanges these members prepared agreements on cooperation and exchange of information. (Memorandum of Understanding – with the London SE; a similar agreement – with the Stock Exchange in Berlin).

These valuable contacts provided an opportunity gradually to send a number of Czech employees (from banks and other financial institutions) to London and later also to Berlin and Frankfurt on short-term stays. At the same time, educational programs on the theory and practice of the capital market were held in Prague – in a short time (approx. of two years) more than 2000 participants took part in these programs. The Capital Market Institute, established on the initiative of individuals in Prague, was a pioneering venture as regards financial education. Later, institution also became a member of ECMI at the FESE in Copenhagen (1993).

Throughout 1991, the Preparatory Committee proceeded to clarify current problems. For example, the Committee asked the following questions: is it possible to establish an electronic stock exchange right from the beginning? Should we set up the traditional open-outcry system,

followed by a gradual transformation to a fully automated system? How many stock exchanges should exist, and where they should be located within the former Czechoslovakia?

*Huge Cleland* (a consultant acting as part of the overall technical assistance provided by the Canadian government) contributed to resolve these questions and made a number of short-term visits to Prague.

*Jens Bache*, director of the Copenhagen Verdipapircentralen, wrote a study focusing on the clearing system in security trading. *Luca de Brabandere*, consultant from PHARE completed a short assignment in Prague (1991). *Gernot Ernst*, then the President of FIBV and of the Stock Exchange in Berlin and *Mr. Schwan*, then the President of the Stock Exchange in Frankfurt visited Prague and helped us. *Jean-Pierre Paelinck*, the President of FESE, commented on the above questions as well.

At the beginning of 1991, first non-bank securities trading companies were established. In the first half of 1992, the Preparatory Committee organized a tender to select trading and clearing systems for the PSE; the winner of the tender was the Paris Stock Exchange. A very fruitful and successful cooperation with the SBF-Paris and SICOVAM started from this point in time. The Franco-Czech team undertook the task of providing software for the PSE in record time (around 6 months). The PSE start in 1993 was due to the generous technical and financial assistance provided by the French government. However, The PSE founders did not dispose of necessary capital to acquire requisite technology. At the most critical moment, the French assistance solved the problem.

## **4.5 Phase II**

The PSE started to operate on 6 April 1993 following the end of the first wave of coupon privatization that brought more than 1000 share issues by privatized companies onto the secondary market in June 1993.

Shortly thereafter, trading in shares generated by the voucher privatization started on the off-stock exchange system RM-S. The original declared objective of this system was to facilitate trading in the shares of the privatized joint stock companies that belonged to individual holders. Through RM-S these holders obtained direct access to the existing system without being dependent on the services of a licensed securities trader.

The setting up of the RM-S and its role as a quasi-exchange inevitably led to many serious difficulties which left their mark on the birth and on the consequent development of the Czech securities market in later years. These included the attempt to limit trading on the PSE, as from its very beginning, to a very small number of quoted securities. The PSE, however, resisted this proposal. Further, direct attempts to discriminate against the PSE were made, the suggestion being put forward that the Securities Center Prague (SCP), responsible for clearing securities transactions (see below), should have a direct information link with the RM-S but not with the PSE. This would have led to serious complications for PSE trading; this anomaly was overcome (regrettably only partly) thanks to the intervention of a

delegation from the French Ministry of Finance directly at the Ministry of Finance of the Czech Republic.

#### **4.6 The regulatory framework of the Czech capital market**

The regulatory framework of the Czech capital market was set up in the course of 1990–1992. It consisted of a number of legal Acts; let us describe the content of basic Acts.

*The Securities Act* governed agreements on securities, the securities market, publicly tradable securities, and the protection of the financial market. Under the Securities Act, securities issue was possible either in book-entry or certificate form. Since joint stock companies which were privatized in the course of the voucher privatization were under an obligation to issue book-entry shares (and had to retain this form of securities for a period of 3 years). The majority of publicly tradable shares on the secondary market were of the book-entry type.

*The Stock Exchange Act* governed the legal form of the stock exchange, the conditions on its establishment, its bodies, trading, acceptance of securities for trading on the PSE, stipulation of securities rates, clearing securities transactions, disputes arising from securities trading, state supervision of the exchange and other matters.

*The Act on investment companies and investment funds* governed the activities of these institutions, provides protection for the investor and ensures state supervision.

*The Bonds Act* set forth the legal requirements on bonds, the conditions under which an approval for a bond issue is possible, the provisions governing bond repayment, and definitions of special forms of bonds (pledges, state bonds, communal bonds).

Parliament approved these Acts very quickly during the initial period that followed the so-called Velvet Revolution. This helps to explain why this set of Acts was not consistent enough. The rather chaotic use of the method “*per partes*” proved to be a very risky method.

In addition to this, some of the above Acts were strongly influenced by models from abroad – for example, the Stock Exchange Act was influenced by the actually somewhat out-date models of the Austrian laws and the laws of Federal Republic of Germany. The consequence of uncritically accepting certain elements of foreign regulations was evident very soon: Czech Acts governing the Czech capital market did not represent an integrated structure and contained heterogeneous elements.

The bulk of regulations seem to be adequate to existing situation; however, if compared with foreign countries, i.e. the Czech capital market was “under-regulated”. The Securities Act, the Stock Exchange Act, and the Act on investment companies and investment funds shortly after issuance required urgent amendments; the capital market developed rapidly and Acts, from many points of view, became outdated.

## 4.7 Clearing and settlement system

This is another example of an incomplete and unsatisfactory regulation. Let us briefly describe it.

Title to book-entry shares or “immobilized” bearer shares was possible to transfer only via the SCP, which was concerned only with movements of securities, not with the financial side of the transaction. It was possible to transmit the payments for securities traded on the secondary market as non-cash transaction via financial institutions (banks) which were members of the CNB clearing center. Non-bank securities traders kept accounts with a selected bank; this bank intermediated payments for stock exchange and off-stock exchange transactions. It was possible to pay some securities transactions (particularly between individuals) in cash; as these probably represented a minority, it was impossible to be sure of the real extent of these transactions.

PSE securities transactions were cleared through the PSE Securities Register (PSE SR) linked both with the SCP (securities clearing institution) and with the CNB clearing center (payment/settlement center). The RM-System was linked both with the SCP and with the *Poštovní banka* which arranged payments. The Czech capital market thus did not possess a central clearing body that would clear securities and payments.

It is evident that non-standard elements of securities clearance procedure existed. On the PSE side, the under-developed custodial services represented one of the existing obstacles.

## 4.8 Multiple trading channels

The situation discussed above means that in securities transactions a multiplicity of trading channels existed. Investors could currently select one of 4 possible "channels" for a security transaction (this availability of choice was initially considered to be advantageous).

Trading channels:

- (1) via a licensed securities trader on the PSE; this was the method preferred by the more experienced investors, be they individuals or institutions, domestic or foreign;
- (2) directly through the RM-S (this method was preferred by individuals, less experienced investors, some funds and securities traders and generally those who are not members of the PSE);
- (3) through a securities trader in the RM-S (this was sometimes the method selected by individual investors seeking price advantages since some shares could be acquired more cheaply in the RM-S than on the PSE);
- (4) as a direct deal with the investor thus avoiding the organized markets, although the transaction was cleared through the PSE SR (this method was used by those securities traders, who, being members of the PSE, did not wish any quoted securities transaction to be cleared outside the PSE system).

The avoidance of the organized markets trading was one of the negative sides of the emerging Czech capital market. Its impact on PSE trading was destructive. Many professionals and academicians criticized the existence of “too many channels” as well. One of the causes of market fragmentation was the non-existence of a universal settlement center (Chapter 11.3). The fact that the Czech financial market infrastructure was incomplete was one of the factors which caused its dysfunctional character. (The World Bank, 1999, p. 18.)

Let us cite a comment on Securities Center (SCP written by M. Tůma, 1995). “A frequent criticism is addressed to the trading at the Center. Although, based on the new legal regulations, the Center has the duty to report the volume and prices, there are opinions that this trading should be forbidden entirely.”

Of course, this is possible, but before declaring prohibition, it is necessary to ensure another trading channel in all cases. The examples stated at random were only a small part of the list of examples:

- Publicly non-marketable securities (it is to be remembered that majority of new shares is being issued for the existing shareholders, i. e. a limited group of persons, and the issuer is not obliged to apply in advance for permission of the public marketability).
- Securities for which the trading marketability the both public markets for some reason rejected.
- Free (of charge) transfers.
- Very small, charged transfers, where if traded through stock brokers, an enormous growth of transaction cost would be involved.
- Exchange (replacement) of shares (in case of acquisition, either shares of acquirer or another security are offered usually for shares of company under the acquisition). May the securities traded at the Center be or not be prohibited, reporting duty should be imposed upon regulated investor, i. e. banks, funds, and stock dealers (perhaps other institutional investors too). This duty is usually associated with trade size – volume (the higher the trade volume, the more time is given to the buyer, so that he could be given a chance to liquidate his open position). (Tůma, 1995.)

# 5

## The features of the emerging Czech capital market and PSE position as seen through the lenses of 1993–1994

5.1 First year of the Czech capital market

5.2 First year of trading on the PSE

5.3 The specific and unique features of the emerging Czech capital market

In this chapter, the first year of the Czech capital market existence and of the first year of the PSE trading are described and analyzed. The part 5.1, and the part 5.2 findings, describe and analyze specific and unique features of the Czech capital market.

### 5.1 First year of the Czech capital market

Experts (both domestic and foreign) anticipated the start of the Czech capital market in 1993 with certain reservations and partially with fears. If we now evaluate the results of the first year trading in the secondary market, we can say that they have exceeded – at least quantitatively – the original expectations.

The creation of the capital market was an indisputable success. That included a required legal framework (roughly 12 laws), the establishment of a great deal of broker-dealer firms (more than 120 firms), the training of over 250 brokers, the establishment of privatization funds (more than 400), as well as the Stock Exchange, in addition to the implementation of the non-traditional RM system. The result of this success was the opening of the trading in the first one thousand share issues of the joint stock companies privatized during the first wave of the coupon privatization. In addition to shares, trading of a limited number of bond issues in the secondary market started.

Block 2

#### Introduction by the Chairman of the Stock Exchange Chamber

##### ***Introduction by the Chairman of the Stock Exchange Chamber***

(PSE Annual Report, 1993, p. 3.)

*“At the opening of the exchange trading in April 1993 the trade volumes represented the amounts of a series of a couple millions of CZK. Then the growth of trade volumes accelerated in order to run at the full speed after 22 June when the issues of shares of the companies privatized during the first wave of Voucher Privatization were introduced on the Exchange in two rounds. Hardly anyone anticipated that as early as in October the turnover could exceed the amount of CZK one billion (i. e. one thousand million) for the first time. However, this level was surpassed as early as at the beginning of November 1993. The maximum turnover was reached at the latest trading session held in 1993, i. e. on 16 December when this amount exceeded the level of CZK two billion almost by a quarter of a billion. For the entire period of trading on the Exchange of 1993 the total turnover surpassed the amount of CZK 18 billion.”*



## **5.2 First year of trading on the PSE**

The successful start was marked by a surprisingly fast growth of the secondary market volume. On the Prague Stock Exchange alone during the period from April 6, 1993 (the date when the Stock Exchange started to function) till May 31, 1994, the securities worth of more than 33,8 billion CZK were traded and it represented 85% of the total volume of trading in securities on the organized markets.

During 41 trading sessions held in 1993, the PSE achieved a relatively positive development. While at its first session only seven issues of securities were at the disposal for trading, the number of marketable issues at the last session, held on 16 December 1993, reached the figure 982. The whole market comprised 969 share issues, 2 trust units and 11 bond issues. The major part of the issues was accepted for trading during two sessions: 622 bearer share issues coming from the voucher privatization were introduced on the market on 22 June and additional 333 registered share issues were introduced on 13 July. Of the 982 issues mentioned above, 8 issues were traded on the listed market (5 bond issues and 3 share issues). (PSE Annual Report 1993, p. 14.)

The proportion of the listed security market was 58, 2 per cent of the total trading volume on the Prague Stock Exchange (out of this, 77 per cent were listed shares and 23 per cent were listed bonds). Block trading represented about 69 per cent of the total stock exchange trading. Twentyone per cent of the total volume was carried out through the central automated system.

To resume: at a first sight, the results seem to be positive. However, the securities trading in 1993 was obviously under-developed.

## **5.3 The specific and unique features of the emerging Czech capital market**

The Czech capital market indicated on one hand a number of features typical for emerging markets, but on the other hand, it also had its unique characteristics conditioned by the circumstances of its origin.

Among the most important general features of new markets are the following factors:

1. A prevailing goal of both investors and mediators (broker-dealers) is speculation, orientation on reaching quick maximum profit, often at the expense of the interests of the long-term market development.

The speculative character of capital market transactions has some objective causes resulting mainly from the lack of information. As there is not enough reliable and objective information, decisions have to be made on the basis of subjective estimates.

2. Relatively very high risks. Subjective evaluation of the situation in the market leads to high risks. It is not easy to protect against those risks since there exists little important information needed for the selection of a suitable protection strategy.

3. In addition, inexperienced investors and mediators are not able to calculate risks and these

risks are often underestimated. This creates the potential for high profits during the initial “rocket” rise of prices and volumes of trading, but generally extreme fluctuations or a fall of the market, usually causes fatal losses.

4. A lack of information about issuers. At the start of the first coupon privatization wave, investors had only very limited range of information on the privatized joint stock companies at their disposal. The additional submission of the prospectuses at the end of 1993 did not remove this gap when trading in shares was rising.

Because of the lack of reliable information, investors often make speculative decisions resulting from putting too much weight to the effect of subjective psychological factors. This contributes to the fluctuation and volatility of share prices and thus increases risks. The lack of information is a factor that inevitably strengthens the elements of speculation.

5. Relatively low liquidity of the market is another significant feature of emerging capital markets. In the Czech environment, the market capitalization of the overwhelming majority of issues is very low. The exception concerns the issues that are placed among the first 10 or 15 most attractive shares.

6. The typical characteristics of the Czech emerging market was the insufficient experience of all of its participants, i.e. issuers, investors and broker-dealers. Most of the managing staff of the privatized joint stock companies were not fully aware of the meaning and impact of the financing by way of issues in the capital market. Instead, they still prefer bank credits. It is just a question of time before the joint stock start to use the exchange to raise new capital. A low number of primary issues was the result of this situation. The lack of experience was one of the factors resulting in the absence of ethics on the side of all market participants.

7. The lack of information caused the high price volatility. Another negative factor was the absence of efficient arbitration between the stock exchange and the RM-S.

Apart from the above general features, the Czech capital market had some unique characteristics. These specifics are closely related to the economic reform since 1990, and mainly to the coupon privatization.

### Block 3

#### **On the lack of information**

##### ***On the lack of information***

Without persuading the managers that it is in their personal interest to provide high-quality information, they would keep providing a flood of insubstantial details. This means that we are going to face a long-term process of convincing efforts and education accompanied with orders (through Acts or Decrees it is impossible to achieve the desirable effect).

The cause of the current gloomy quality of the information is not a clever clownery, but also a mixture of incapability, ignorance, and efforts to cover the real state of affairs.

There is a desperate lack of both people able to give the information its digestible form. At the same time, only few people were able to digest it.

Here is one example for all: in prospectus reading room, there are available about 30

prospectuses of bus services operating companies. These prospectuses were prepared strictly according to the generally applicable instructions issued by the Ministry of Finance. One can read in each and all of them that the given company does not possess any draught livestock, but no company considered it suitable to state how many buses it possesses. This is a typical, not an exceptional example.

The Exchange is also a large debtor in this respect (a remarkable is the comparison to the reading room of the Center, but one can find many other examples as well). Performance of auditors is also causing tears. Some of the auditors are tending to sign anything, including statements in which sums of figures are incorrect.

Let us resume the *unique* features of the Czech capital market in 1993–1994:

- (a) Czech Republic had a relatively highest number of shareholders in the whole world. The outcome of the first coupon privatization wave caused that almost all adults of the Czech Republic became shareholders regardless of whether they were direct shareholders in the first wave of privatized joint stock companies (if they invested individually as individual coupon holders), or shareholders of investment privatization funds (if they deposited their coupons into these funds);
- (b) A dominant position of shares (about 82%) in the market product structure; the share of bonds was only about 18 per cent of the total trading volume. This atypical market structure and an increased risk, with which it was connected, depended on the policy of the balanced state budget.
- (c) The stock exchange established under the observance of international standards and based on the principle of membership existed together with the nontraditional RM system, which is a market maker, i.e. an organizer of the market on which any investor can enter directly without the assistance of a financial mediator (a broker-dealer).

In spite of the fact that the trading results of the Czech secondary capital market were successful, numerous deficiencies that blocked its further evolution existed. (Pavlát, V. ABK, 1994.)

# 6

## PSE priorities for the first two years of its activity

6.1 Structure of PSE organization

6.2 The PSE trading system

6.3 A survey of the PSE regulatory documents issued in 1992–1994

Towards the end of 1992, the bulk of laws and main rules necessary for working of the emerging financial sector, the capital market and the Stock Exchange in the Czech Republic already existed.

The laws and rules defined – in principle – the role of the Stock Exchange in the emerging Czech market. The process of setting up the Exchange started according to the plans of the Czech government. Nevertheless, it is important to stress that many important questions related to the Czech capital market remained open; they were not defined or simply not mentioned. It is true that this fact could simplify the situation of the emerging Exchange, formally founded in November 1992: The Exchange formally had the right to take any practical measure the scope of which the existing regulation defined. However, in some cases the reality was different: not very clear wording of certain paragraphs of the Stock Exchange Act did not allow the Exchange to act freely according to the declared right of self-government.

**Note:** Ministry of Finance several times (*expressis verbis*) refused the self-government right to be applied, under the pretext of the lack of professional skill etc.

As one of the first practical steps, the emerging Prague Exchange had to define priorities of its activities for the next period of some 12–18 months.

Let us characterize the priorities in the following range:

1. To take all organization, financial, material, technologic and other measures necessary to be able – as soon as possible – to start securities trading.
2. To create the (inner) Stock Exchange Rules necessary for a successful start of trading.
3. To start trading (after fulfillment of the first two tasks).

Undoubtedly, this was a realistic decision – except for the missing date of start. The reason why the Stock Exchange itself could not decide this date independently was the SE Law: according to this Law, two parallel secondary market places should exist. The Stock Exchange was obliged to agree with the RM-S (the second quasi-exchange) the date, when both institutions would start securities trading. According to an agreement, it was the March 6, 1993.

## **6.1 Structure of PSE organization**

The basics of the PSE organization structure were derived of the Stock Exchange Law (Zákon o burzách) and the Company Law (Obchodní zákoník).

The supreme Exchange body was the General meeting of Shareholders (as in all Czech joint-stock /a.s./ companies). The Exchange Chamber represented the executive body. The third Exchange body was the Supervisory Board (as a body responsible for control of the company activities, business strategy, accounting etc.).

The Secretary General (equal to Director General of a Company) was the head of Exchange executive. On the PSE, there were three Exchange Committees (Committee for Trading, Securities Listing Committee and Committee and Membership Committee, as of 1993).

Exchange Court of Arbitration, Association Exchange Guarantee Fund, and Exchange Registry of Securities, Ltd. (s.r.o.) were bodies of the Exchange Market. PSE Statutes Division regulated the division of labor between these bodies. (The Prague Stock Exchange, 1993, p. 7.)

## **6.2 The PSE trading system**

Let us cite from the first PSE Annual report (1993) the description of the Exchange Trading System (settlement included):

“A fully automated system of conclusion and settlement of the Exchange trades has been chosen for the operation of the PSE. The trading system is based on centralization of the offer of and demand for securities up to a certain moment of time and after this deadline, and on the basis of pre-set algorithms, the rates of individual securities are calculated (this method is called “fixing”). The rates of securities are determined once a day. PSE selected this trading system upon having taken into account the fact that the Czech capital market is a newly emerging one, just being formed, and that the system would fully meet the market requirements during the trading on the PSE. Initially only one trading session was held in a week. On 2 Nov. 1993, PSE introduces two sessions per week. At the end of 1993, PSE took the measures enabling a gradual increasing of the frequency of the trading sessions up to five times a week by the end of 1994. Currently, only prompt deals are concluded on the PSE.

In order to achieve balance between the offer and demand at a certain trading day, additional orders for securities on the listed market are called upon and received on a preferential basis. The additional orders are received according to their nature either as orders to buy or sell securities.

The additional orders are only received to the quantitative level of the maximum difference occurred between the counterparts on the market (i. e. between the buyers and sellers) and they only are accepted at the rate quoted at the given trading day.

Settlement of the exchange deals is carried out by the Exchange Registry of Securities, spot, s.r.o., a subsidiary of the PSE, a.s. The exchange trades are settled on the third day following the day of their conclusion on the basis of securities delivery against their payment. In

accordance with this rule, the transfers between the partners' holding accounts maintained with the Exchange Registry of Securities are carried out parallel with the delivery of the relevant irrevocable instructions (orders) for the cash transfers carried out at the Clearing Centre of the Czech National Bank. The deals are settled at the level of Exchange members, while making distinction between the trades concluded on a trader's own or on a certain client's securities. To cover the risk and liabilities arising from the exchange trades concluded through the automated trading system, the Exchange Guarantee Fund was established. Participation in the Fund is obligatory for all trading members of the Exchange.” (The PSE Prague Stock Exchange 1993, p. 13.)

The described PSE trading system fully corresponded to the normal system of fixing used on smaller European Stock Exchanges; the settlement system fulfilled the rule of 3 + 1. A number of smaller Stock Exchanges in Europe used the less demanding settlement system 5 + 1. This means that PSE in no case was “old fashioned” – as some of the Czech adversaries of the concept of gradual transition from the reliable fixing to the more complex price-driven system used to say with a clear intension to discard the PSE. In 1993, many existing and/or potential Czech PSE members still were not sufficiently aware of the differences of both trading systems and its advantages and disadvantages and some of them simply repeated what they heard “somewhere”. Another calumny was labeling the “French System” (they evidently had the Lyon Stock Exchange in mind) as “less reliable” than the “more reliable” German or British systems. (See: Chap. 12.4.)

### **6.3 A survey of the PSE regulatory documents issued in 1992–1994**

The Stock Exchange Rules and Regulations are extremely important for every Stock Exchange. Based on general Laws regulating the financial sectors' activities, they must be adapted for practical use of the Stock Exchange. Without correct and efficient rules and regulations, the Exchange would not be able to work.

As far as the PSE is concerned, it was necessary to create as much as 16 rules during a short period. Without this set of most important rules, it would not be possible to start trading on the D-Day, i.e. sixth of April 1993. Therefore, the bulk of rules had to be preliminary prepared by lawyers, discussed and approved by all Committees and finally approved by the Stock Exchange Chamber and by the shareholders meeting as well. Before the rules validation, practically all drafts of the rules, PSE first discussed with the Capital Market Department of the Czech Ministry of Finance to avoid potential problems.

The first Extraordinary General Meeting of Shareholders held on 30. Nov. 1992 approved one of the most importing basic documents that are the Statutes of the PSE.

However, PSE approved Rules of the Prague Stock Exchange, a.s. only at the first General Meeting of Shareholders held on 21 April 1993 (i.e. ex post, some three weeks after the start of trading). By the same general meeting, PSE approved Exchange Regulations of the Prague Stock Exchange, a. s., Rules of Procedures of the Exchange Court of Arbitration.

Different Exchange Committees and/or by Exchange Chamber approved a number of regulatory documents only during the following months of the year 1993 (until December). The process of preparing, discussing, and approving of regulatory documents was time-consuming for the Exchange functionaries and for the Exchange staff as well. However, there were no complaints and the process was smooth. By the end of December, 13 documents were validated. (See the table 1.)

Table 1

**The list of approved PSE documents**

✓	<b>Statutes of the joint-stock company Prague Stock Exchange, a.s.</b> approved by the 1st Extraordinary General Meeting of Shareholders held on 30th Nov. 1992
✓	<b>Rules of the Prague Stock Exchange, a.s.</b> approved by the 1st GM of Shareholders held on 21st April 1993
✓	<b>Exchange Regulations of the Prague Stock Exchange, a.s.</b> approved by the 1st General Meeting of Shareholders held on 21st April 1993
✓	<b>Rules of Procedures of the Exchange Court of Arbitration</b> approved by the 1st General Meeting of Shareholders held on 21 April 1993
✓	<b>Rules and Regulations of the Exchange Membership</b> approved by the Exchange Chamber on 10th February 1993
✓	<b>Conditions and Requirements for Admission of a Security to Trading on the Exchange</b> approved by the Exchange Chamber on 10th February 1993
✓	<b>Conditions and Requirements for Registration of Securities for their Trading on the Unlisted Securities Market</b> approved by the Exchange Committee on Trading on 17th March 1993
✓	<b>Securities Rates and their Calculation</b> approved by the Exchange Committee on Trading on 8th December 1993
✓	<b>Rules Governing the Fees</b> Set out by the Prague Stock Exchange approved by the Exchange Chamber on 10th February 1993
✓	<b>Securities Special Events</b> approved by the Exchange Committee on Trading on 8th December 1993
✓	<b>Rules of Procedures of the Stock Exchange Chamber</b> approved by the Exchange Chamber on 3rd February 1993
✓	<b>Rules and Regulations of the Stock Exchange Registry of Securities</b> approved by the Exchange Chamber on 22nd December 1993
✓	<b>Stock Exchange Guarantee Fund Association Agreement</b> approved by members of the Prague Stock Exchange, a.s., on 2nd April 1993

Source: PSE Annual report, 1993

During the year 1994, the legislative process and validation of regulatory documents of the PSE continued. The second Regular General Meeting of the PSE in April 1994 approved further documents, namely: The Statutes of the Stock Exchange Prague, a. s., The Stock Exchange (SE) Rules, and Rules of the SE Court of Arbitration.

The Exchange Chamber and/or Committee on SE Trading issued and approved 12 new regulations. (See: Table 2.)

PSE had to support the development of trading at the PSE by new regulations, for example, the regulations of block trading and settlement, direct trades, funds shares registration, information disclosure etc.

The first two years of trading on the PSE were the phase of Exchange maturing and/or an assessment phase, because only completing the “second priority” (see above), the trading could be safe and efficient.

Table 2

**New PSE regulations**

✓	<b>Requirements for Admission of a Security to Trading at the SE</b> (Listing Requirements), approved by the SE Chamber on July 15, '94
✓	<b>Rate of Securities and its Calculation</b> , approved by the SE Committee on SE Trading on September 15/94
✓	<b>Rules of the SE Membership</b> , approved by the SE Chamber on October 20, '94
✓	<b>Stock Events</b> , approved by the SE Committee on SE Trading on December 8, '94
✓	<b>Rules of the SE Securities Register</b> , approved by the SE Chamber on February 7, '94
✓	<b>Securities Buying-in - Intervention Purchases of Securities</b> , approved by the SE Committee on SE Trading on March 16, '94
✓	<b>The Direct SE Trade</b> , approved by the SE Committee on SE Trading on May 11/94
✓	<b>Continuous Trading at Fixed Price</b> , approved by the SE Committee on SE Trading on August 10, '94
✓	<b>Block Trading</b> , approved by the SE Committee on SE Trading on September 29, '94
✓	<b>Settlement of Block Trades</b> , approved by the SE Committee on SE Trading on September 29, '94
✓	<b>Obligation of the Exchange Members to Disclose Information</b> (Information Disclosure by the Exchange Members), approved by the SE Chamber on July 15/94
✓	<b>Requirements for Registration of Shares of Investment Funds and Trust Units of Unit Trusts for Trading in the Unlisted Securities Market</b> , approved by the SE Committee on SE Trading on November 23, '94

Source: Summary Rules and Regulations of the PSE. In: The Prague Stock Exchange 1993, p. 19



# 7

## **The phenomenon of privatization funds: the PSE role**

*7.1 Selected facts on investment companies and funds position in 1994*

*7.2 Negative impact of the funds' liberal regulation and a lack of an efficient supervision*

*7.3 The PSE role in trading the privatization funds' shares*

Factors outside the financial sector influenced the rapid development of the capital market and of some non-bank financial institutions in the Czech and Slovak Republics. Primarily, it was the Czech program for rapid large-scale privatization from 1991 to 1995, and an important role was played by both voucher privatization, and sales to domestic entrepreneurs.

### **7.1 Selected facts on investment companies and funds position in 1994**

It is clear, that relatively small number of founders of privatization funds started to play an important role in Czech and Slovak economies. Moreover, the structure of owners of the “founders”, i.e. of founding institutions, is interesting. It can be seen, that 11 out of 13 strongest founders are banks, private or partly/fully owned by the state, that collected 84% of point of “Top 13”. In general, future shareholders preferred to invest in traditional monetary institutions with a wide network of affiliates and large advertising capacity. These institutions also disposed of a large number of financially trained experts. However, it was not clear whether they would be able to control property worth “billions”.

Banks in the group are also major credit granting institutions to the companies. They used directly also other forms of privatization in addition to voucher privatization. This gave them significant control over the Czech economy. This combination of both direct banking control (as main creditors and co-owners) and indirect bank control through banks' daughter investment companies resembled more the German model than the American model.

The fact, that other shareholders were often the non-organized small investors or the Fund of National Property increased the importance of the financial groups as co-owners of companies.

Generally, if we take the sample of 949 Czech voucher privatized companies, the investment privatization funds owned in 473 companies about 57% of shares (*Mejstřík, Marcinčin et al., 1993*). The group of individual fragmented investors had a majority on average of 62% shares in another 318 companies. Investment privatization funds most probably controlled these companies.

The investment privatization funds were the second most important investors through their 27% (pushing the total in average up to 89% of controlled shares).

Only 102 companies' shares are held in more than 20% by single funds (in 9 companies single funds hold even more than 30%) that violates 20% ceiling of diversification rule of IPF law.

Usually the funds (with less or more than 20% shares each) combine their shares and create alliances of companies that could be easily dominated by them (at least above mentioned 318 + 390 = 708 companies).

All that provides only preconditions for efficient corporate governance in co-owned enterprises that should be restructured in order to stabilize them and to increase their efficient operation. It was not a typical and easy task for funds to exercise their property rights. Usually, it was not their task at all (except for an emergency period). In the transition period in the Czech Republic, many companies faced emergencies and there was a need for highly active asset management (Wendelová, Bukač, 1993).

Most of investment funds registered higher assets and equity with commercial courts in order to include the shares distributed through. As a result of described processes and in accordance with existing legislation, more than 90 investment companies, 218 “old” investment funds, and 60 independently established “cash” funds existed.

Cash funds attracted a negligible fraction of cash (less than voucher privatization). Many investors added most of the investment funds' shares to the shares traded on the capital market.

Unfortunately, the state supervision was too weak to be able and punish the frequent cases of under-reporting of portfolios and performance. There was an evident gap between systematically lower price of funds and the price of weighted portfolios. All these factors evidently contributed to the fact that citizens restricted their investment into funds in the second wave of privatization.

## **7.2 Negative impact of the funds' liberal regulation and a lack of an efficient supervision**

The original voucher privatization approach gave Czech and Slovak citizens the right to allocate their investment credits either individually or through financial intermediaries. Imperfect CSFR regulation of 1991 provided a liberal framework for the spontaneous establishment of 429 “voucher market” oriented investment privatization funds (IPFs), established as joint-stock companies and founded either by the commercial banks, by other joint-stock companies, or by private individuals and companies. IPFs started from scratch, but were able to attract 71.4% of all distributed voucher points. At the end of 1992, voucher privatization IPFs had acquired equity in Czech firms with a nominal book value of more than CZK 176 billion (Czech IPFs acquired 86%, Slovak IPFs 14%). This figure represents nearly two thirds of all Czech shares available in the 1992 voucher privatization program. It gave to the funds both control over a significant portion of the Czech economy and a super-significant share of individual investors' investments. This power was highly concentrated in the hands of the founders of the top 13 financial groups that managed funds owned more than 43% all Czech shares available through 1992 voucher privatization. Nine of the 13 founders were commercial banks, and Czech and Slovak insurance companies.

In investment privatization funds (429 funds) there was allocated not only a substantial part of investment points (6,111 mil. (71.35%) out of 8,565 mil. available inv. points), but

consequently also most shares of joint-stock companies privatized in the first wave of the voucher privatization. The above data were often quoted as a proof of a high concentration of the funds. A much more significant indicator of concentration was the number of points collected by each investment company. Any investment company could establish any number of investment funds. For example, Harvard Capital and Consulting investment company established 8 funds, Investiční banka established a daughter investment company PIAS that established in turn 11 funds. The most of other banks followed the suit and avoided the violation of provision that bank's funds could not buy shares of the other banks.

These investment companies were usually parts of “financial groups”, resp. “bank groups” which had a legal form of holding companies. *M. Mejstřík* and *J. Mládek* identified 343 financial and bank groups founders. (Mejstřík, 1999. IES Occasional Paper 1/1999, IES FSV. Charles University.) During the period of 1994–1997, 126 investment funds (of the total number of 429) were converted into the holding companies. “The decline in the number of IPFs has been due to conversions into holding companies, voluntary mergers, and forced interventions by the supervisory authority, which is usually followed by liquidations and mergers.” Most IPFs conversions into holding companies were implemented in 1996 (86), and in 1997 (29), IPFs poor performance was due mainly to liberal licensing criteria, lax supervision, limited disclosure rules and the weak incentives related to the closed-end structure of most funds. (The World Bank, 1999, p. 31.)

The privatization funds were created in a rush, with a minimum staffing and have inherited a portfolio fully (100%) invested in shares. They had a limited influence on the portfolio structure. The privatization was running under a transformation phase of the economy. Unfortunately, this phase chronologically fell within the cycle of the worldwide economic recession. Due to both internal and external factors, majority of companies was undergoing a deep restructuring whose impact could not been foreseen before the crisis.

According to evaluation of the biggest privatization funds behavior by some authors, the big funds inclined towards behavior typical for venture capitalist. They had only a limited interest in a dynamic restoration of their portfolio.

*M. Tůma* (1995) in one of his articles mentioned that most of funds were not interested in active trading and they kept their portfolios intact. According to his view, the funds were “not strongly interested in information disclosure or improvement of market transparency, although they apparently would not actively be opposing any improvement in this respect”. In his opinion, “...the funds are not opposing the providing of the information to serious investors at their request, and following thorough negotiations, they effect sales at prices which are not derived from prices quoted at the Stock Exchange.” (Tůma, 1995.)

Tůma criticized the big funds’ behavior, however, he stressed that they were forced to their non-standard behavior by a non-standard environment: “We are not arguing that the funds may not be criticized for a number of shortcomings, nevertheless, they cannot be criticized for their nonstandard conduct in the nonstandard environment. We rather assume that one of the main problems prevailing in the Czech capital markets is the disharmony between the terminology, and legislation on one side (particularly the public marketability of shares etc.), and reality on

the other.” (Tůma, *ibidem*, 1995.) *Simonetti* and *Tříška* in 1994 (*Simonetti* and *Tříška*, 1994) analyzed the behavior of investment funds. Exercise of ownership rights by investment funds was unsatisfactory. (*Kotrba*, *Kočenda*, *Hanousek*, 1998.) In References selected information on Ministry of Finance IPV's supervision can be found (*Guoth*, 1994c); *Jezkova*, 1994a, 1994b; *Libnar*, 1995a). Many trespasses against the IPV Law were detected and punished, however, the supervisory powers of the Ministry of Finance were too weak to handle the situation. The World Bank Report prepared (for internal use) a survey of structural deficiencies of the emerging Czech capital market (IPFs included) which corresponds to main results of analyses published in our monograph. (*The World Bank*, 1999, p. IX–X.)

### **7.3 The PSE role in trading the privatization funds' shares**

PSE was obliged to follow the investment companies' and funds' legal regulation valid since 1991. Unfortunately, the law on IPV's was very liberal so that it was impossible to eliminate the circumvention and/or misuse of the Law. It is evident that PSE itself was unable to prevent potential negative impact of such regulation.

PSE was only one of trading channels for block trading through which the funds' assets concentration in hands of 4 biggest funds was achieved. It is necessary to explain that originally 439 funds were set up; it is evident that such a high degree of assets' concentration completely changed the character of competition: instead of a normal free competition, the oligopoly competition existed. The multi-channel trading system was one of the reasons why the PSE Chamber was unable to manage the situation.

The Stock Exchange Chamber discussed the possibility to prohibit or at least to reduce the off-exchange block-trading; however, it proved to be unfeasible. From the economic point of view, the cost (fees) for block-trades through RM-S channel or through SCP was lower than the cost of exchange block trades. Although it was clear that block trades through the SCP in fact enabled tax evasion, nobody seemed to care. Even the 3 biggest PSE members were not inclined to take any positive measure except for application of ethical rules.

One of the reasons for hesitation on the side of Stock Exchange Chamber was the fact that it was very difficult or almost impossible to identify the trade volumes of investment funds' shares. It would be necessary to completely change the PSE statistical system because shares' trades evidence was based on three market segments – main, secondary, and free markets. The existing statistical evidence would have to change to allow for evidence of individual trades. This was probably the main reason why no measure was taken, although critical voices were growing. (See: Chapter 12.)

# 8

## The PSE governance

*8.1 The Exchange Chamber*

*8.2 Supervisory Committee*

*8.3 Exchange members*

*8.4 Territorial deployment of non-banks (1993-1997)*

*8.5 PSE Ownership structure (1992–1997)*

A success of all Stock Exchanges highly depends on their governance that should be professional to be efficient. All emerging Exchanges should draw on experience of developed Exchanges with longer history. Unfortunately, this was not the case of PSE.

In 1992, the PSE *de facto* started from scratch: it was not possible to draw on experience and knowledge from the pre-war Czechoslovak Stock Exchange. The old archives got lost and no Stock Exchange publications were available. This was the reason why the PSE had to act in a pragmatic way: it was necessary to set up a completely new, own information system, the structure of organization, simply everything what a new company needed. At the same time, it was impossible to copy foreign patterns, because the specifics given by the Czechoslovak legislation which “did not know” anything about the Stock Exchange and securities trading. It was not possible to wait until the new regulations are ready to use. Briefly, PSE had to implement this long-run task immediately and very carefully. PSE had to “open the door” to members, potential investors and to public to give them – as soon as possible – transparent information on its activities.

A great deal of this exhaustive activity has done Stock Exchange Secretary General *Jiří Franc*. His pro-active approach in the field of Stock Exchange publications has to be highly appreciated.

As far as we know, up to now, no special findings about the PSE Governance can be found. *Michal Mejstřík* examined the theory and practice of corporate governance in the Czech Republic in 1999. (The research work is based on the results of EU-ACE Research Project P96-6171-R “Corporate Governance, Privatization and Industrial Policy” and grant of the Czech Science Foundation (GAČR No. 402/99/06066.)

In many respects, his general research findings indirectly confirm that the PSE Governance (in the given period of 1993–1997) was – according to his Corporate Governance definition – efficient, although it was pragmatic, and did not correspond to all demands of Corporate Government theory. (Mejstřík, M., 1999.)

Chapter 8 has five parts: the first two parts deal with the main Stock Exchange bodies – The Exchange Chamber (8.1) and the Supervisory Body (8.2). The chapter describes and analyzes activities of both bodies from different aspects. The analysis stressed the role of the Exchange

Chamber personal structure. The third part (8.3) deals with the membership and the development of its conception. The analysis was based on different sources; some of the data from these sources, unfortunately, is not possible to verify, because of missing documents. The part (8.4) of this chapter deals with the territorial deployments of PSE shareholders and members. The last part of this chapter (8.5) deals with the changing ownership structure.

## **8.1 The Exchange Chamber**

The Exchange Chamber is one of the most important Exchange Bodies, as it is responsible for current policy of the Exchange, for its strategy and development strategy, and for many other activities defined by the Statute.

During the researched period (1993–1997), the Exchange Chambers' policy in many respects was gradually changing, mostly according to the needs of that time. It is quite clear that nothing than a large portion of pragmatic behavior – in a situation when the Czech capital market started to emerge – someone could expect. Especially during the first two years (See: Chapter 3.), Exchange Chamber worked under high pressure, as practically all had to be set up from scratch.

It was impossible to use and apply some experience from the pre-war Prague Stock exchange, because there was hardly somebody from the former staff alive. And more than that: in the Exchanges' world, since the end of World War Two, so many events have happened and so many things have changed that it was necessary to draw on the actual experience from abroad to be able to succeed.

In 1992, the Association (see Chapter 3) was forced – under the rapid changes resulting from the Czechoslovak Republic Central Government Program and its implementation – to speed up the preparative activities and to transform in the Stock Exchange. Apart from the state of legal affairs, it was necessary to prepare and sign the Memorandum of Association (Founding Agreement) as soon as possible, and to find a consensus of majority actors to find such personal structure of an Exchange Chamber that would correspond to the preceding activity, ambitions, and objective power of the majority of interested parties. It is necessary to note that banks which have founded the Association were – in a certain sense – forced by the Czechoslovak State Bank to be engaged to participate in preparative works “*re: Stock Exchange*”. Major efforts – undoubtedly – were performed by Komerční banka, ČSOB and Živnostenská banka: the banks which were expected to find some bankers able to take the lead.

If you have a look at the personal structure of the first Exchange Chamber elected at the first meeting of the emerging Prague Stock Exchange, it is clear that banks dominated this body.

During the period of 1992–1997, the number of Exchange Chamber oscillated between 16–18 members. Later on, the PSE modified this model.

Table 3

**The first PSE EXCHANGE CHAMBER (1992)**

Chairman JUDr. Richard SALZMANN (Komerční banka, a.s.)
Vice-Chairman Ing. Pavel KAVÁNEK (ČSOB, a.s.)
Ing. Miroslav ADÁMEK (Ekoagrobanka, a.s.)
Zdeněk BAKALA (Credit Suisse-First Boston, a.s.)
Ing. Aleš BARABAS (Živnostenská banka, a.s.)
Ing. Pavel JANDA (Agrobanka, a.s.)
Ing. Jaroslav KLAPAL (Česká spořitelna, a.s.)
Ing. Arnošt KLESLA (Banka Bohemia, a.s.)
Ing. Miroslav KUČERA (Česká národní banka)
Ing. František PALIČ Doc. (VÚB, a.s.)
Ing. Vladislav PAVLÁT, CSc. (Dominick & Dominick Praha, a.s.)
Ing. Libor PROCHÁZKA (Investiční banka, a.s.)
Ing. Jaroslav SNÁŠEL (Zemská banka, a.s.)
Ing. Alfréd ŠEBEK (Poštovní banka, a.s.)

Source: PSE Annual Report, 1993

Only a few elected Exchange Chamber members – of a total number of 16 – had some experience in investment banking (say 3–4); some 6 were employed in the “old” (socialist banks) and other 5 were representatives of the “new” banks (set up after November 1989) and 3 were representatives of banks with foreign capital (1 USA, 1 Austria, 1 Hungary). This professional structure evidently was far from an ideal structure. Majority of members had to learn “on the go” and under a high stress. Banks dominated the Exchange Chamber. However, this situation was a short-time emergency solution, as it can be seen from the following table (Table 4) giving a view of further development of the Exchange Chamber personal structure.

Table 4

**Institutions represented in the Exchange Chamber 1993–1997**

<b>Institution</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>
Komerční banka	x	x	x	x	x
ČSOB	x	x	x	x	x
Ekoagrobanka	x	x	x	x	-
Credit Swiss First Boston <sup>1</sup>	x	-	-	x	x
Patria Finance	-	x	x	x	x
Živnostenská banka	x	x	x	x	x
Agrobanka	x	x	x	x	-
Česká spořitelna	x	x	x	x	x
Banka Bohemia <sup>2</sup>	x	(x)	(x)	-	-
ČNB	x	x	x	x	x
VUB	x	x	x	x	-
Dominick and Dominick <sup>3</sup>	x	(x)	-	-	-
Iceberg	-	-	x	x	-
Investiční banka	x	-	-	-	-
Investiční a poštovní banka	-	x	x	x	x
Zemská banka	x	x	x	-	-
Poštovní banka	x		x	-	-
Interbanka	x	x	x	-	-
Creditanstalt Securities	x	x	x	x	x
Pragobanka	-	x	x	-	-
ČEZ	-	x	x	-	-
Effekta	-	x	x	-	-
Česká pojišťovna	-	-	-	x	x
Harvardská burzovní spol.	-	-	-	x	x
Member of Parliament ČR <sup>4</sup>	-	-	-	x	-
Finity, a.s. <sup>5</sup>	-	-	-	-	x
Independent members <sup>6</sup>	-	-	-	-	xx

Source: PSE Annual Reviews 1993–1997; author's own elaboration

**Notes:**

1. During the years 1994–1995, Credit Swiss First Boston was no more represented in the Chamber; its membership was renewed in 1996.

2. Bank Bohemia was no more official represented, however, in 1994–1995, its former representative still remained member of the Exchange Chamber.



3. The Company has changed its name.
4. Tomáš Ježek (for a short time, expected to be elected Chairman).
5. A former representative of ČNB.
6. Experts, consultants.

If the above development is analyzed, it is evident that – through the whole period – the structure of Exchange Chamber was dominated by a few “core” banks: Komerční banka, ČSOB, Živnostenská banka, Česká spořitelna and Creditanstalt Securities. The first 4 banks were the leading banks, and their attitudes were decisive for the exchange policy and strategy.

In 1994, the first of the “new” banks disappeared, because of its failure (however, its representative was staying for another year (evidently to keep the continuity). Other “new” banks – soon or later – had to leave the Exchange Chamber, because they failed. This happened mainly in 1996: Zemská banka, a.s., Poštovní banka, a.s., Interbanka, a.s., and Pragobanka, a.s. followed. In 1996, two so-called “broker-firms” (i.e. licensed securities private companies): Effecta, a.s. and Harvardská burzovní společnost, a.s. were their substitutes. The importance of private “broker houses” grew, however for one year only. In 1996, Iceberg a.s. had to leave. In 1996, the representative of CEZ, a.s. (after two years only) was not re-elected; the reasons were not released. In 1996, a representative of Česká pojišťovna, a.s. was – for the first time – elected. In the previous years, the Exchange Chamber rejected insurance companies’ membership for not explicitly explained reasons. There was an apprehension that only banks should be involved in investment banking, i.e. able to be elected. In 1997, another person replaced one former representative of ČNB; however, the former representative of ČNB was elected as a representative of Finitia, a.s. In 1996, The Exchange Chamber elected one deputy of the Czech Parliament, however not as a representative of Parliament, but as an expected new Chairman of the Exchange Chamber; this was rather misleading.

During the first two years, discussions at the Exchange Chamber meetings often were in many cases not professional; an insufficient information supply and/or a relatively low level of professional experience of participants explains it.

Table 5

**Membership in the Stock Exchange Chamber ended**

<b>1991</b>
J. TESAŘ
J. MÚDRIK
J. VOPÁLENSKÝ
<b>1994</b>
Alfréd ŠEBEK, Poštovní banka, a.s.
<b>1995</b>
Karol TÓLGYESI, Interbanka, a.s.
František PALIČ, VÚB, a.s.
<b>1996</b>
Petr MATEJČEK, Ekoagrobanka, a.s. (membership ended on June 26, 1996)
Pavel JANDA, Agrobanka, a.s. (membership ended on October 31, 1996)
Richard SALZMAN, Komerční banka, a.s. (membership ended on Dec. 16, 1996), (Ar-96, p. 16)
<b>1997</b>
Vladislav PAVLÁT, Iceberg, a.s. (membership ended on June 26, 1997), (Ar-97, p. 21)

Source: author

## 8.2 Supervisory Committee

Ing. Martin KRYL (Živnostenská banka, a.s.) was Chairman since 1992 until September 11, 1996. On this date the new Chairman Ing. František VEJMOLA (Komerční banka, a.s.) was elected. Ing. M. KRYL continued as a Supervisory Board until 1997.

At the end of 1994, membership in the Supervisory Board ended for Ing. Jaroslav ŽÁK (Agrobanka, a.s.) and Ing. Ctibor LUSK (Creditanstalt Securities, a.s.).

New 3 members of this Body Vladimír HOFFMAN (Delta Securities, a.s.), Radko RESCH (Harvardská burzovní společnost, a.s.) and Jan STRUŽ (ING Baring Capital Markets - C.R., a.s.) were elected and served till 1997.

Table 6

**The PSE members represented in the Supervisory Board (1993–1997)**

	<b>Company</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>
1.	Živnostenská banka	x	x	x	x	x
2.	Komerční banka	x	x	x	x	x
3.	Creditanstalt Sec.	x	x	-	-	-
4.	Agrobanka	x	x	-	-	-
5.	Delta Sec.	-	-	x	x	x
6.	Harvardská burzovní	-	-	x	x	x
7.	ING Baring Cap. Mkt.	-	-	x	x	x

Sources: PSE Annual Reports 1993, 1993, 1994; PSE Fact Books 1995, 1996, 1997.

### 8.3 Exchange members

According to the rules of the SE Membership, there were two categories of Exchange members. As for ownership, shareholders were the first category of members, a “core group”; the second category of members was called “Other members”. Later on (since 1996), there was a sub-category of shareholders who were not Exchange members. (See table 4.)

On December 31, 1993, The Prague Stock Exchange had 62 members, of whom there were 38 shareholders and 24 others members. (Ar-93, p. 11–12). On Dec. 31, 1994, PSE had 71 members, of which 37 were shareholders and 34 possessed different status. (Ar-94, p. 29–30) On December 31, 1995, PSE registered 101 members of whom 40 were its shareholders and 61 were other members. (Fact Book 1995, pp. 54–59) On December 31, 1996, there were 109 members, 63 of whom were shareholders and 41 other members. In this year, 11 new members were admitted and membership of 3 members was terminated. (Fact Book, pp. 55–60.) On December 31, 1997, the number of PSE members decreased from 109 to 88; there were 51 shareholders and 34 other members. In 1997, 6 members assigned their membership to other companies on a contractual basis and 8 companies terminated their membership. Only 2 new members were admitted. (Fact book, 2007, pp. 57–61.)

Except for 1995, during the other four years of the examined period, shareholders had a majority.

However, the relation between the shareholders and “other members” was changing. The change of relations was caused primarily by the changing structure of participating institutions. In 1996, the number of shareholders was at a maximum. At the same time, the number of “other members” decreased. In 1997, the total number of PSE members – for the first time in the examined period – decreased from 109 to 88.

The Table 7 shows that in 1996 and 1997 an anomaly existed: several companies were shareholders, but were not admitted as PSE members.

Table 7

**Number of PSE Members (1993–1997)**

As of 31. 12.	1993	1994	1995	1996	1997	Notes
<b>PSE Members</b>	62	71	101	109	88	
<b>Shareholders</b>	38	37	40	58	51	
<b>(only shareholders)</b>	-	-	-	(5)	(3)	
<b>Other members</b>	24	34	61	51	34	

Sources: PSE Annual Reports 1993, 1993, 1994; PSE Fact Books 1995, 1996, 1997.

During the period 1993–1997, the Rules of the SE Membership were changed five times (*sic!*):

**Rules of the SE Membership**, approved by the SE Chamber (AR-93, p.19);

**Rules of the SE Membership**, approved by the SE Chamber on October 20, 1994 (AR-94, p. 29);

**Rules of the SE Membership**, approved by the SE Chamber in 1995;

**Rules of the SE Membership**, approved by the SE Chamber on December 16, 1996;

**Rules of the SE Membership**, approved by the SE Chamber on February 2, 1997.

The relation between the two main categories of membership plays a certain role, as it usually reflects the different power of different categories of members.

Up to 1997, the impact of these changes on the PSE policy and strategy was of a lower importance in comparison with substantial changes resulting from two main factors in the following years. The first main factor, undoubtedly, was the creation of the Czech Securities Commission (1997–1998) which accelerated the attempts of European standards implementation in the field of Stock Exchanges. Later on, the second factor was the foreign capital massive penetration to the Czech capital market due to privatization of leading banks.

It is important to notice that the first Rules and Regulations of the Exchange Membership approved by the Exchange Chamber on February 10th 1993 (AR-93, p. 19) were changed *five* times. There were several reasons for these changes: first, the frequent changes of the Company Law and Securities Law; second, a competition between the banks and the non-bank PSE members, and third, a rivalry between some of the exchange members.

One of the other reasons was the unsatisfactory level of financial literacy that resulted in a pragmatic policy: the membership rules were not based on clear principles. In fact, the Chamber was never able to answer the following basic questions in a clear way: 1. Must members be incorporated, or can individuals, partnerships, and branches (in particular, branches of overseas firms) be admitted? 2. Can banks (and insurance companies) become members or must they use separate subsidiaries? Should supervision be on an institutional or a functional basis? 3. Are there to be any restrictions on foreign ownership of members? (CSFR – Stock Exchange Development, 1991, p. 88.) The decision making of the Chamber – in many cases – was not based on transparent data supplied by potential members to the Exchange Member Committee before the Chamber had to decide.

One of the basic questions was whether the applicant for PSE membership was “fit and proper”, i. e. its capital adequacy ratio.

However, we have to take in consideration that in many cases such data did not exist yet: the new firms had no history. A necessity not to disturb the already existing state of affairs dictated some decisions. These were, for example, the cases corresponding to the above questions No. 1 and No. 2.

Table 8  
**Banks and non-bank PSE members (1993–1997)**

	Category	1993	1994	1995	1996	1997
1.	<b>Banks</b>	<b>25</b>	<b>23</b>	<b>33</b>	<b>32</b>	<b>23</b>
2.	<b>Non-banks</b>	<b>37</b>	<b>34</b>	<b>68</b>	<b>77</b>	<b>65</b>
3.	<b>Total</b>	<b>62</b>	<b>71</b>	<b>101</b>	<b>109</b>	<b>88</b>

Source: PSE Annual Reviews 1993–1997; author’s own elaboration.

Regarding the legal form of Exchange members, in 1995, the form of the joint stock company prevailed, the rest were Limited Companies (Ltd., in Czech: s.r.o.). It was quite exceptional that one of members was a cooperative (družstvo).

According to the Company Law, higher capital requirements for joint stock companies than for Limited Stock Companies (Ltds) existed. However, this does not mean that Ltds’ economic power necessarily would be lower than the economic power of joint stock companies. Anyway, there was a general opinion that joint stock companies were “more reliable” than Ltds.

Table 9  
**Legal form of the non-bank PSE members (1993–1997)**

	Legal form	1993	1994	1995	1996	1997
1.	Joint stock company	32	26	34	46	40
2.	Ltd.	4	5	21	24	19
3.	Cooperative	-	-	1	1	0
4.	Other forms	1	3	3	3	3
	Total	37	34	68	77	65

Source: PSE Annual Reviews 1993–1997; author’s own elaboration.

The legal form of a joint stock company prevailed through the analyzed period 1993–1997. The number of Ltd. companies in 1995–1996 was growing; nevertheless, in 1997 it slightly diminished.

## 8.4 Territorial deployment of non-banks (1993-1997)

With regard to the structure of the capital market it is also interesting to analyze its spatial dimension. In 1993–1997, the territorial deployment of trading companies was changing. The main cause of these changes was the growing cost connected with running a local branch, and lowering return from its securities trading. The number of inhabitants of a given area played a decisive role. Higher returns were expected in regional centers and industrial agglomerations, however, the necessary initial investment cost were higher as well.

The cost of initial investment incurred by non-bank securities traders – if they did not own their own building – were higher than similar cost incurred by banks.

At the same time, the operating expenses of non-bank securities traders were – on average at the initial stage of their business activity – lower than analogous expenses on the side of bank, because non-bank securities traders usually have a limited staff compared with the staff number of investment-banking departments. To be able to prove the above reasoning it would be necessary to dispose of the relevant banks' balance data. However, it most probably would be impossible, because a two-decades' period already elapsed.

One of the important motives for a majority of banks setting up their investment departments outside Prague in district town etc. was the prestige of the given bank which locally competed with other banks.

Table 10

**Territorial deployment of non-banks (1993–1997)**

	<b>Localization</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>
1.	Brno	2	2	4	6	3
2.	České Budějovice	0	0	1	0	1
3.	Dobruška	0	0	0	1	0
4.	Hradec Králové	0	0	1	1	1
5.	Jihlava	0	0	1	0	1
6.	Karlovy Vary	0	0	1	1	1
7.	Liberec	1	1	1	0	1
8.	Mladá Boleslav	2	1	0	0	0
9.	Olomouc	1	1	1	1	0
10.	Ostrava	0	0	3	4	3

11.	Plzeň	1	1	0	0	0
12.	Prostějov	1	0	0	0	0
13.	Třebíč	0	0	0	1	0
14.	Ústí nad Labem	0	1	0	0	0
15.	Vsetín	0	0	1	0	1

Source: Annual Reports, Fact Books. Author's own elaboration.

Majority of non-banks were concentrated in Prague. In 1993, outside Prague 11 non-banks of 37 were located. In 1994, 10 of 34 had their sites outside Prague. Later on, in 1995 the number increased to 15 (of 68); in 1996 – 14 (of 77), and in 1997 it fell to 12 (of 65). In the period of 1993–1997, 3 Slovak banks had their branches in Prague.

## 8.5 PSE ownership structure (1992–1997)

This part of Chapter 8 presents a survey of PSE ownership structure changes in the period of 1992–1997. We do not discuss theoretical questions related to ownership, ownership forms etc., and to specifics of the Czech legislation (Mejstřík, 1999.)

Prague Stock Exchange – as a legal entity – is a joint stock company, regulated primarily by the Czech Commercial Code. At the same time, it is regulated by the Stock Exchange Act as well, and by its own specific rules and regulations. (See: Chapter 6 – the PSE regulations).

The ownership structure of every joint-stock company reflects the position of every shareholder in the company that, in turn, is decisive for the company behavior, its policy and economic results. The organizational and technical mechanism of a stock exchange company (given by legislation) is reflected in the company rules, for example the rights and duties of majority and minority shareholders etc.

According to the PSE rules, there are different categories of PSE members: members who own PSE shares and members who do not own PSE shares. (See: Chapter 8, table 7.)

The following text deals with selected aspects of the PSE shareholders “inner relations”: 1. Growth of PSE equity (shares issue in 1992–1997); 2. The “PSE Founders” changing position; 3. Relative position of banks to non-banks; 4. PSE shareholders' size; 5. Shareholders' policy of the PSE Chamber, and its impact on the structure of ownership. (See: Chapter 13.)

### 8.5.1 PSE Equity Growth

A survey of the PSE Equity Growth is to be found in the Table 11.

At first sight the PSE equity (as of November 30, 1992) was very low. The “Founders” majority did not want to invest their money into the PSE, as it was not sure when trading would begin. In 1992 the PSE had to be authorized by the Ministry of Finance to start trading, however, the Ministry demanded the PSE equity to be risen. After some hesitation and longer negotiations,

the PSE equity was substantially risen. (See more: Chapter 13.1.2 Relations between the Ministry of Finance and PSE.) The Notary deed from the PSE 1992 November General Meeting describes the circumstances of these negotiations.

Table 11

**PSE Ownership Structure (1992–1997)**

No.	Year	Equity (in Czech Crowns)	No. of share- holders	Source (Notary deed No.)
1.	1992 (Nov. 30)	5,360.000	17	NZ 1571/92
2.	1993 (March 21)	97,860.000	17	NZ 113/94 (x)
3.	1994 (Febr. 2; April 22)	153,716.000	38	NZ 113/94
4.	1995 (Nov. 14)	289,810.000	43	NZ 625/95
5.	1996 (June 26)	384,948.000	64	NZ 600/96
6.	1997 (June 26)	384,948.000	63	NZ 1111/97

Source: Commercial Register of the Municipal Court in Prague, Archive.

**Note:**

According to the Notary Deed, the new shares issue approved by the Extraordinary General Meeting in November 1992 was not fully successful; therefore, a new issue was voted: 65 000 + 27.500 new shares, to be paid within the next 3 months.

Until the beginning of 1994, the PSE had only 17 shareholders that owned 100% of shares.

After a new issue of shares, the number of PSE shareholders has risen to 38; the higher equity corresponded to the growing role of PSE. In the following year (1995), five new companies became PSE shareholders, and the equity grew by more than 300%. By June 1997, the 63 shareholders owned the equity of almost 385 million Czech Crowns.

### 8.5.2 The “Founders” deteriorating relative position

In 1992, the “Founders” owned 100% of PSE equity. With the growing number of shareholders, the share of “Founders” fell down. (However, in absolute terms the share value was higher.)

In 1994 the “Founders” (11 banks and 3 other non-bank dealers) owned 54 038 shares, and the “Other shareholders” owned 31 822 shares (of the total of number of shares, i.e. of 97 850 shares). The “Founders” still owned the majority of shares.

In 1997 the “Founders” owned 190 936 shares and the “Other shareholders” owned 194 012 shares, of the total number of shares (389 948); i.e. the “Founders” did no more dispose of a majority of PSE shares.

However, a deeper analysis would show that the representatives of the “Founders” representatives in the Exchange Chamber still had a strong position in this body, although they lost their former majority, as far as total equity is considered.



### 8.5.3 Relation of banks PSE shareholders to non-banks shareholders

In 1992, banks dominated the emerging Czech capital market. Only three non-bank entities were accepted to become PSE shareholders.

In 1994, PSE had 38 shareholders of whom 23 were banks. In 1995, the number of PSE shareholders was 43, of which 23 were banks. In 1997 the relation of banks to non-banks completely changed: of 63 shareholders, there were 23 banks and 40 non-bank entities.

In general, the big Czech banks were more experienced in securities trading than smaller banks and small dealers' companies. The growing share of small new banks and of non-bank entities in the PSE ownership structure represented a risk factor on the securities market. Smaller securities traders were more flexible than bigger entities, but they suffered from a serious lack of liquidity. They had to take bank loans for their daily securities trading. It was easier for them to borrow from new Czech banks than from the big banks. Anyway, many loans never were repaid. This practice was considered to be as one of the destabilizing factors.

### 8.5.4 The PSE shareholders' entities size

In table 12 the PSE shareholders' are divided into 4 categories according to ownership size. Only one company (Harvard SE Company, a.s.) disposed of more than 10% of PSE shares, i. e. according to the Commercial Code this company had a greater potential influence on the PSE policy. Since 1995 until 1997, a representative of this company was member of the Exchange Chamber.

Table 12  
**PSE Shareholders' Structure (as of June 26, 1997)**

No.	Shareholders category	Number of shareholders	Banks	Non-banks	%
1.	up to 1%	46	11	35	<b>14,19</b>
2.	up to 5%	9	7	2	<b>24,13</b>
3.	up to 10%	7	5	2	<b>49,22</b>
4.	more than 10%	1	-	1	<b>12,56</b>
<b>Total</b>		<b>63</b>	<b>23</b>	<b>40</b>	<b>100,00</b>

Source: Commercial Register of the Municipal Court in Prague

The significance of the data in the above table should not be over-emphasized, as they do not reflect the share of companies in the trade volume. This is one of the points, which researchers should study in future to show the economic role of significant market players more in detail.

### **8.5.5 The PSE Chamber policy and its impact on PSE shareholders' structure**

In 1992–1993, the PSE Chambers' membership policy was rather restrictive: most banks were not inclined to invite new securities traders, however, more capital was needed, and the door for new members and shareholders had to be opened. In April 1994, there were 38 PSE shareholders while 21 were new (10 banks and 11 shareholders).

Not all interested subjects were accepted as shareholders. The PSE Membership Committee very carefully examined all subjects (non-banks included) according to standards generally applied to banks in Europe. However, there is a historical paradox. Practically all new banks selected to become PSE shareholders, in a few years disappeared from the Czech capital market because of their failure. On the contrary, some of the non-bank securities traders survived.

The selection process – through the period examined – was changing. In the first two years, Exchange Chamber strictly regulated the minimum (1000) and maximum (1500) number of new shares which could be acquired by new members. Later on (1996–1997) this restriction was removed with the process of re-sale of PSE shareholders who failed. In June 1996 there were five securities companies which owned not more the 15 PSE shares (Cimex Trading, a.s., Moravskočeská burzovní společnost, a.s. and Zvěřina a Bělohávek, s.r.o. owned only 10 shares each, Goldes, a.s. and Pražská brokerská a.s. 50 shares each). Other nine securities traders owned only 100 shares each. As a result, the PSE equity remained concentrated in the hands of big owners (almost two thirds – see Table 12).

In comparison with the situation in 1995 nobody of 43 PSE shareholders owned less than 666 PSE shares; the biggest shareholder was the Czech Saving House – Česká spořitelna, a.s. with 30 608 shares.

Exchange Chamber tried to hold the process of PSE shares resale under control. Exchange Chamber had to approve every sale in advance; otherwise, the transaction would not be valid.

# 9

## **PSE and financial education**

*9.1 Czech financial education in the nineties*

*9.2 PSE activities on the field of financial education*

*9.3 PSE role in brokers' professional education*

For the developments of financial markets, financial education represents one of the decisive factors. This is the reason why all emerging financial markets have to develop its financial education systems adapted to the needs of a given country.

This Chapter deals with three main questions. Firstly, the Chapter characterizes the financial education level in the Czech Republic at the beginning of the nineties (9.1). This research was based on the data of the Capital Market Institute in Prague (CMI – member of the European Capital Institute), however, it was not possible to include complete data in this monograph. Secondly, the part 9.2 contains the analyses of PSE policy in the area of financial education. Thirdly, the part 9.3 describes brokers' financial education, and the role of PSE.

### **9.1 Czech financial education in the nineties**

At the beginning of nineties, only limited information about the pre-war Prague Stock Exchange existed: almost all pre-war documents – even in archives – were lost. This is the reason why it was necessary to start financial education from scratch.

After November 1989, the Government documents - for example the first Government Program – did not explicitly mention the financial education.

However, majority of Czechoslovak populations' positive knowledge about “capitalist” financial markets, stock exchanges, financial investment and other categories of finance were equal to zero. The “state of affairs” was “catastrophic”.

The PSE founders were aware of their responsibility for financial education of the Czech potential capital market participants and decided to prepare initial measures in this field. The Preparatory Committee (See Chapter 3) collected information on developed financial markets and financial education system especially from advanced European countries – Great Britain, France, Germany etc. and tried to apply their experience for the Czech capital market development in 1990, as soon as several private inquiries about basic financial education level existed. In banks, young bankers had a relatively good level of financial basics knowledge.

### **9.2 PSE activities on the field of financial education**

The emerging PSE financial education policy was a pragmatic one: it was decided to be active in this area, up to the PSE own capacity. It was decided to concentrate this capacity on basic

questions, such as the Stock Exchange and its functions, securities trading, clearing and settlement, etc. More complex questions were postponed until the Stock Exchange would accumulate its' own experience. One of the examples of such questions was the financial derivatives' trading, because a pre-mature derivatives trading was connected with high financial risks and speculative trades.

The PSE decided to publish its own publications containing relevant and precise information on its activities not only for its own needs, but for a broad public as well. (See: Chapter 1.)

The fact that the PSE published a new printed journal "Exchange" ("Burza") was very important for potential investors and for public as well. (See: Chap. 1.2.)

After 1989, several financial education companies from Western Europe (Great Britain, Sweden, Austria) tried to penetrate the emerging market. However, different financial education courses were offered which did not correspond to the low level of financial literacy of potential students. Let's recall a striking example of an incompetent approach. In 1990, the OM Company from Sweden organized a free-of-charge seminar in Prague. The Company presented its proposals about the organization of the Czechoslovak capital market, which did not correspond to local financial infrastructure, technical possibilities, and financial literacy level. Many participants did not understand a word and the seminar was a complete failure: its benefit for financial literacy of participants was equal to zero.

Up to 1995, a lot of information on the practice of securities trading imported from the West to the Czech Republic were incorrect and misleading. Many "false prophets" were telling their stories and tales how to get rich; sometimes, it was difficult to oppose the glorified "myths". It was possible only to systematically coerce the change of this chaotic trade with "education."

PSE through its transparent informational channels and Ministry of Finance by its system for professionals' education contributed a great deal to the general rise of financial literacy.

### **9.3 PSE role in brokers' professional education**

According to legal regulations, one of the important tasks of the Ministry of Finance was to take care of brokers' financial education.

The Ministry of Finance signed a contract and outsourced the practical implementation of this activity to a private company called "Institute for financial market development support" (further on: Czech abbreviation "IPRFT" will be used). This training company task consisted in preparation of content of brokers' education courses and organization of these courses in Prague. Department of Supervision approved, and strictly controlled the content of these courses. The fees for participation were very low; the training company had to transfer – after deduction of cost incurred – the rest to the Ministry of Finance account. The aim of the low fees policy had to attract interested persons – practically young employees from financial sectors' entities – to study the financial markets' basics in a condensed form. Majority of courses were two-weeks' courses. The participants had to pass a final brokers' examination at the end of every course to be awarded a diploma.

In the years 1993–1997, approximately 4,500 participants passed the brokers' examinations. The courses were highly appreciated by majority of participants and by the Department for Supervision as well. (Ministry of Finance, Archive; Pavlát, V. IPRFT Company Archive.)

The PSE supported financial education of its staff from the beginning of trading; knowledge and skills of practical questions of specific stock exchange activities had the highest priority. Members of the PSE staff participated in the courses organized by the training company IPRFT to be able to get the diploma recognized by PSE and the Ministry of Finance as a brokers' license.

In connection with the preparative works for PSE financial derivatives trading, Ministry of Finance set up a Commission for financial education (1996). Its members were selected specialists from the Ministry of Finance, one PSE representative and a number of independent professionals.

# 10

## **The Czech press about the Czech capital market and PSE**

*10.1 The Czech press about the Czech capital market and PSE in 1994*

*10.2 The Czech press about the Czech capital market and PSE in 1995*

*10.3 Findings*

This Chapter deals with the information on the development of PSE trading, and about the emerging Czech securities' markets published by the Czech Press. This Chapter is based primarily on the Press Survey published in the "ABK" (Magnet-Press monthly and its Supplements in English), on the PSE internal "Information from Periodical Press" (1994), and other selected sources. (See: Chapter 1.2 and Chapter 9.) Monthly surveys are based on articles published in Czech language in different newspapers and journals (See: Chapter 1. 2 – sources).

The selection process prepared a small group of 2–3 ABK Board members. The members of this group occasionally consulted the PSE Secretary General Jiří Franc, eventually other members of the PSE Chamber to be able to present the current event in an objective way. Lecturers evaded any subjective polemics. ABK Board approved the significance of selected articles for the Czech financial market development.

The monograph does not include the Czech press articles published in 1996–1997 for three reasons: firstly, the most important events and discussion questions are dealt with in Chapter 12 (the discussions' participants' opinions were commented) on; secondly, the second reason was the loss of a part of the ABK archive, and the third reason – the limited scope of this monograph.

The purpose of this Chapter is to present the development of views that were published by the Czech Press as a reaction and reflection of current events on the Czech emerging capital market, PSE trading and many emerging unsolved questions. This approach enabled to create a set of facts needed for evaluation of the PSE general policy, which is analyzed in Chapter 13.5. Unfortunately, not all monthly commentaries were available in January – April of 1994; the September commentary partially covers the missing two summer months – July and August, December; December 1995.

This Chapter is based primarily on the Press Survey published in the "ABK" in English (Magnet-Press monthly), on the PSE internal "Information from Periodical Press" (1994), and other selected sources. (See: Chapter 1.2 and Chapter 11.) For methodological reasons, articles published in ABK English supplements in 1994 and 1995 were not included into the statistical tables in Chapter 9. However, the Sub-Chapter 13 dealt with them in 10.3 because of their high importance.

## 10.1 The Czech press about the Czech capital market and PSE in 1994

MAY– JUNE 1994

*Motto: “Securities market still cloudy, but...”*

A decline in share prices was a characteristic feature for the development on the Prague Stock Exchange for the period of the last May through the first half of June 1994. This fact was also reflected the articles and comments brought by various economic periodicals, as well as the pages of dailies, namely the columns reporting on the exchange news. As of the first half of June, the prices started to go up again, but the trade volumes have already stabilized at the level of about CZK 1 billion (one thousand million) per week.

In the article “*Exchange trading week - Stabilization of prices at the bottom line*” the **daily Hospodářské noviny** of 16 May reported that the “Overall price level of shares is currently maintained at the level that is, for the time being, close to this years’ lowest level which was recorded on May 3. Mondays and Tuesdays trading sessions (with the same trade volumes amounting to CZK 47 mil.) represent this years’ record minimum and the quarterly trade volume of CZK 56 mil. was higher than the existing lowest volume achieved on 18 January (CZK 51 mil.).”

On Monday, 17 May 1994, the daily **Rudé právo** confirmed that all SIS indices suffered recorded loss.

Outflow of foreign capital is the main reason for the current decline in the trade volumes, and rates of many securities that was anticipated as to follow the boom of the end of the last and beginning of this year. This opinion shares, for instance, **Zdeněk Jakoubek**, Director of the company *Expandia Finance*. He thinks that by the coming autumn there will be no significant surprise on the Czech capital markets. In the daily **Lidové noviny** he states that, from point of view of foreign investors, the Czech market is too small. A passive foreign investor, being unable to acquire any transparent information about financial positions of companies, is only ready to invest in the safest securities providing sufficient liquidity. In the case of these securities, the profits have already been realized. This is one of the reasons for the outflow of foreign investments.

The decline in share prices stopped during the second week of July when the PX-50 Index recorded growth anew for the first time.

The newspaper **Burzovní noviny** (stands for Exchange Newspaper) of 13th June the last published information from the Czech National Bank about a different trend in development of share prices by individual sector that monitors the CNB-120 Index. In the first week of the last June, the share rates had a tendency to rise namely in engineering and electro-engineering (+ 23 points), in finance sector (+ 35 points) and in commerce and services sector (+ 3 points), whilst in sectors such as power generation, building and food industries they kept still going down.

With anticipation of further development of trading on the Prague Stock Exchange, many

controversial opinions exist. For instance, **Alois Dušek**, Director of a brokers firm *Body International Brokers* in an interview for the daily **Český deník** (of 22 June) anticipates that the increase of trade volumes on the Prague Stock Exchange will occur during the last quarter of this year.

The weekly **Profit** (of 21 June) also assumes that the holiday season will probably be characteristic for a rather lower interest in capital transactions. “The outflow of the interest, of individual investors in particular, could, however, have rather a more significant impact on the RM-System than on the Stock Exchange, as it is the RM-System where majority of instructions/orders come from these (individual) clients”.

On the opposite side, **Pavel Kohout** from the investment company *PPF, a. s.*, in the daily **Mladá Fronta Dnes** (of 23rd June) writes: “What is striking is the sovereign assurance with which an overwhelming majority of experts expects a silly season in this summer. The only important seasonal divergence, in terms of statistics, is the rates growth, which occurred in January (called “January effect”). No theoretical or empirical evidence exists which would be in favor of the hypothetical summer stagnation on the stock exchange. Even the horse sense is against: if we expect an increase in rates no earlier than in the coming autumn, it is logical to buy as early as now... On the developing markets to which the Prague Stock Exchange also belongs, no periods of stagnation practically occur. These markets either go [...] up or fall down headlong – there is nothing left in between. Should a revival of the market [...] come, this will not happen in the coming autumn, but immediately.”

In an interview for **Lidové noviny**, **Emil Mládek** indicated that “...exchange cycles in our country will be shorter than on stabilized markets. In America, a market goes up for about 18 months and down for about 18 months. In Prague, the rates went up for five months and down for four months. And now they are going up again”. The rates are expected to go up at least for two months before the second wave is over: “...after it is over, a lot of securities will be offered for sale which will push the market down again”.

**Zdeněk Bakala** (of *Patria Finance, a. s.*) assumes that the Czech capital markets need revision of the relevant legislative standards. In the daily **Hospodářské noviny** (of 23rd June) he classified the environment for the Czech capital market in terms of legislation as considerably insufficient; the laws need revisions. As the weakest point, he considers the way of settlement of the trades and acquisition, processing and publication of information within companies.

**Zbyněk Fiala**, (the daily **Rudé právo** of 24rd June) informs about the fact that the exchange starts to actively consider a possibility to distinct the exchange market by dividing it into three parts in working terms known as “three markets”. The first two markets would be listed markets where issuers are ready to provide more details about their financial results, and about important events occurred within the joint-stock company. The third market would be unlisted market. This would take care of the issues not complying with the listing requirements, not providing sufficient information. A number of written contributions give comments on a long-term declining trend in the trades executed through the periodical auction under RM-S.

**Lidové noviny** (of 21st June) write that along with the decline of the total trade volume also



the average prices of traded (sold and bought) securities are going down getting below the exchange level. According to **Lidové noviny** (of 21st June), **V. Stecher**, Deputy-Director of the RM-S, stated that "...so far, we have not yet considered cancellation of the periodic auction. I expect that, thanks to the current increase of prices on the capital market, the trades executed through the periodic auction will go up again". In the course of the last few months, interest in bond issues went up.

**Pavel Richter** (of **Burzovní noviny** of 20th June) states that during the years 1990–1992 the Ministry of Finance authorized altogether 17 publicly marketable bond issues, 15 issues were authorized in 1993. Since the beginning of this year, seven publicly marketable bond issues amounting to CZK 7.4 billion have been authorized and additional nine applications are under review. To the municipal bonds of Smržovka, Liberec and corporate bonds of CEZ in June, the issues of Union banka, C. I. V. Zlin corporation, Chemapol and SPT Telecom were added.

A growing interest in issues of investment funds also was recorded during the last weeks. **M. Boháček** (**Mladá fronta Dnes**, of 23rd June) reports that, in June, shares of IF Creditanstalt went up by 45%, of Spořitelní privatizační fond by 40%, of První investiční fond by 18% etc. (**ABK**, 1994, No. 2, p. 7.)

#### **JULY–SEPTEMBER 1994**

The months of summer season have an impact characteristic for an overall reduction of activities on majority of exchanges all over the world. The Czech capital markets have had, so far, no experience in this respect, as the last year's start of the capital markets here occurred in an entirely atypical situation. Therefore, no wonder that complaints regarding low trade volumes repeatedly and periodically appear in the Czech press. This sort of news mostly vary only in their headlines that are formulated either more or less funny way: "*Black Monday - or an unforeseen Revival*", "*Holidays on Stock Market*" or even "*Holiday Damping on the Prague Stock Exchange Has Even Deepened During the Tropical Heats*" (**MF Dnes**, 28 July).

However, more attention should be paid to certain press contributions evaluating less ephemeral events than a growth or decline of rates of either these or the other shares. Introduction by Komerční banka of its STOCK LIST that was appreciated very much, became undoubtedly the event of the month of July. On 13th July, **Zbyněk Fiala** wrote in the daily **Rudé právo** that "...the new service offered by the Capital Department of the Komerční banka and named in the American style – the Stock-List, creates an opportunity, from point of view of a petty shareholder, how to sell quickly and without complications. The service consists in publishing a list of shares with the bid prices by the Komerční banka, twice a week, i.e. for which the bank is ready to buy the same shares in fact without limiting their volume. From the viewpoint of a trader, this is an attempt to accumulate larger packages of shares for an attractive direct trading and thus to reduce the dependence on sales of the funds which used to trade only when they needed cash at the end of a year. From the viewpoint of the capital market, this service may become an extremely interesting once the Komerční banka has succeeded in opening the two-way trading, i. e. parallel buying and selling over-the counter."

Analogous meaning expressed the weekly **Profit** (on July 20).

A significant contribution written by **Jiří Schwarz** was published by the daily **Hospodářské noviny** (standing for Economic news, and dated 13th July). The author is the Chairman of the *Liberal Institute*. He, *inter alia*, criticized the statutory regulations on taxation, which he considers a break of the capital markets in the Czech Republic. [...] in comparison with holders of bank deposits, shareholders are currently discriminated, as they have to pay a tax from their earnings, i. e. from dividends, at the rate of 25% against 15% from interest on deposits. This difference does not provide enough stimulation for the population in order to keep its temporarily free assets in the form of shares. Also a relatively high tax burden on earnings from trading in securities on an emerging capital market that is based on the difference between purchase (acquisition) and sale (deposition) price does not provide enough stimulation. It not only provides insufficient incentive for a further growth of trading volume on the capital markets but, on the contrary, it leads to a reduction of prices and, at the same time and thanks to that, also to a decline in the trading volume.

A low activity on for bonds markets also stirs up the attention of the press. The daily **Rudé právo** (on 12th July) stated that “[...] trading in bonds on the central market has practically stopped. There are big differences between the offer prices of bonds on the Exchange, and substantially lower bid prices for which anyone is ready to buy from behind. There are probably varying views of the future development trends in the interest rates. Those who wish to sell dear (i.e. at high prices – V.P.) count on a decline in the rate and so, an old bond, i. e. with a higher interest, becomes more profitable and advantageous. Therefore, it is, as early as today, offered at the higher price, so that both its old and new holder can share this benefit. However, the number of those who, on the contrary, bid the lower price is much higher, and they thus indicate their expectations that the interest rates will go up, and accordingly the old bonds will become less advantageous.”

In the daily **Hospodářské noviny** (of 20 July), **Vladislav Pavlát**, the Chairman of the Committee on Exchange Trades of the *Prague Stock Exchange*, gives an information about the results of the World Conference of Representatives of Markets for Securities, organized last June by the International Federation of Stock Exchanges (FIBV). Sixteen new stock exchanges appeared in the program of this Conference. “A discussed topic was the development of well-functioning capital markets and the increase of the existing number of issuers. Discussion about the application of electronics to newly emerged Exchanges also was the topic (when it is possible and appropriate to open trading in derivatives). The experts came jointly to the agreement that none of the new emerging European exchanges has [...] the requirements for starting to trade in derivatives of this type. Regarding the Czech capital markets, the participants in the Conference gave this process an overwhelmingly positive evaluation except for clearing and settlement of trades in its connection with the Securities Center.”

In the daily **Lidové noviny** (of 30th July), **Emil Mládek**, *adviser* to the Director-General of the *Komerční banka* on exchange issues, expressed also some points on the defects in the operation of the Securities Centre. Prices of many shares are very attractive, unfortunately, we do not know what is going on in the field of direct trading (block trading) through the Securities Centre. Large packages of stock can be transferred via Securities Centre without disclosing their volumes and prices, i.e. the reason why our organized capital market is suffering. It is more than necessary that these transfers through the Securities Center are disclosed to the public

on a daily basis if possible. Only this measure can prove the seriousness of our capital market in the eyes of foreign investors. Public disclosure shall remove the myth of the mystery that serious foreign investors dislike.

In the first half of August, daily press intensively commented on the course of the second privatization wave in connection with the opening of the fourth round. A great deal of attention attracted the shares issued by the companies already privatized under the first three rounds. Subjected to a severe criticism were, in particular, the approaches of both the Centre of the Voucher Privatization, and the Ministry of Finance that, allegedly, do not envisage the necessity of giving shareholders certificated shares as early as this time.

**Vladimír Rudlovčák**, *Deputy-Minister of Finance*, stated that: “[...] having analyzed the situation in the companies already sold out, we have come to the conclusion that, there is no necessity for physical shares to be issued”.

**Petra Wendelová**, *Director of the Harvard (Stock) Exchange Company*, took an opposite position when she said, that “she can see no reason at all, why physical shares could not be issued now”. The issue of physical shares and handing them over to the shareholders could avoid the stock that is going to hit the capital markets which will have to successfully face the inflow of above eight hundred types of new shares.

**Jan Suchánek**, manager of the *Y.S.E. Funds*, shares the opinion that the continuous postponement of the issue of the physical shares coming from the voucher privatization is nothing but evidence that the state bureaucracy does not care at all about the development of the economy. Bureaucracy is continuously hindering the privatization process at their convenience, due to their laxity.

The daily **Hospodářské noviny** of 15th August 1994 has published information about securities for which prospectuses should have been submitted to the Ministry of Finance by the companies already privatized under the second privatization wave. However, only a quarter of these Companies presented their prospectuses. The latest deadline to tolerate was the end of the last August.

In the daily **MF Dnes** (of 18th August 1994), **Michal Urban** devotes his deeper thoughts to the low dividend yields on majority of shares.

“Only for two decades the dividends have exceeded 10% rate of yield, taking into account the current level of the rates, i. e. roughly at the level of a “p. a. interest” on one-year time deposits paid by large banks and, at the same time, just at the level of the inflation rate anticipated. Taxation, however, will yet reduce the earnings by an additional quarter. The shares placed on the exchange market for listed securities are, by far, not among those most yielding. Most of those are currently promising only dividend yields at the rates of approximately 1% to 2% which, of course, is not too much attractive for the investors.”

A major interest evoked the article in the **Hospodářské noviny** (of 17th August 1994) in which **Jana Bobošíková** disclosed the information from the Ministry of Finance about the outcome of an investigation of 15 illegal dealers in securities operating within the region of the town of

Ostrava. As discovered during the check by the staff of the Ministry's Department on Supervision over the Capital Markets, these fifteen corporate bodies, although unauthorized for trading in securities, have gained a significant profit from the transactions, just thanks to buying-out shares. (No question this was done at the prices deeply below those quoted in the stock rate-list) and selling them subsequently. Experts assume that, under the current legislation on securities trading, the exact point of distinction between the securities trading (as defined in the Securities Law) and purchases and sales of securities for the purpose of maintenance of a company portfolio, can hardly be clearly and sufficiently determined. The only way to remove the existing anomalies is a revision of the current regulations, imposition of charges on trades conducted on unorganized markets, and further improvements in the operations executed on the organized markets in a manner, which would attract more deals for this category of markets. (ABK, 1994, No. 3, p. 6.)

## OCTOBER 1994

During October the press drew attention to the continuous decline of the share prices of investment funds and to the general decline of all prices including the prices of listed shares. Press commentaries were more moderate than in the past, perhaps, because of the simultaneous growth of transactions on the Prague Stock Exchange. Apart from the standard commentaries concerning the price movement, the press also paid attention to the number of already existing or only expected events, i.e. the question of when shareholders would have shares of companies privatized in the presently held second coupon privatization wave in their hands.

**Profit** (No. 40) said that shares from the second wave would be handed over to shareholders only after the whole coupon privatization would be completed. "The chance that shares could be handed over continuously is definitely gone. The Securities Centre is able to transfer the shares to the owners only two months after the end of the last round at the earliest." The Securities Centre decided that February 15, 1995 will be the supposed date of the transfer. The Centre will interrupt its running activities for nine days. It will suspend the transfers of shares to the owners' accounts. Therefore, the Prague Stock Exchange and RM-System will also interrupt trading. "So the situation of the end of the last year when the Securities Centre interrupted its activities because of the transfer of statements from securities owners' accounts will be repeated."

The intention of the Finance Ministry of the Czech Republic to increase the income tax resulting from the sale of securities (capital yield) from the current lower rate valid for 1994 to standard 41 per cent rate, which all other legal entities pay, caused major dissatisfaction among fund managers. A critical comment was made by **Jan Suchánek**, the director of *YSE* – the fifth largest investment fund in the Czech Republic. He wrote in **Profit** (No. 40): "If the proposal of the FMCR was realized, the profitability of investment funds would further decline. [...] The investment funds are an important part of the capital market and they take part significantly in the optimization of capital flows in the Czech economy. That phenomenon causes a certain aversion to the forces that prefer "democratic centralism". They try to press down the role of the investment funds by the introduction of the tax restriction of capital yields. The cost of this restriction is a loss of thousands millions of national capital."

**Rudé právo** (5<sup>th</sup> October) brings the discussion of **Miroslav Kučera**, the General Director and member of the Bank Council of the *Czech National Bank* with the agency Reuters under the title: “*The transactions over the Securities Centre counter reduce market liquidity*”. “The lack of liquidity and low price transparency causes uncertainty and hinders activity of not only investors but also of issuers. The market organizers have been complaining for long time of the organized market trading where it is necessary to register only at the Securities Centre and no disclosure concerning information about the contract is needed. According to *M. Kučera*, the main cause of this situation is the absence of a central body engaged in transaction settlements which would operate under the usual standards i.e. delivery versus payment.”

**Hospodářské noviny** (5<sup>th</sup> October) said that the majority of companies involved in the second wave have passed their prospectuses to the Ministry of Privatization. **Hana Jakobová** from the Department of the Supervision of Capital Markets of the FMCR stated: “Till today the Ministry has received about 61 prospectuses of the companies from the second wave, out of which approximately one hundred had to be returned for revision. Mainly, prospectuses lacked sufficient information about the members of the boards of directors, supervisory boards, their professional abilities, business activities apart from the activity of the issuer and membership in other boards of directors”. Although the companies from the second coupon privatization wave prepared their prospectuses better than the companies from the first wave, the quality of the new prospectuses does not correspond to the requirements.

**Lidové noviny** (6<sup>th</sup> October) published an interview with **Emil Mládek**, advisor to the Stock Exchange General Director of Komerční banka who, while evaluating the activities of the Prague Stock Exchange, said that “its results speak for themselves and suggest that the Stock Exchange was getting on very well. [...] The problem that remains is that trading through the Securities Centre especially movements in the capital market lack transparency and that it may discourage foreign investors from more active participation”. **E. Mládek** also assumes that in addition to the 29 companies that list their shares on the Czech market so far, there are at least 50 others which would meet the requirements needed for trading in this market.

**Rudé právo** (19<sup>th</sup> October) published rather controversial article written by **J. Dědič** entitled, “Is protection of minority shareholders in the Czech commercial law appropriate?” In his article, he tries to prove that “the number of questions concerning the protection of the minority shareholders, which is not virtually covered by the Commercial Code, is solvable in a concrete dispute” by the application of the provisions of the Commercial Code which also involve the protection of minority shareholders. In contrast to this theoretical approach (unrealizable in practice), the participants of the business practice believe that the protection of minority shareholders is on the low level in the Czech Republic and that it necessarily has to be strengthened.

**Lidové noviny** (20<sup>th</sup> October) state that “*Foreign investors do not purchase in RM-S*”. The Director of the Capital Market department of Živnostenská banka **Martin Kryl** said: “We want to be transparent, we prefer the Stock Exchange. [...] As the Stock Exchange member we trade in shares of the listing market and therefore we cannot take them to the RM-System”. The relatively slow settlement system of the transactions in the RM-S also discourages foreign

investors. Živnostenská banka regards estimates suggesting that 90 per cent of all transactions in the Czech capital market go through the Securities Centre as exaggerated.

**Český deník** (8<sup>th</sup> October) published the statement made by the press spokesman of the *Stock Exchange Z. Skobla*, who said that the split of the Stock Exchange market to three markets “will increase the whole capital market quality and transparency, because shares will be divided according to quality and marketability. By accepting an issue of shares of the given company to the second tier of the listed market, the issuer is obliged at the same time to disclose information about his economic situation.” By this step, the whole market will become definitely more transparent and that is the requirement of the thumping majority of investors today. (ABK, 1994, No. 5, p. 6.)

## NOVEMBER 1994

In November, we can find numerous comments in the Czech press on the continuous decline of shares rates on both the Prague Stock Exchange and within the RM-S as well. In general, the authors of the comments repeat the well-known arguments about the “break” in inflow of foreign investments in portfolio, about impact of large issues of Czech banks, and about the systems shortcomings that have appeared within the Czech capital markets.

**M. Achremenko** (*Lidové noviny* of 14th November) assumes that the decline in shares rates on the PSE is not corresponding to the favorable indicators reflecting the results of the Czech economy: “Our stock exchange... is not providing the picture of the Czech economy, and the panic is unjustified”.

**T. Tepper** (*Hospodářské noviny* of 15th November) noticed the instability of the emerging Czech capital market, and particularly its impact on psychology of investors that has a considerable influence on seeking the real rates. He estimates that the rates of shares, from mid-September 1993 to February 1994, have risen almost four times. “Index HEN-Wood 3 culminated on February 1<sup>st</sup> of this year, having reached 2,805 points [...] now, after ten months, it fell down significantly below 1,600 points level. Thus, the value of shareholder's equity balance has declined since the last February to the mere 40%, although it continues to be higher than at the start of the capital market.”

The daily **MF Dnes** (of 17th November) published the information that “...from time to time, shares get lost in the Securities Centre. Several investment funds and broker's companies confirmed this information. The holder found out such a loss as late as at the time when he is giving instruction for sale of the shares, i. e. when SC returns the instruction for sale as not executable, since the SC states that it has had no such shares on its account. Upon submission of the respective claim, it is usually proved that a mistake had occurred in the Centre; then the claim is executed in affirmative and in no time, and the shares are sold. Experts, however, argue with pointing out that, in the meantime, the rate of the shares could have declined, and so the client may be facing a threat of a financial loss.”

**K. Klein** and **P. Richter** (*Hospodářské noviny* of 17th November) reported that the PSE did not admit the YSE Fund that ranks among top ten privatization funds to the listed securities

market of the Exchange. The Listing Committee announced that the “listing would contradict the principle of investors’ protection and other participants in the stock exchange market as well”. This is the first case when the Exchange did not admit an issue of a privatization fund to the listed securities market of the Exchange.

**Šrédl** and **D. Lorenc** (**MF Dnes** of 17th November) published information about the fees collected by stock dealers for the broker's services related to a purchase of stock worth 20 thousand CZK. As the information implies, considerable differences exist among individual broker's companies.

The daily **Český deník** (of 14 Nov.) published news from a session of the *Citizen's Democratic Alliance* (Občanská demokratická alliance), according to which **V. Dlouhý**, *Minister of Industry and Trade*, required to make the situation on the Czech capital markets more transparent. He stated, inter alia, that “the securities operations should be prevented from being executed outside the institutions the Czech capital markets have at the disposal, or even outside the republic, and at the time which does not correspond to the requirements of the capital markets”.

A sad hit of the month for the Czech press became the arrest of **Jaroslav Lízner**, for his alleged acceptance of a bribe in the amount of CZK 8,5 mil. J. Lízner held recently two very significant positions: he was Director of the *Voucher Privatization Centre* that prepared and organized the voucher privatization process, and simultaneously, he was Director of the state's central Securities Centre which performs the role of the central registry for dematerialized securities. J. Lízner is currently in custody, and the investigation of his case continues.

The “Lízner affair” has provoked a series of critical responses. Several important and famous politicians, such as **Ivan Kočárník**, *Deputy-Prime Minister and Minister of Finance*, and **R. Češka**, *Chairman of the National Property Fund of the Czech Republic* commented. They assured the public that the Lízner case was exclusively a matter of failure of a human factor involving a single person. They had refused to link this event to the shortcomings in the securing of the course of the voucher privatization process, and they promised that the Lízner scandal would not negatively affect the successful accomplishment of the second privatization. Czech Parliament has rejected the proposal tabled by the opposition, and asking for the creation of a parliamentary commission that should examine the course of the privatization process.

In addition, several computer experts made comments on the case. They generally tried to argue and prove that J. Lízner could not have penetrated the information system dealing with the second privatization wave, and could not have influenced prices of the shares. These arguments, as a whole, however, sound unconvincing in the light of daily **Mladá Fronta Dnes**. This daily, first of all, reminded its readership of the fact that there are close ties and links existing among the Voucher Privatization Centre (VPC), Securities Centre (SC), and Computation Technology Company known as Podnik výpočetní techniky (PVT) whose subsidiary company is the RM-System (RMS), i.e. the organizer of the over-the-counter market for securities. One of the shareholders of the PVT, a. s., is the privatization fund named Zlatá brána (Gold gate), founded by the company Zlatá cihla (Gold brick), and they are also interconnected with the consulting company Zlatý klíč (Gold key), as well as the software company POSTPO Soft.

The dailies **Mladá Fronta Dnes** (of 11th November) and **Český deník** (of 12<sup>th</sup> November) rose the question of a possible conflict of interests. They seemed to result from the fact that “the person who is a co-participant in the process of creation of the shares rates of the companies under the voucher privatization has also a very close links to privatization fund”. According to the daily **Český deník**, both the company Zlatá brána and RM-S are residing in the same building.

The dailies **Mladá Fronta Dnes** (of 11th November), and **Český deník** (of 12th Nov.) rose the question of a possible conflict of interests. They seemed to result from the fact that “the person who is a co-participant in the process of creation of the shares rates of the companies under the voucher privatization has also a very close links to privatization fund”. According to the daily **Český deník**, both the company Zlatá brána and RM-S are residing in the same building at Klimentská street. *Dušan Tríska*, a former deputy to the Ministry of Finance, was allegedly a co-owner of these companies. He was one of the authors of formulas, according to which prices of shares for both privatization waves were calculated. The spouse of *Dušan Tríska* is a member of the Supervisory Board of the company Zlatá cihla. Apart from the known facts, i. e. that J. Lízner held simultaneously the positions of Director of the Voucher Privatization Centre, and Securities Centre, it was disclosed that certain employees of the PVT are working simultaneously also for VPC, RM-S, or for some of the above mentioned companies bearing the meaningful “golden” name.

Reuters agency reported that **Adrian Basora**, the *US ambassador* to the Czech Republic, expressed his opinion on J. Lízner’s case. According to his opinion, now it was no longer admissible to carry out trades in the same way as under communist era when corruption used to be a common phenomenon. Investigation of J. Lízner commercial scandal has not been accomplished yet, neither was published, in November, any official information about its progress, with the exception of the information about J. Lízner's arrest and his accusation of having accepted the bribe.

The outbreak of the commercial affair once again raised doubts about a consistent preservation of the confidential information about the course and results of the voucher privatization. These doubts arise, in particular, when considering various links and ties among the numerous cited companies, in which the same names appear to be repeating so frequently. (ABK, 1994, No. 6, pp. 5–6.)

## 10.2 The Czech press about the Czech capital market and PSE in 1995

### JANUARY 1995

The previous month represented another turning point in the development of the Stock Exchange trades. It was the last month counting full 31 days during which deals were carried on at the Prague Stock Exchange before 677 new securities issues entered the capital market. This had a serious impact also the development of volumes, rates and structure of the trades. One can state that mass movements of securities from one group of holders into the hands of other holders resulted in a partial release of financial assets needed by stock dealers as capital



available for their trading that is going to start as of the coming March. At this time, shares from the second wave of the voucher privatisation will be traded too.

General status of the preparations for the 'second wave inflow' will undoubtedly be reflected in prices development at the Prague Stock Exchange and in the Exchange Index PX 50 in particular. Development of the index reflected the declining tendency in order to record a historical collapse at the end of the month reaching the value of 495.1 points.

There is absolutely no doubt about at all that the stock of the Komerční banka and ČEZ belonged among the most traded securities issues. They were attractive for the investors who were inspired by this signal and started buying these shares. The trade volume achieved in trading of the Komerční banka stock represented remarkable amount of CZK 790 million, and in trading the ČEZ stock – CZK 630 million. These two issues replaced one another in the ranking as far as trading in central market is concerned where shares of the ČEZ company were traded in the amount of CZK 251 million and Komerční banka – CZK 218 million. Each of the three sectors, i.e. power generating, finance & banking, and investment funds accounted roughly for 25% of the Stock Exchange market trade volume. Should we wish to award the “hit of the month” title to any of all the stock issues traded in the Exchange in January 1995, then, no doubt, it should be awarded to the Komerční banka stock. These securities really became the issue talked about not only among brokers and dealers but within the entire community of public investors. Guessing what was so special about it is easy. The reason was its price development which, however, did not mean any deviation vis-a-vis other stock issues within the banking & finance sector, on the contrary, it held the line in the middle. Nevertheless, in spite of this fact, the Komerční banka stock traded for poor CZK 1.170 at the last trading session in January which is a very attractive price taking into account the fact that the nominal value is CZK 500. One could hardly admit any speculation that dizzies, not even to mention warning, while these events were taking place in one of our largest banks, i. e. the events which would acknowledge necessity of a change in the rate downward from long-term point of view. Development of the banking & finance sector (which includes eleven issues) almost fully copied the declining tendency of the PX 50 Index; better to say, the decline of this sector was somewhat more down-streamed. A detail analysis indicates that the radical decline in the rate has affected the entire finance sector as a whole. Perhaps, this has happened according to the saying that “shares of banks will not run away from our investors to any place whatsoever”. Perhaps, it was the stock of the Komerční banka which ranks among the most liquid companies, together with the Česká spořitelna, and that offered the best chance of the above mentioned high-volume trades in January.

One can judge that the further price movements in the issues coming from the finance and energy generating sector will continue to be also interesting.

## **FEBRUARY 1995**

Shares from the 2nd wave of privatisation have finally floated in the stock market waters. It took three whole years to complete the privatisation process of the Czech economy by applying the specific voucher scheme. There were many revolutionary moments and interesting events

which took place in the process. Today, however, everything comes to its irrevocable end. There are no more DIKs (holders of investment booklets), voucher booklets as well as investment points no longer exist in their previous context. Following the last anticipated speculative wave that is (as a rule) usually accompanying any start wherein a real indicator such as market price is missing, the market will get calmed and relaxed again in the same way as a clarifying surface of the lake does after some moments following a throw of a stone in its water. The previous month was a very atypical one in many respects. This might perhaps be the reason why the exchange floor was absolutely empty during its certain part and why stock brokers and dealers made no deals. The reason is known. The Securities Centre was undergoing the last preparations necessary for the launching of trading operations in both the stock exchange as well as over-the-counter. The Centre was carrying on the operation known as the entering (posting) of the shares emerging from the voucher privatisation to their new holders' accounts, so that it could announce its readiness for the start-off as early as of March 1, 1995, it means that the trading on the Prague Stock Exchange was going on primarily during the first half of February. This caused that certain trading sessions became even much richer. The main task of many stock dealers was to exploit the month-end days for concentration of free (available) financial assets for purchases once the shares from the 2nd wave will have entered the market which has already started in the past period.

It was purchases and sales of the Komerční banka stock which took the absolute lead among these trades. They were namely traded in the central market reaching an unusual high, better to say, gigantic volumes of CZK 633.7 million. An interesting feature was that everything materialised on the wave of a mostly uninterrupted price decline which was intensively demonstrated also during the past month. A per share rate of the mentioned stock issue approached the lowest level achieved so far, i.e. CZK 1,065. At that moment, the eager stock dealers were already getting signals to buy this security. And those of them, who had reacted at the right moment, earned a nice package of money making a 20% profit within a few days.

Perhaps, it was due to this fact, why the Komerční banka stock became the hit of the month and this happened for the second time in a row. These events have demonstrated an opportunity of how to make profit under the circumstances making impression of would-be "standing waters" even with the PX 50 Index declining from 495.1 points, at the beginning of the last February, to 479 points, at its end. Only the ČEZ stock managed to get ahead of the Komerční banka stock which happened exclusively thanks to the trades effected within direct transactions. Thus, a trend of would-be a continuing trade competition between the both stock issues has been retained. And exactly for the reason that liquid stock issues are involved, we can expect that these shares, together with other giants from the 1st wave, and favourites from the 2nd wave, will join in the trading also during the period to come. It will be very interesting to monitor the price movements and further development for the both groups. The first one which have already climbed to the peak of the overheated mountain range in order to subsequently go below to the lower floors, and the second one which is standing-by dedicated and ready to conquer perhaps the Himalayas. And it is just this fact which opens the absolutely unsuspected space for investors, the space in which the dynamic growth and radical movements provide unexpected opportunities for effective capital operations for those prudent and well-informed.

But let us not forget that a wise proverb “It's better to be safe than sorry” applies also to the world of securities.

## MARCH 1995

In the first half of March 1995, the attention of the Czech press focused on the listing of shares which have emerged from the 2nd wave of the voucher privatization. According to majority views among commentators, prices of shares, validation numbers, of the Prague Stock Exchange were set too high whilst the prices in RM-S were set too low.

Daily press informed simultaneously about the contradictory movement in stock prices in the both organized markets. An overall tendency in the organized markets was decline in prices of shares, however, at the current, a relatively significant growth of trade volume. SPT Telecom shares became the most favourite security of the 2nd wave, followed by equities of Chemopetrol, Léčiva Praha and Synthesia.

**Lidové noviny** (March 14) wrote that “an enormous mass of supply (offer) had been thrown upon our capital market which our domestic capital was incapable to absorb, and this was the reason for the current decline. It would take some time until this offer would be digested”. Foreign capital is waiting until the situation becomes stable.

Under the headline “*Imposition of a more severe supervision over capital markets is expected*”, **Hospodářské noviny** (March 15), presented an interview given by **Tomáš Ježek** who criticized the fact that the conditions for concluding trades in organized markets within the Czech Republic and outside these markets as well, i.e. when the results only are registered at the SC, should be the same. However, not in this way, at least for the time being, T. Ježek also criticized the companies which fail to provide sufficient information and he stressed the need for information openness.

“Prices in SC have no declarative value for investors” (**HN**, March 15, by **Karel Klein**). “Prices of trades concluded do not have to correspond to the prices available at public markets and they fully depend on the discretion of those who quote them” (*ibidem*). Analogous criticism was also expressed at the European Banking and Financial Forum, organized traditionally by *Comenius company*, where **Vikas Thapar**, an IFC representative (see **HN** of March 23) stated that what, among foreign investors, raises insecurity and fears arising from higher risks, is the fact that almost 70% of deals are effected off-exchange and the capital market in fact only makes estimates of “assets prices”. Low liquidity and non-transparency of the market discourage foreign investors although the Czech market may be interesting for them in the long run. **S. Rudčenko**, Vice-President of Bankers Trust, also acknowledged that low liquidity is one of the reasons for the cold approach towards the Czech market on part of foreign investors.

**Hospodářské noviny** (March 22) provide information on share distribution of the *Savings Bank's Privatization Company* (Spořitelní privatizační společnost) by dividing them into three funds. **V. Srba**, Deputy-Chief Executive of this Company, stated that a large fund is somewhat non-transparent. “We assume that three funds possessing a clear and irreplaceable strategy will be created after the division. Thus, they will become more transparent for investors.”

## APRIL 1995

**Hospodářské noviny** (Apr. 18, 1995) published an article containing views of **S. Czesaný** from *Agrobanka* of certain capital market issues. The author states that three "purpose-oriented trading techniques" are being applied currently at the Prague Stock Exchange. "The first represents a market intervention in favor of rate reduction enabling a purchase of shares for a strongly undervalued price [...] A relatively frequent is the case of a short-term rate rise linked to the efforts of a certain group of investors in order to distribute property for the benefit of gaining the decisive shares for exercising the ownership rights [...] The third type of market intervention is motivated by either group of owners or managers interested in sustaining or increasing market rate for a certain economic entity. The objective of this procedure is to move from undervalued rate towards a band reflecting better the actual value of the stocks." The author assumes that this practice is negatively contributing to insufficient transparency, efficiency and liquidity of the capital market. He is of the opinion that the excessive range of offer currently existing will have some longer-term effects. It is expected that a decisive factor for demand will be the speed of yields' equalization in financial and capital markets and that foreign investors will become a significant factor but, according to his opinion, they can be reasonably expected in 1996.

The author makes some predictions such as, for instance, the anticipation of the improvement in the position of capital investments production sector, improvement of position for infrastructure sector, equalization of market values in agriculture and food industry as well as stabilization of position of banks.

**Zemědělské noviny** (April 18, 1995) stated that the National Property Fund was currently holding assets in the nominal value of CZK 279 billion (thousand million) that is about 40% of shares of all companies either founded or overtaken by the Fund. Almost one fourth of shares held by the Fund so far are shares earmarked for a permanent holding. These involve about 50–60 joint stock companies. Privatization funds were holding assets from the voucher privatization amounting to book value of CZK 230 billion Its current market value was floating from CZK 140 billion to CZK 160 billion.

**Hospodářské noviny** (April 19, 1995) published information that the Ministry of Finance had not prepared the revised Securities Act yet. Protection of minority shareholders is also missing. The authority to introduce or abolish public marketability should be vested in GM of shareholders instead of Board of Directors of a joint stock company. A minority shareholder should be obliged to make offer when trying to repurchase shares from the remaining shareholders. "The Ministry continues to take negative position on a possibility to restrict or cancel so-called over-the-counter trades at the Securities Centre's counter, neither it is supporting the idea of a multi-stage register required by stock dealers."

A number of newspapers provided some views of participants in the conference on capital market arranged for in Prague by Patriae foundation.

**Profit** (April 19, 1995) recorded the view of **V. Rudlovčák**, Deputy-Minister of Finance who thinks that the role of information on companies in the capital market was overestimated and

moreover this information “would not be too encouraging for investors”. Majority of specialists and participants did not share this view. Enough high-quality information is considered by them a prerequisite of a capital market functioning and requirement for inflow of long-term foreign investments.

**Rudé právo** (April 19, 1995) states in this context that the draft of the new Securities Act assumes the increase of periodicity in publication of issuer's business reports. These reports should be published twice a year and they should include the entire closing statement of accounts, including enclosures. An issuer should provide information in the annual reports on all financial and incomes received by members of his Board of Directors and Supervisory Board in the reported (last) year.

**Český deník** (April 19, 1995) makes comments on the opinion of **Kamil Janáček**, *chief economist of the Komerční banka*, stating that new savings (CZK 170 billion), and foreign capital inflow for 1994 new savings (CZK 180 billion) create prerequisites for the development of sufficient liquidity at the Czech capital markets. In addition, Janáček qualified the creation of another, already third in a row, “market organizer” (company RTP whose licence is still under negotiation process within the Ministry of Finance), as a “great nonsense”.

According to **Tomáš Ježek**, Chairman of the *Parliamentary Budget Committee*, “there is a need for return of the trading to public markets via continuous severing of trading at the counters of the Securities Centre, from increasing the fees up to a possible prohibition of such trades”.

**Hospodářské noviny** (April 26, 1995) from an interview with **A. Culík**, Director of the *Capital Market Supervision Department of the Ministry of Finance*, stated that the staff of this Department would be increased from the existing 31 to 65 employees and that it would be provided with more powers than up to date. It was also decided that no Securities and Stock Exchange Commission would be created as yet. Capital market supervision would remain further as a part of the Ministry of Finance of the Czech Republic. A. Culík further stated that investment companies were not complying with their information (disclosure) obligations. Annual Business Reports for 1994 were only submitted by one third of companies and funds. For the non-compliance with the information duties, financial fines ranging from CZK 100 thousand up to CZK 1 million would be imposed (according to estimates provided by the MF of the CR, about 75% of issuers did not properly comply with the obligation).

## **MAY 1995**

**Hospodářské noviny** (May 5, 1995). As of the beginning of last May, the Exchange applies a regulation, pursuant to which companies registered at its unlisted market are obliged to report their business (financial) results to the Exchange twice a year. Until that time, issuers in the unlisted market were supposed to do so once a year although not obligatorily. According to **J. Marko** of the *PSE Trading Department*, non-compliance with the reporting obligation may even be penalized by suspension of issuer's trading in his securities.

**Hospodářské noviny** (May 15, 1995). The following factors are usually stated among the main reasons for the market stagnation and decline in crisis:

1. A crisis in confidence of foreign investor vis-a-vis “emerging markets”, namely following the Mexico events, as well as their prudent and “wait-and-see” approach towards allocation of new sources. Although rates of shares at the Prague Stock Exchange have fallen down quite deeply, foreign business circles still continue to assess them as overvalued (overpriced) and hence wait for their further decline.

2. The market has to fight a lack of domestic liquidity. The population seems not be prepared and to mobilize its saving in favor of capital transactions and, at the given moment, gives preference to more profitable forms of investments. Activities of pension funds have not managed to develop yet and financial resources of investment funds have been weakened particularly after an expensive advertising campaign launched in connection with the second privatization wave.

3. By expanding the spectrum of marketable stocks, the investor's objectives have become somewhat fragmented and the expected selection of shares, by their quality, among the three exchange markets has not contributed to any higher security level either.

4. A sound evaluation is given by foreign countries to the business results provided by companies, including those whose shares are traded in the Exchange's listed market. In this context, an opinion is being voiced quite often that many companies have been suffering from a lack of competent managers.

5. Also qualified as not a petty problem is the conflict of interests resulting from the mutual interconnection between banks as creditors and bank-tied investment funds as majority shareholders of the companies.

6. The legislative imperfections concerning the Czech capital markets are being perceived with sensitivity by foreign business circles as well as there are some delays in tender (selection) proceedings and approval (decision-making) procedures in respect of important privatization projects.

**Český deník** (May 18, 1995). Number of fraudulent transfers of securities executed at the counters of Securities Centre is beginning to grow. These transfers are mostly done upon presentation of either a falsified power of attorney status or personal ID card. To disclose the essential actors of these frauds is generally very difficult, while a shareholder who has suffered such a loss may have serious problems in getting his shares back even if using enforcement actions.

The biggest ever fraud known so far was discovered at the SC's counter in February of this year. Almost four thousand pieces of shares of the Česká spořitelna, in their value amounting to nearly one million of CZK, were stolen from the holding account of the Fidelity Company, The Company Fidelity assumes that responsibility for this fraud is to be fully born by the Securities Centre, due to insufficient controlling mechanism used by the SC.

The most efficient solution would be, if brokerage firms themselves maintain accounts of their clients by themselves. Thus, according to opinions of stock dealers, the number of fraudulent transfers of stocks could be reduced significantly, since a specific firm is much better capable

to guard securities of its clients. In the meantime, licensed stock dealers are pointing out that this “multi-level” registry of securities is functioning almost all over the world. It is to be added that, according to exchange specialists, registration of securities in the SC is also one of the reasons for the dilatory approach demonstrated by foreign investors before they join our market.

**MF Dnes** (May 25, 1995). The Prague Stock Exchange will start to get closer to the world standard; it is almost unimaginable that there are over 1,700 issues of securities registered for trading in such a small market as the domestic exchange undoubtedly is. Perhaps not everybody is going to welcome with applause the differentiation of the exchange markets, nevertheless, this should be supported without reservations.

## **JUNE 1995**

**Roman Pospíšil** (*Rudé právo*, 7 June) refers to the proposal put forward by the *Association of investment companies and funds* (AISF - Asociace investičních společností a fondů) which would give an issuer the opportunity of acquiring its own shares. This is not possible under the existing provisions of the Commercial Code.

**Lidové noviny** (June 9) set out the opinion of the Prime Minister, **Václav Klaus**, on the development of the Czech capital market. Václav Klaus considers a pessimistic prognosis of the Czech capital market to be out of place. At present, two parallel processes are in progress. The first is a fall in the overall share price index; the second is a huge increase in trade volume. The more significant of these is growth in trade since this means that the stock exchange affects an increasing number of financial means, thereby more closely reflecting the economy as a whole.

**Emil Mládek** (*Lidové noviny*, June 10) thinks that, “Until a change in the law restricting over-the-counter trade at the Securities Centre in Prague takes place, the Prague Stock Exchange will remain a powerless spectator of a trade flow that is not subject to any control whatever.”

*Czech National Bank* (**Hospodářské noviny**, June 12) supports the view that the reason for the long-term depression on the stock exchange market does not lie in the lack of potential demand. “As against a mass of shares, there is a fairly significant domestic and foreign capital turnover”. The current position has been caused by the failure of joint stock companies (a.s.) to pay out dividends, so investors are giving priority to bank deposits.

**Vít Vařeka** (*Profit*, June 20) warns small investors not to invest in shares of small businesses where the process of concentrating ownership in the hands of a narrow circle of shareholders has now begun. “Small shareholders can quite easily find themselves in the situation of holding worthless shares with a very low rate and no dividend income”.

**Radek Peleška** (*Lidové noviny*, June 24) assesses new measures taken by the central bank and thinks that they will cause a further fall in investment. High interest rates as against low dividends or the risk of currency exchange losses will cause capital to ebb away from the central market even more.

## **JULY 1995**

**Hospodářské noviny** (July 3) informed about the division of the stock exchange market into trading groups that is under preparation. A criterion for entry of an issue in the first trading group, in which the trading is to be practised on a continuous basis, will become an average trade volume achieved in the central market per session. Considering the amount of CZK 1 million as the anticipated criterion of a minimum trade volume per day, eight stock issues would make it in this group. The second group will include securities traded on a basis of rate fixing (only one rate per day) five-times a week. A condition for inclusion therein should be an average number of trades in ATS (automated trading system) in the amount of at least CZK 10 thousand per day. Currently, this criterion could be met by 328 stock issues. The third group will include securities which will be traded on the fixing basis twice a week, without the minimum trade volume requirement which can currently be applied to 1,418 stock issues.

**Zemědělské noviny** (July 3) published results of an inquiry completed by a joint stock company DEA dealing with the question “what are the services provided by stock dealers (brokers) the Czech citizens know”, Only 9 percent of the population know, apart from immediate transactions, i.e. buying and selling on the spot, at least one more service provided by the stock brokers/dealers. The absolutely overwhelming majority, i.e. 91% of the population has no idea of any additional service. Among citizens who are slightly aware of the services provided, almost every second national named “portfolio management”, one in five stated “advisory services”, and the same proportion spoke about the sale as fast as possible and at the best possible terms via either the stock exchange or RM-System. The lowest number represented those who mentioned, as one more option, the using of securities as collateral. Fifty-two percent of shareholders from the voucher privatization would be prepared to entrust their assets in the form of securities to specialist professionals, 48 percent of the citizens would never entrust their assets to stock dealers. Should the citizens be entrusting their assets to stock brokers (dealers), this would only be done by 21 percent under the assumption that they would be going to make a profit on it, 20 percent under the condition that the stock brokers (dealers) would be serious, and 12 percent only if they would be provided with guarantees.

**Mladá Fronta Dnes** (July 7) published an article which evaluates the prices when trading via Securities Centre (SC). The article presents views of several stock brokers (dealers) including the deputy to the Director of SC. “Although the results published by SC can partially be used, these results are being distorted by senseless prices set for majority of securities transferred”, pointed out a stock broker (dealer) of the Atlantik FT. “Publishing the results has met its purpose by one half only”, insists a stock exchange analyst from the Živnostenská banka. In his opinion, it is prices that continue to present a great problem, since in most cases these are absolutely not corresponding to the reality. However, the key issue is still not solved properly. The Živnostenská banka – together with a good number of other banks and stock dealers – has been fighting for the establishing of multi-stage securities registers since the creation of SC. Stock brokers also assume that more frequent publication of results on transfers would positively contribute to the increase of information awareness level. In their opinion, the current practice based on a weekly publication is a too long period which requires to be cut down to one day. However, SC stands firmly against any such change. “Only to make the calculation



itself takes 48 hours, under ideal circumstances, so, it is out of question, at the present time”, said *J. Diviš*, a Deputy-Director of SC.

## AUGUST 1995

In the first half of August, a number of Czech daily newspapers published a piece of information about an agreement reached between eight major stock dealers on the disclosure of data on direct trades concluded outside both the Prague Stock Exchange (PSE) and RM-S as well. This is an attempt to create a system providing a daily publication of direct trades, while its main purpose is to make the trading in securities registered by the Securities Centre (SC) more transparent. The declarative value of the data published by the SC on a weekly basis is considered to be very low. The data on direct trades will be passed daily by participants in the agreement to the Czech capital information agency (ČEKIA). The participants will advise this agency, i.e. a subsidiary company of PSE, on the price, number of pieces negotiated, trading volume achieved in CZK, and type of trade (direct, repo, forward). The prices will include a dealer's margin while excluding commission and fees. To avoid any duplicity in the disclosure of trades, any transaction between two participants in the agreement will only be announced by the seller. In order to assure anonymity, individual firms are going to trade under assigned codes. For the time being, only eight of 368 licensed stock dealers (brokers) have signed the agreement. These are: Atlantik, Bayerische Vereinsbank, BVV Brno, Citibank, ING Capital Markets, Komero, Patria Finance, and Wood and Co. Large banks have not signed the agreement and some of them have taken negative preliminary positions (e. g. the Česká spořitelna – Czech Savings Bank). According to the information brought by the *MF Dnes* on August 9, the Komerční banka is expected to join the agreement, but the investment funds of the Komerční banka are not. Some investment funds, nevertheless, welcome the agreement.

*R. Pospíšil* (in *Rudé právo*, August 9) states that creation of a clearing centre will be a definite solution for transparency of the market. In order to make this emergence possible, it is necessary to change the Securities Act in a manner allowing the development of a multilevel register of securities.

A considerable attention attracted the interview with the Minister *J. Skalický* (*Hospodářské noviny*, August 7) dealing with ODA's ideas concerning the reforms in the Czech capital market regulation. “We have dropped the idea that the capital market functioning can be improved just and solely through either a revision of the Securities Act or introduction of a more severe protection of retail shareholders [...] we have come to the conclusion that to take this only and sole action would not be enough. A more consistent analysis has demonstrated to us that the anticipated effect can only be brought by a comprehensive change to the existing legislation, provided such changes will enter into force simultaneously [...] This type of privatization could not have created a definite and optimum structure of ownership. A further cultivation of ownership relations has to follow.”

The state will sell a part of its shares held in many strategically significant companies with a key importance for the domestic economy and which are still under its control (*MF Dnes*,

August 9). The nominal value of the firms currently held by the National Property Fund is CZK 161,000 million.

In his article comparing PSE with RM-S, *Petr Wawrosz* (*Ekonom*, issue No. 32) provides comments on the Czech capital market conception: “At the time when the relevant regulations were being adopted [...] it was assumed that one ex-change market (the Stock Exchange) and one or more over-the-counter markets would emerge. All the markets should have essentially been equal, competitive to one another and only a later development should demonstrate which of them would be preferred by customers. This liberal approach [...] however, is causing problems [...] At least in the phase of the capital market development [...] both the competitiveness and competition is appearing to be more damaging than beneficial to the matter itself.”

## SEPTEMBER 1995

In September, the Czech press paid most of its attention to the commenting of price trend changes taking place at the Prague Stock Exchange and to the considerable increase in trade volume there. In addition to this common news, some events of higher importance are recorded, particularly the statement of the Citizen's Democratic Alliance (ODA - Občanská demokratická alliance) and that of *Tomáš Ježek*, Chairman of the Parliamentary Budgetary Committee, on the revision of statutory regulations governing capital markets in the Czech Republic. The prepared proposals differ from each other. Whilst T. Ježek supports only the Security Act revision, ODA's proposal prefers a consistent, global reform which would mean amending a number of legislative acts, and not only an amendment to the Securities Act.

A principal article informing about ODA's concept and approach was published (on September 13) in the *Hospodářské noviny* (HN) by *Libor Kudláček*, a Vice Chairman of this political party.

Comments were also published in other daily newspapers, such as *Lidové noviny* (September 13) and *Svobodné slovo* (September 21). Overwhelming part of Ježek's proposal dealt with the protection of minority shareholders. Ježek proposed, inter alia, that a holder of 34 percent of a company shares has to make a public offer in order to buy-off thus the remaining shares at the highest rate reached during the last 12 months. The change of shares from publicly marketable to non-publicly marketable should be decided by General Meeting (of shareholders) by two third's majority of votes.

The daily *Svobodné slovo* assumes that “to restrict the interest to DIK's (investment coupon-holder's) protection only seems to be somewhat smelling of a pre-election recruitment of votes. Despite that, let us be grateful to *T. Ježek* for the proposal, since a wanted view sounds from his today's party, ODS, arguing that everything is O.K., let the genius invisible hand of the market do it. ODA is more consistent in its views.” It recommends to amend seven legislative acts and, inter alia, also to reduce the tax rate on income from securities, i.e. dividends, from the existing 25% to 15%.

The daily **Rudé právo** (September 22) is reporting that for further development of the market, it is the very important to establish secondary registers and thus get rid thus of the necessity to carry on any and all trade-related operations only and exclusively through the Securities Centre (SC).

Dissatisfaction with the proposal for mandatory buying-off the shares was expressed by representatives of funds. Protection of minor shareholders, in their opinion, is not a panacea for all the problems and issues the market is facing (**HN**, September 15).

The **Denní Telegraph** (September 15) states similarly that the best way how to protect a minor shareholder is an efficiently functioning capital market, provided that it has to face the problems associated with sale or purchase of shares for price satisfying both parties of the deal.

The **Mladá Fronta Dnes** (September 23) puts emphasis on the importance of a multi-level register, while writing literally: “The Ministry of Finance should finally comply with the crying coming from banks and other traders in securities and asking for permission to maintain their shareholding accounts by themselves, i.e. outside the central register in shares, but essentially it would be them, who would then assume the guarantee obligations related to the security of shares. It is the highest time for Securities Centre to leave the grown-up coupon children and give up its exclusive position in the domestic capital market.”

## NOVEMBER 1995

A considerable part of articles and reports in the Czech press for the whole month was focused on events concerning the Plzeňská banka. A partial attention was devoted to the issues related to funds, i.e. the topic attracting the attention firstly, due to the fact that the final version of the revised draft of the Act of Investment Companies and Investment Funds is expected with a great interest and secondly, because, as it has already been a tradition that with the end of a calendar year approaching, the funds do the “fine tuning” regarding their results.

**Právo** (November 6) reported on a press conference at which **Pavel Tykač**, a member of the Management Board, said, inter alia, that the operations of the Plzeňská banka should have led to the establishment of a strong domestic financial group. As the main source of funds needed for the large purchases of securities he identified deposits of large clients. “Our bank has been providing no loans for almost one year; certain banks invest even as much as 60–80% of their assets in loans. We consider investments in loans much riskier than those in securities, and banks may perform both of these activities.”

**Lidové noviny** (November 7) qualified rather moderately the Plzeňská banka's attempt to take control over the portfolio of certain large funds controlled by banks, when under the title “*No need to dramatize Plzeňská banka's attack*” it continues: “Although the Plzeňská banka's raid over the investment funds of our leading banks was stopped in most cases, nevertheless, in no way, the managers of these funds should not be lulled by this. The threat of potential attempts to take control over their funds in the future should force the managers to do their best in order to keep the prices, for which shares of their funds are traded at the exchange, at a higher level than until now... The splash around the operations of the Plzeňská banka is a little bit

exaggerated. As it generally appears, the Plzeňská banka has suffered no loss from this operation and the large banks have not gained either...”

Separately, in another place, the same newspaper stated that the *Minister of Finance, Ivan Kočárník*, qualifies the activities of the Plzeňská banka as “a sound movement within the capital market, a wind-blow needed in order to wake up the banks resting on their investment funds' laurels”. He admitted that the large banks had exercised a certain pressure calling for the state intervention. But simultaneously, he also emphasized that the government was not going to take any measures whatsoever in this respect. “I have made it clear to the bankers that it is the banks that must take care of their investments funds and not the state or capital market supervision.”

**Profit** (November 7) through *Jan Suchánek* put generally in doubt credibility of the funds. “... A simple administrative act would be sufficient for to turn the funds into capital market entities with their credibility. Through this act, the state supervision would enforce the disclosure of the information which would make presentation to the shareholders on whether the statutes of investment funds are or are not complied with.”

An attitude full of strong criticism was taken also by *Hans-Jorg Rudloff* (**Právo**, November 23): “The funds are not performing the role they are expected to play. The funds are bad investors, they stick too much to the posts they occupy both in boards of directors and supervisory boards and which are often personal posts but which are of no benefit to the companies. They bring no capital, no credits as well as no professional skills and information either. You should settle the matters with the funds, because the present situation is a handicap for the development of your capital markets.” In his interview given to **Právo**, the quoted Swiss specialist mentioned, inter alia, that the Czech capital market should go its own way and should not take the way of its adaptation to the American capital market, but it should enhance its transparency. This particularly involves transparency of prices. “It should not happen that a transaction is executed, which the market is knowing absolutely nothing about. If somebody transacts 10 thousand SPT's shares in an over-the-counter market for a price that differs from price available at the exchange, O.K., no objection, but he has to report both the deal and price. You have to push through and constitute the obligation to disclose the information on prices in the markets as well as outside them... If a public supply (offer) and demand are missing and if there is a stock exchange existing behind whose back a would-be private trading is performed, then the prices formed by such an exchange are wrong... Without transparency there will be no foreign investors.”

The press also kept returning to the Securities Centre and its working which was especially in connection with the fraudulent alluring of securities and defeated attempts to commit other swindles. Client's account protection continues to be considered the most serious problem. **Ekonom** (Nov. 16) wrote in this connection that shares of accountholders should be blocked by those traders whom they have confidence in. Nobody else then would have access to them and the risk of misusing the access to the account would thus be reduced. Around November 20, majority of dailies published a piece of news that, effective as of December 15, the *Česká banka* was deprived of the permission to act as a bank by the (Czech National Bank (CNB - central bank; Česká banka).

The Plzeňská banka has filed an appeal against this decision. Two-thirds of deposits of natural persons are insured by virtue of Law. The Deposit Insurance Fund (Fond pojištění vkladů), to which all banks are contributing on obligatory basis, possesses enough assets to meet the obligations to the clients of Czech banks.

### 10.3 Findings

Chapter 10 has two parts to be able to discuss separately the different character of the market development in 1994 (10.1) and 1995 (10.2). The reactions of the Press were changing: different opinions and doubts appeared; articles “pros and cons” were published and discussed.

The bulk of information presented to the Czech public by the Czech daily press and the weeklies is available in Czech language. Only a part of the PSE information was available in English (for example, Annual reports, selected articles in “Burza” etc.). There were no official translations of PSE regulations. However, a lot of information was supplied by correspondents of foreign press agencies (Reuters, Financial Times, The Economist etc.) based on unapproved translations of different official Czech documents, on interviews with selected representatives of different Czech institutions and on views and feelings of English speaking foreigners living in Prague, or given by Czech population. No wonder that some items of information did not correspond to reality, but – on average – the tone of a great part of information was positive and friendly. Nevertheless, since 1995, negative reports on the Czech capital market were more frequent.

In the autumn 1993, the Editorial Board of a new monthly called “Shares, Stock Exchange, Capital (ABK – “Akcie, burza, kapitál”) decided to support the PSE efforts by providing objective information on the Czech capital market formation and financial education (See: Chapter 9.) In 1994 and 1995, the ABK published monthly supplements in English language based on a broad co-operation with financial professionals, academicians, and business managers. Press Surveys in English reported the most important events on the Czech emerging capital market (as reflected in the Czech press to the end of 1995).

Our research on the role of the Czech press is based on a survey of a limited number of articles in English published on the Czech capital market development in 1994–1996, i.e. its research scope is limited. However, the statistics in Table 13 contain an appraisal of a short-term change of a group of informed persons’ opinion on topical events and discussion questions that might have influence on the Czech official authorities’ reactions, attitudes, and final decisions. Table 13 (The Press Survey of articles) contains quantitative information reflecting the qualitative information structure of the Czech capital market.

#### *A note on methodology*

In the Tables 12a and 12b five sections (A–E) deal with data of a different information value. Section A. identifies the names of dailies and weeklies that published articles on the Czech capital market and financial sector development in 1994 a 1995, and the number of articles published by every newspaper in a given month of the relevant year. Section B. contains the sum of all articles published in the given month (or months). Section C. enumerates the

following types of articles' authors according to their relation to the capital market and the number of articles written by authors of the given type: a) Securities trader, b) State official, c) Advisor, d) Academic, e) Financial journalist, f) Politician, g) Other. Section D. deals with the following types of articles: a) Informative, b) Discussion, c) Critical/polemic, d) Other. Section E. enumerates institutions and/or other subjects involved in the events referred to in the given month (months) respectively in 10.1 or 10.2.

Most relevant data or a qualitative analysis contains the sections C (types of authors) and D (types of articles). For example, a comparison of discussion papers' numbers written by securities traders in 1994 and 1995 can indicate the change of securities traders' interest in finding solutions of unsolved questions.

Table 13  
Press articles' survey 1994

Year and Month	A. Source and numb. of articles	B. Total no.	C. Authors' Type	D. Type of Article	E. Institutions and/or other subjects involved
<b>1994</b>		(47)			
<b>May-June</b>	3 RP 3 LN 2 HN 2 MFD 2 BN 1 ČD 1 Profit	14	4 FinMkt 1 advisor 6 journal 3 others	7 inform. 3 discussion 4 critical	Expandia, Body Int. Brokers, Patria, KB, RM-S
<b>July- September</b>	4 HN 2 RP 2 MFD 1 LN 1 Profit 3 other	13	3 FinMkt 3 state of off. 2 advisors 5 journ.	5 inform. 4 discussion 3 critical 1 other	YSE, KB, Harvard, MinFin, FNM, PSE, Liberální institute, FESE
<b>October</b>	2 RP 2 LN 2 Profit 1 HN 1 ČD	8	3 FinMkt 1 advisor 2 state.off 1 journal. 1 academic	5 discuss. 1 critical 1 inform. 1 sec.tr.	YSE, ČNB, MinFin., Živnostenská banka, PSE
<b>November</b>	2 HN 4 MFD 1 LN 1 ČD 1 Reuters 3 other	12x/	2 Fin.Mkt 3 state off. 1 academic 1 politician 5 journal.	4 inform. 4 discussion 3 critical 1 other	Government, MinFin, FNM, Min. Econ, SC Živnost.bank, a, ODA, US Embassy

Source: ABK Monthly press survey, 1994

Table 14  
Press articles' survey 1995

Year and Month	A. Source and numb. of articles	B. Total no.	C. Authors' Type	D. Type of Article	E. Institutions and/or other subjects involved
<b>1995</b>		(43)			
<b>March</b>	4 HN 1 LN	5	5 journalists	1 inform. 2 discuss. 2 polemics	Comenius, Bankers Trust
<b>April</b>	4 HN 1 RP 1 Profit 1 ČesD. 1 ZN	8	4 FinMkt 2 state.off. 1 journalisst 1 other	6 inform. 2 discuss.	2 MinFin
<b>May</b>	2 HN 1 MFD 1 other	4	2 inform. 2 discuss.	3 journal. 1 other	PSE
<b>June</b>	1 HN 1 RP 3 LN 1 Profit	6	5 inform. 1 discuss.	1 FinMkt 1 advisor 2 journal. 2 other	Government, ČNB, PSE, KB
<b>July</b>	1 HN 1 MFD 1 ZN	3	2 inform. 1 discuss.	3 journalist	
<b>August</b>	1 HN 1 MFD 1 Profit 1 Ekonom 1 ZN	5	2 inform. 2 discuss. 1 polemic	1 state off. 3 journal. 1 other	Min. of Privatization
<b>September</b>	2 HN 1 RP 1 LN 1 MFD	6	3 discuss. 3 polemic	5 journal. 1 other	ODA Parliament
<b>November</b>	2 RP 2 LN 1 Profit 1 Ekonom	6	3 discuss. 3 polemic	3 FinMkt 3 journal.	MinFin Plzeňská banka

Source: ABK Monthly press survey, 1995



# 11

## Evaluation of PSE information sources

### *11.1 Classification of sources and evaluation criteria*

### *11.2 Findings*

This chapter deals exclusively with the PSE sources. Part 11.1 contains main classification criteria. Part 11.2 deals with main research findings.

### **11.1 Classification of sources and evaluation criteria**

From the sources cited in Chapter 1.2, only the PSE sources were classified, i.e. the *PSE official documents* (legal, international agreements, internal, memos etc.) and *Publications issued by the PSE* (mimeographed, printed). The evaluation of these sources is highly relevant for the analysis of the PSE activities and results.

The PSE sources analysis is based on the following characteristics:

- a) Year of the first issue.
- b) Addressees.
- c) ISBN, and/or ISSN.
- d) Form of issue.
- e) Notes.

Analysis of Agreements and contracts between the PSE and foreign institutions was impossible, as the original documents were not available. The analysis does not include the legal aspects of the cited documents.

Selected PSE sources were evaluated according to the following criteria (See: Chap. 1. 2 and 1.3):

1. *Authenticity*: (a) Original documents, (b) Copies of original documents;
2. *Completeness*: (a) Complete, b) Not complete (missing pages etc.);
3. *Similarity or identity of data*, in comparison with other or similar PSE sources (mainly statistical data): (a) Identical data, b) Not identical data.
4. *Suitability to be published*: (a) Free; (b) Amendments necessary; c) Not possible to publish.

**Note:**

The first PSE Annual Report (1993) was issued in 1994 followed by the internal press information bulletin. In 1994, the PSE Stock Exchange journal (“Burza”) first issued. In 1996, the first Fact Book and the PSE Monitor (Věstník) followed.

The following PSE sources were analyzed:

- a) PSE Annual Reviews (Ar.; výroční zprávy BCCP), 1993, 1994, 1995, 1996 a 1997;
- b) Information bulletin PSE (Informační buletin BCCP), 1993, 1994;
- c) SE Journal (časopis Burza), 1993, 1994, 1995, 1996 a 1997;
- d) Fact Book PSE (Ročenka BCCP), 1995, 1996 a 1997;
- e) Monitor PSE (Věstník burzy), 1996 a 1997.

The PSE sources analysis was based on selected characteristics. (See: Chapter 12.1.)

Table 15

**PSE Sources**

No.	Source	a)	b)	c)	d)	e)
1.	Annual Reports	1993	Addressed to the shareholders and the general public	sine ISBN	Printed	Entered in the Commercial Register
2.	Intern bulletin	1993	PSE functionaries; selected PSE employees	sine ISBN	Mimeo-graphed	Not entered Issued till the end of 1993
3.	SE Journal „Burza”	1994	Subscribers; partially free sale	ISSN	Printed	Not entered
4.	SE Yearbook	1995	For use of PSE	sine ISBN	Printed	Not entered brochure
5.	SR Monitor („Věstník burzy”)	1996	For use of PSE and market participants	sine ISBN	Mimeo-graphed	Not entered

Sources: see the list of the PSE publications

## 11.2 Findings

The purpose of the PSE sources’ special analysis consisted in the credibility verification of the sources that were at the author’s disposal.

The analysis objective was the following: firstly, whether the above documents were duly entered into the Commercial Register of the Municipal Court in Prague (see: column “e”). Secondly, whether the PSE Sources are available in the National Library in Prague.

According to the Czech legislation, one copy of the above items with ISIN, has to be available to readers in the National Library in Prague. For results of a more detailed analysis (based on additional data) see the following Table 16.

Table 16  
**Official Legal Documents**

No.	Title	a)	b)	c)	d)	e)
1.	Founding Agreement	copy	Full text	No Context with other PSE legal documents	Available in the Commercial Register	Open access (at a request)
2.	Annual Reviews for 1993, 1994, 1995, 1996, 1997	printed	Full text	Some parts of ARs are identical with PSE Statistics	Available in the Commercial Register  Open Access	Author's Archive; PSE Archive

Sources: see the list of references

**Note:**

Sub a) original or a copy; sub b) full text; sub c) context or a similarity to other legal documents; sub d) availability; e) open accessed or not.

The PSE Founding Agreement (November 1992) has been entered in Commercial register of the Municipal Court in Prague. The Agreement has 9 pages; the founders' shares are included.

In 1992, the PSE became a legal successor of the Preparative Committee. Up to now, it was not possible to find out whether the documents of this Committee were transferred to the PSE archive or not.

The first information about the PSE can be found in the Commercial Register in 1992 (see: [www.justice.cz](http://www.justice.cz)) under PSE Identification Number ID 47115629.

The PSE annual balances are available in the Archive of the Commercial Register. However, almost in all entries there is a lag of two or more years between the origin of the relevant document and the date of entry of the document in the Commercial Register Collection of Documents. Since 2017, the PSE official documents relevant for the period 1993–1997 are available in digital form in the Archive of Commercial Register.

The data published in the PSE Fact Books or other PSE sources probably are not fully authentic and reliable in all cases. There are some minor mistakes in the lists of SE Members.

The analysis does not include PSE Chamber Memos, Memos of the Trading Committee, or Memos of other PSE Committees. In the monograph, we cite all information taken from these documents.

Names, technical data and characteristics of the PSE sources have been included in the Chapter 1.2, eventually in Chapter 9.2. No data about the number of copies for each type of publication are available.

In the above Table 16, the different role played by the enumerated PSE sources is visible. Every source had a different significance for the PSE activities on one side, and the perception of these differences by professionals and for public.

**The Stock Exchange Journal (“Burza”)**, edited since 1994, had a prominent position among other PSE sources. It was the most respected information channel for public. The main task of the popular SE Journal (“Burza”) consisted in informing not only the market participants, but the public as well, about daily trading and other events. However, this was the reason why the information – because of its diversity – could not correctly reflect issues related to the SE strategy.

**Stock Exchange Chamber Memos and Stock Exchange Committees’ Memos** played a very important role for the PSE development strategy. Memos are not open resources because of their specific character; it is possible to cite only selected information.

Full information on the PSE shareholders and stakeholders is available in the **PSE Annual Reports**. Unfortunately, not all Annual Reports (for the researched period of 1993–1997) are available in the Document Collection of the Prague Municipal Court Commercial Register.

Block 4

#### **Contents of the Fact Book 1996**

The Prague Stock Exchange in 1996
Requirements for admission of securities to the exchange markets
Summary review of securities included in the Main and Secondary Markets
Types of trades offered by the Prague Stock Exchange
Exchange indices of share market
Settlement of the trades concluded at the PSE
KEY DATA
EXCHANGE INDICES
Exchange indices in 1996 by sector
Index PX 50 - value (points) in 1996
Index PX 50 - development in 1996
Index PXL - development in 1996
Index PX - GLOB - development in 1996
TRADING RESULTS - SUMMARY REVIEW FOR 1996 AND YEAR-TO-YEAR COMPARISON
Trade value by market and type of security - 1996 review
Trading results - year to year comparison
Trade value by security type broken down by CM, DT and BT
Total exchange trades in 1996 by market and type of security

Trade values - 1996 structure
Central market trade values - 1996 structure
Trade value broken down by CM and DT + BT
Yearly trade values broken down by CM and DT + BT
Monthly trade values - development in 1996 - broken down by CM and DT + BT
Trade value broken down by Main + Secondary and Free Markets
Yearly trade values broken down by Main + Secondary and Free Markets
Monthly trade values - development in 1996 - broken down by Main + Secondary and Free Markets
Volume of securities transacted
Trade volume - yearly development
1996 trade volume monthly development
Shares + units - trade value by sector and as percentage of the total value
ISSUES TRADED IN MAIN AND SECONDARY MARKETS
1996 trade value and market capitalization at Dec 31, 1996 - for shares + units traded in Main and Secondary Markets
1996 trade value and market capitalization at Dec. 31, 1996 - for bonds traded in Main and Secondary Markets
Trade value in KOBOS from March 15 to Dec. 31, 1996
Issues with the highest trade value in KOBOS
LISTED MARKET INDICATORS
Listed market indicators Listed market indicators-development in 1996
Number of listed issues of shares and units in 1996

The **Fact Book 1995**, for the first time, presented a broader view on the PSE development in a broader context with the development of the CzCM. The SE Fact Books gave an opportunity to highlight the PSE strategy, to inform on the activities of the SE staff, to analyze the SE statistics, and the changes of the members' structure. The first Fact Book was issued in 1995. All Fact Books were bi-lingual; the Czech text first, English translation followed.

A logical step on the way to a higher transparency level was the creation of **SE Official Monitor** in 1994. Information on legal, economic, technical and organization measures prepared by the PSE was separated from the daily events on the markets.

The Monitor issuance ("Věstník") was significantly enhanced the PSE transparency. It was an important step towards the high transparency level of Securities Exchanges and more advanced capital markets in Europe. Monitor was an internal printed bulletin for use of PSE members since January 1995. PSE published its Monitor occasionally several times per month in Czech language. Each number contained 12 pages (minimum). Contents: 1. Information on activities of the Stock Exchange Chamber; 2. Information on activities of the three Stock Exchange Committees; 3. Information on PSE activities; 4. Information on activities of the Stock Exchange Register. Broad scope of PSE sources was one of the important factors that supported the start of reform measures and legislative changes of the Czech capital market.

# 12

## The time of discussions and reforms

*12.1 Conferences and seminars (1994–1996)*

*12.2 Initiative ODA (1995)*

*12.3 Discussion on the Securities Centre and clearing and settlement (ABK, 1995)*

This Chapter deals with selected conferences, seminars, reform initiatives and discussions about the necessary modification of the Czech capital market legislation, theory, and practice in accordance with the European standards.

### 12.1 Conferences and seminars (1994–1996)

Three important events demonstrate the growing necessity of fundamental reforms.

#### 12.1.1 Capital Market Institute Round Table (December 1994)

At the end of 1994, the Capital Market Institute from Prague (co-editor of the ABK magazine) and of its ABK English version – The Czech Capital Market (further: CzCM) – held a round table discussion called “Information Disclosure Duties of a Securities Issuer”. The main objective of the event was to confront experience of issuers from prospectus creation with that of the Capital Markets Supervision Department of the Ministry of Finance of the Czech Republic and thus contribute to clarification of some disputable issues dealing with market transparency. In addition to representatives of the Ministry of Finance, Capital Market Institute, and ABK Editor's Office also selected top-management representatives from large joint stock companies privatized under the 1st wave of the voucher privatization participated in the discussion.

In her speech, *M. Kudlíková*, Department Manager (MFCR) stated, *inter alia*, that the Securities Act ordered joint stock companies issuing publicly marketable securities to update on a continuous basis the data stated in their prospectuses. “These are particularly the details on whether the organization concerned has entered into bankruptcy proceedings or it has been under liquidation, or whether the organization merged or was split, whether for instance the membership of the Supervisory Board or Board of Directors has changed.” The issuer is further obliged to disclose, at least once a year, the Business Report (Income Statement) providing information on the issuer's financial position, about profit apportionment among other things. If subscription for shares is done on the basis of public offer (appeal), the issuer is obliged to publish prospectus on the security at least 15 days prior to the first day of subscription for the stock. MFCR Supervision Department is not currently satisfied with the fact that a number of joint stock companies have failed to deliver their annual reports to the MF.

*B. Jakubová* (also from the MFCR) pointed out the shortcomings disclosed in issuer prospectuses. Most of these imperfections relate to details on membership of company statutory

bodies. “Many joint stock companies stated only names and addresses of their members. In our opinion, however, their qualifications such as education, skills, experience and their current activity are by far more important [...] These details were missing in most cases although we pointed out the necessity of their disclosure. Issuers pointed to the fact that the persons in question refuse to provide this information. The main task of the popular **SE Journal** (“**Burza**”) consisted in informing not only the market participants, but the public as well, about daily trading and other events. However, this was the reason why the information – because of its diversity – could not correctly reflect questions of the SE strategy. We, however, are insisting that each company with publicly marketable securities should be obliged to provide this information to investors.”

*J. Duchan* (Efekta Liberec) stated in the discussion that he considered the data on issuer's prospects very important. “This, however, should be data covering period longer than one year. Prospectuses frequently miss the data on the past years' investment objective orientation. Insufficient or not understandable data may discourage potential investors.”

*V. Pavlát*, who chaired the Round Table, said that although the situation regarding the information on issuers had improved significantly, there were still cases when issuers stated their distorted data, eventually stated varied data on the same facts in different documents (such as issuer prospectuses and annual reports).

The Capital Market Institute when processing the publication “The Capital Market in the Czech Republic 1993–94” which includes data on 100 joint stock companies with the most liquid shares had to face this fact.

Other discussion participants, among them *V. Sojková* (Pražská teplárenská, a.s.), Mr. *Strážnický* (Česká zbrojovka, a.s.), Mr. *Jeřábek* (Transporta, a.s.), presented a series of questions addressed to the Ministry of Finance and made interesting practical suggestions.

### **12.1.2 Patria Foundation Conference (April 13–14, 1995, Prague)**

In April 1996, PATRIA FOUNDATION organized a successful two-day conference on the Czech capital market.

One of the most interesting conference speeches was delivered by *Jan Kalvoda*, Deputy prime minister of the Czech government and Chairman of the ODA (see Chap. 12.1.2). In his speech, he gave a perfect analysis of the Czech capital market (CzCM) regulation, its development, methods, tools, and future tendencies.

The following text comments on his evaluation of the Czech capital market legislation tendencies and the discussed expected measures. He openly criticized some of the already implemented measures, which – in his opinion – could cause unwanted changes of the CzCM organizational structure as well.

Our comment is based on the English version of his speech, which was published in ABK. (ABK, The Capital Market in the Czech Republic, 1995, No. 6, pp. 1–2.)

Jan Kalvoda commented on the expected legislative modifications in the following way: "... a brief note regarding the second question, i.e. the adaptation of our capital market legislation to the anticipated entry of the Czech Republic in the European Union. This adaptation is absolutely indispensable [...] this adaptation, however, should not be understood as a single act, but as a gradual process." (ABK, 1995, No. 6, p. 1.)

The gradual adaptation would prevent unwanted changes of the CzCM organization structure, as far as the position and role of small traders is concerned. As an example of the sudden unprepared and isolated (anti-systemic) modifications, Kalvoda pointed out one of the Securities Law modifications with negative impacts: "...the requirements for capital increases for stock traders (dealers) to CZK 25 million (or more), would eliminate majority of non-banking traders from the market although, currently, these are performing important roles therein, particularly to the regional and local extent. This would lead to the process of a forcible concentration, eventually to abolition of a number of small previously prospering firms." (ABK, 1995, No. 6, p. 2.) He was obviously referring to the tendency to reduce the number of small and medium securities' traders' companies; this happened a few months later on in 1996.

Another frequently discussed question was the urgency to solve the role of the state owned Securities Center (SCP – Středisko cenných papírů).

According to Jan Kalvoda, previous discussions reflected that "...one of the ways of changing the behavior of the Securities Center, as of a state-owned organization, to behavior adequate to a generally beneficial organization, could, for example, be a change in SC's legal status. What is possible, is its transformation to a joint stock company, in which capital market participants could, based on their shareholding, participate in further improvement of services even in more efficient manner than, let us say, through a mere discussions held with the staff of this institution. In a number of countries, operation of similar, significant institutions is regulated by a special Law which, no doubt, bears also certain advantages." (ABK, 1995, No. 6, p. 2.)

At the end of his speech, *Jan Kalvoda* confirmed that many other questions should be carefully prepared to meet the European standards.

He referred to many questions previously discussed on the first conference day, inter alia derivatives trading regulation, minority shareholders protection, mergers and acquisitions, the possibility of companies' form transformation, custody service, securities administration (securities lending) etc.

He expresses verbiis admitted the "niches" in laws existence and the necessity of relevant legislation amendments. Let us cite his words: "...there are many niches (holes) in the Law. A modification of a possibility to transform a joint stock company to another form of a trading company, namely a limited liability company and a vice versa process, seems to be generally inevitable. These aspects are relatively well incorporated in legislation of Germany, just to mention one example." (ABK, 1995, p. 2.)

In fact, *Jan Kalvoda* confirmed the need of a thorough reform of capital market legislation. ODA Party set forth the reform as one of its priority political tasks.



In 1996, the ODA readiness to prepare important legislative changes was in 1996 manifested by the draft document enumerating a list of proposed changes. (See par. 12.4.) However, this draft document probably served to the ODA for further discussion.

Anyway, the PATRIA conference significantly contributed to the further changes, implemented during the following years

### **12.1.3 Securities Market Workshop (May 23-24, 1996, Prague)**

Securities Market Development Workshop, sponsored by The Capital Market Institute (Prague) and the Development Institute of the World Bank (Washington) took place on May 23–24, 1996 in Prague under the title “Basic assumptions for a more effective functioning of capital markets in the Czech Republic.”

The workshop agenda had 5 sessions. The session I (Welcome and Introduction to the workshop) was opened by *Vladislav Pavlát* (Chairman of the Capital Market Institute, Prague) and *Joseph E. Pegues* (Economic Development Institute of the World Bank). The opening speech was delivered by Jan Kalvoda, Deputy-Prime minister of the Czech government.

Session II (moderated by *Joseph E. Pegues*) dealt with Securities market development questions. The session contained five presentations: 1. Securities Market Development – Global Perspective/Policy Linkages (*Joseph E. Pegues*); 2. A comparison of different countries’ experiences (*Gary Kleiman* – Kleiman International Consultants, Inc. Washington D.C.); 3. Securities Market Development, Czech Republic, General Consultants, London). Overview (*Vladislav Pavlát* – CMI Prague); 4. Market Development Strategy, part I (*Barry Bird*, International Securities. After the first three topics, a discussion followed.

On the first day afternoon session III., *Barry Bird* presented the second part of his presentation.

On May 24, the workshop continued by section IV. On the Legal Framework of securities market development, presented by Ms. Claudia Morgenstern, Senior Investment officer, Capital Markets Department, International Finance Department.

The session V. role consisted in the Workshop Summary preparation and evaluation. Several groups of workshop participants prepared partial summaries (See Block 1). Summaries – closely connected with the situation on the Czech capital market – tried to formulate practical measures feasible to improve the current deficiencies. Participants discussed the summaries in the workshop final plenary session. A wrap-up and workshop evaluation closed the workshop.

The workshop has been prepared for several months by organizers to be able to fulfill its goals. The main role of the workshop consisted in a confrontation of international capital market standards with standards of the Czech capital market since its opening in 1993. The speakers prepared all presentations to demonstrate that only by the adherence to the worldwide recognized standards, an efficient and successful capital market can be created. The capital market legislation of new capital market should respect the international recognized patterns; potential investors will not understand “homemade” rules, and they will not be willing to invest

on a risky capital market. Confidence of market participants is the base and condition of the securities trading.

## Block 5

### Summaries elaborated by groups of workshop participants

<b>Trading and Confidence:</b>
1. The concepts of market liquidity and transparency, why are they important?
2. On-exchange versus off-exchange markets
3. Floor-based exchange versus electronic exchange
4. One or more exchanges, what are the ramifications?
5. The role of rating agencies
<b>Administration and Confidence:</b>
6. Clearing and settlement systems
7. Custody and depositary arrangements
8. Group of 30 requirements
9. Role of tax incentives in market development






Source: Bird (1995)

Participants in the workshop and both organizing institutions positively evaluated the Workshop. The summaries elaborated by participants (Section V.) reflected on one side the participants' ability to analyze the questions and to propose feasible solutions for the CzCM development. On the other side, the participants' opinions reflected the still not very satisfactory level of financial literacy.

The Development Institute of the World Bank applied the workshop experience in preparation of similar country workshops. On the Czech side, it was used to an upgrade of courses and – in cooperation with a Ministry of finance Committee – for modification of brokers' examinations.

## 12.2 Initiative ODA (1995)

The ODA Initiative was of a great importance for the further Czech capital market development.

The aim of the ODA Initiative was to propose a fundamental reform of capital market legislation. One of the first versions of reform proposals was the Draft Proposal prepared by the ODA Economic Committee (probably in 1995 before the Patria Conference (see 12.1.2).

The ODA Initiative was very important not only for the *economic* development of the Czech capital market, but for its emphasis on the market ethics as well. Both these aspects were crucial for a political solution of the accumulated unsolved economic and ethical questions discussed for a long time before. The ODA was the only political party that decided to open a discussion about these difficult and complex questions and to ask for a fundamental reform based on professionally prepared proposals. The Government with ODS majority was willing – under the pressure of a 'growing number of market participant's criticisms – to allow for minor changes of capital market legislation, but it was not inclined to accept fundamental changes. One of the crucial points of the proposed changes was a categorical demand to set up the

relatively independent Capital Market Commission (Securities Commission) as soon as possible to be able to regulate the Czech capital market in a correct and fair way according to internationally practice. It is worthwhile to stress that the Czech Republic in the mid-nineties – was the only central European countries without such a central regulation Board (!). Foreign potential investors simply did not want to trade on a poorly regulated and risky market where a Securities Commission did not exist.

### **12.2.1 The draft proposals concerning the Securities Trading Law**

The draft proposed to change the regulation of tradable securities issuance in such a way that would stimulate the growth of market liquidity and new securities' issues.

The following main legal measures should support this aim:

- a) A longer than 3 years' existence of the issuer company.
- b) A minimally 250 million CZK volume of issues.
- c) Minimally 250.000 securities pieces per issue.
- d) An expected 5% profit per share for 3 years.
- e) An offer of 50% of issued securities to the market.
- f) Additional conditions: reduction of fees per issue.

### **12.2.2 The draft proposals for other systemically important changes**

In the draft, there were three main measures aiming at a higher investors' protection. Firstly, minority investors' protection against all sorts of discrimination is necessary; secondly, information asymmetry and insider trading should not exist; thirdly, the sanctions for trespassing information duty should be substantially higher.

A new Law on the Securities Commission had to be enacted as soon as possible. In the draft a necessity to regulate financial derivatives' trading was included. The draft heavily criticized the existence of multiple trading channels.

The daily newspapers and professional press criticized many of the above deficiencies. Ministry of Finance either ignored or rejected the critical remarks.

The original of ODA proposals was available only as a copy in the Czech language without signature. The document had seven mimeographed pages.

Several working groups or individual persons prepared the draft proposal, as different proposals were not duly structured and the wording of proposed measures had a different quality. In the draft proposal, the questions of clearing and settlement were not included, although declared Patria Meeting in April 1996 (see above) declared a necessity of a reform.

However, the drafts proposal represented a very important working document. From the side of ODA, it was a very significant political act, and probably a signal for political campaign in favor of the capital markets legislation.

### **12.3 Discussion on the Securities Centre and clearing and settlement (ABK, 1995)**

In 1995, the ABK magazine published a series of articles dealing with the basic problems of the Czech capital market, especially with the topical question of clearing and settlement as a key element of capital market infrastructure. The seminar “Basic assumptions for a more effective functioning of Capital Markets in the Czech Republic” included these problems. (See: 12.3 – Seminars and conferences.)

The seminar accepted the following papers for presentation and discussion:

- Pavel Slosiarik: Analysis of the Role of the Securities Center (ABK, 1995, No. 3)
- Vladimír Kaucký: What do we expect from a reform of the Securities Center? (ABK, 1995, No. 3, pp. 1–2)
- Jan Slosiarik: Why do we need securities settlement center? (ABK, 1995, No. 2, pp. 1–2)
- Petr Koblic: Why does the Czech capital market need its own clearing institution? (ABK, 1995, No. 4)

All these papers reflected the actual state on the Czech capital market and were of a great value for discussion about clearing and settlement.

On one side, the papers had several common features: 1. They were based on their authors’ practical experience since 1993; 2. Although they were strictly based on facts from trading on the Czech capital market, they were trying to apply European standard solutions; 3. They were written with a great zeal, as the authors sincerely supported the reform ideas.

On the other side, they seemed to undervalue the power of reform adversaries. Anyway, they played a positive role in trying to present feasible solutions.

Let us enumerate and characterize the main discussion problems: First, it was the question about the role of the Securities Centre (SC). Secondly, it was the question of setting up a clearing institution, which would correspond to European standards valid and prevailing at the time of mid-nineties.

#### **12.3.1 A need of a thorough reform of Securities Centre**

In the Czech Republic, the system of dematerialized securities started in close connection with the Coupon privatization. All securities generated through the Coupon privatization had a dematerialized form.

“The book-entry form for majority securities was imposed from the top, i.e. by central authorities. The same authorities introduced their uniformed one-level record keeping

guaranteed by the same way, i.e. from the top. This radical solution reflects the specific development of the Czech capital market.” (Kaucký, V., 1995, No. 3, p. 1.)

The Securities Centre (SC; in Czech – SCP, Středisko cenných papírů) was set up according to Securities Law and other relevant legal regulations to manage all agendas connected with dematerialized securities.

The Securities Law amendment in 1994 enlarged the scope of SC competencies because of a higher securities trade volume and because of other practical capital market needs.

The SC basic services consisted of the following agendas:

- a) Registration of issuers and stock issues, changes in these registrations and their solutions.
- b) Establishing of investor's holding accounts, changes in personal data on account holders, cancellation of the accounts at their request.
- c) Registration of other persons authorized to dispose of securities.
- d) Registration of collateral rights and their deletion.
- e) Registration of any suspension to exercise the right of the securities disposal and the settlement associated therewith.
- f) Registration of changes in stockholders (including transfers and succession).
- g) Account blocking, including all dispositions in respect of the account.
- h) Processing of statements of the holding accounts (including both balance and movement stating (nominal) accounts.
- i) Processing of statements of issuer's registry.
- j) Providing information for state (government) authorities.
- k) Providing information on the average prices at which transactions not input through organized markets were implemented.

During the 1994, the CzCM structure changed in favor of the PSE (and to the detriment of the second market organizer – RM-S), but one of the other trading channels, i.e. the OTC took the lead: “... At present (i.e. in the spring of 1995 – V.P.) ...majority of securities trades is executed outside the organized markets”, (Kaucký, ibidem, p. 1) at the Securities Centre counter.

There were important reasons for these changes: on organized market, “it takes up to seven days from the moment when the path is set up as a preparation for a trade, to have the trade definitely settled, whilst a deal made on the OTC market is settled immediately at the counter [...] and it is immediately verified whether the participants [...] own a sufficient quantity of securities.” (Kaucký, ibidem, p. 1.) In addition to this, the SC services were cheaper than services of market organizers (PSE, RM-S fees).

However, it does not mean that SC services would fully convene to the traders. They would like to reform the SC to be able to serve clients from abroad as well. Traders heavily criticized the SC because of its monopolist and bureaucratic behavior.

Since its creation, SC behaved as a monopolist. There was a widespread opinion that all market participants “only existing here for SC and not SC for them”. (Koblic, P., 1995, No. 4, p. 1.)

“The Centre should not operate as a bureaucratic office; on the contrary, it should be driven by majority needs of capital market participants.” (Kaucký, V., ibidem, p. 1.)

*Kaucký* proposed a partial or complete privatization of the Securities Centre. Another possibility could be the SC transformation into a company by shares with an equal participation of private shareholders and state.

In the discussion about the role of the SC, many professionals proposed the authorization of the access to the SC. The reason was to prevent any activities of the so-called “black” stock dealers and to prevent tax evasion.

*Kaucký* wrote: “One can easily imagine a situation that only a limited number of authorized institutions would be allowed to make deposits on all transfers and successions of securities [...] Then the State Supervisory Body, on the [...] information from the SC, would be able to retroactively verify whether these institutions were [...] authorized by heirs for such acts.” (Kaucký, ibidem, p. 2.)

In connection with the SC reform, all discussion participants stressed that European standards should be applied.

In connection of the SC reform, discussion included the question of risk as well. For instance, *P. Slosiarik* wrote: “... the trades made at the SC are very operative ...if compared to the trades made on organized markets, however, they are too risky, and the only guarantee, if one can call it like this at all, may serve either the previous positive experience with, or [...] confidence vis-à-vis the trading partner.” (Slosiarik, J. 1995. ABK, No. 2, p. 1.)

“Since [...] the SC was projected solely as a registration rather than clearing (settlement) centre, it is incapable to provide settlement of trades on the ‘delivery versus payment’ principle, but transfer of securities only.” (Slosiarik, ibidem, p. 1.)

Therefore, OTS trades are high-risk transactions. “One of the participants must take the first step, i.e. to assume the risk of the counterparty insolvency, and to transfer either financial assets or securities as the first of the two trade participants.” (Slosiarik, ibidem, p. 1.)

### **12.3.2 The main reasons for a fundamental reform of clearing and settlement in the Czech Republic**

In 1995, according to *P. Koblic*, the “essential imperfections” in the current Czech settlement system of trades were the following deficiencies:

- Non-existence of a multi-level register;
- Stock dealers cannot open positions;
- Non-existence of Delivery-versus-Payment;
- Absence of “end of day”;
- No opportunity to “back-to-back” trading (purchase and sale on the same day);
- Administrative problems related to SC;
- Imperfections in the Securities Act;
- Impossibility to act as a real custodian;
- Deformation of the market.

These shortcomings resulted in the following impact: (a) low market liquidity, (b) lack of confidence in the settlement system on the side of users, because of its limited reliability.

According to *Koblic*, the lack of confidence on the side of brokers and dealers stems from the following facts: “Foreign investors are used to the risk of a bank as their custodian and dealer and they rely upon the counterparties. However, they do not envisage the situations under which the SC system fails and does not work, when they join the chain of not delivered securities, and it is unacceptable for them, if they do not receive daily statements of their accounts. These statements are usually created by their custodians on the basis of statements from SC, but this is a piece of mediated information and the dealers and brokers can never be sure whether any change will occur to their account that day. [...] Market is not transparent, it is one-way oriented and it reflects deformations, among them settlement of REPO operations through the Exchange trading system. This leads to absolutely senseless prices as price only is a by-product for REPO operations.” (*Koblic*, *ibidem*, p. 1.)

In 1995, setting up of a new, independent settlement center would be very expensive. Another option was to open clearing hours at the Czech National Bank (CNB). This option, however, faced a conflict of interests that the CNB may have in such a Centre.

“I can imagine that the CNB clears state bonds in the same manner as it has been applying to treasury bills, but I doubt that it would be interested in clearing trades in shares”. A somewhat visionary view was also the option to select one commercial bank and authorize it to perform this role.

However, three possibilities of feasible solutions existed:

1. A foreign clearing institution, i.e. Euroclear or Cedel would open its account with Stock Exchange (Prague) and would provide settlement in Brussels and Luxemburg for its clients. The foreign clearing institution would keep one custodian in Prague who would maintain securities for all its clients with its multi-level registry. In such case, trades (as OTC trades) would migrate from Prague.

2. SC – converted into a clearinghouse – will open cash accounts for stock dealers and will carry on settlement of both cash and securities. However, in this case, the PSE would not be prepared to change its current system. “Next step would be the maintenance of the cash on the accounts, and SC would have to separate its clients – stock dealers – from retail shareholders

created by the voucher privatization. SC would have to upgrade the information level, to connect dealers on-line, etc. A certain solution could be a connection via an electronic bridge (similar to that existing between Euroclear and Cedel) between SC and CNB Clearing Centre. The CNB would carry on settlement and cash and SC settlement of securities, i.e. delivery versus payment would be assured.” (*Koblic*, ibidem, p. 2.) This solution would imply a radical upgrade of SC software, and an interest and a consensus on the side of CNB.

3. Without any doubt, the Prague Stock Exchange could play the role of the Czech Settlement Centre.

In 1994–1995, the Stock Exchange Register (SERS) did not have many technological advantages. However, its priority consisted in the fact that its founder was PSE whose shareholders were primary interested in the correct and fair working of a clearinghouse. In the opinion of *Koblic* (1995), SERS could implement a real on-line connection with SC (instead of the existing batch processing). SERS should guarantee the rights of a priority access. At the same time, SERS should be obliged to develop and install an electronic bridge to the CNB Clearing Centre connected with the certificated depository.



# 13

## Evaluation of the pros and cons

*13.1 PSE and Ministry of Finance*

*13.2 PSE and RM-S: a strange symbiosis*

*13.3 Relations between PSE and the Czech press*

*13.4. Dilemmas of the PSE general policy*

*13.5 The PSE international position*

The purpose of this Chapter is to try to answer the following question: Was the PSE development in the period of 1993–1997 successful or not?

However, we probably have to re-formulate such a strong formulation of this question for – at least – two points of view.

Firstly, it is evident that researchers can evaluate the activities of every institution or organization from many aspects; therefore, it is necessary to define these aspects.

Secondly, the evaluation of positive and negative sides of development should be based on a set of criteria, but not only on one criterion (for example, the profit). Only if we separate the analysis of the positive sides of the PSE activities from the analysis of negative sides, we are able to evaluate an objective result.

It is also possible to divide the main question into several subordinated partial questions. In case of the PSE, it is possible to ask a few partial questions. For example: Has the PSE contributed to the creation and formation of the Czech capital market; if so, then why and how? Another partial question could be, whether the PSE development was beneficial for the Czech national economy as a whole and the financial sector as a whole as well.

In this Chapter, five partial questions are examined: 1. The PSE and Ministry of finance mutual relations during the given period; 2. Mutual relations between the PSE and the RM-S (i. e. relations of the two market organizers and their consequences for the Czech capital market); 3. Relations between PSE and the Czech Press; their impact on the Czech capital market development; 4. Evaluation of the PSE general policy; 5. Evaluation of an international position of the PSE.

The items 1, 2, 3, and 4 are based on partial facts, data, and research findings of different preceding chapters of monograph. Item 5 is mainly based on American research.

### 13.1 PSE and Ministry of Finance

After November 1989, all parts of the Czechoslovak state administration (and its Czech and Slovak national institutions as well) had to adapt their behavior to the unexpected new situation and had to start systemic changes connected with the program of a gradual transition from the

so-called socialist system to the democratic system based on the market economy. It was a very difficult task (almost impossible to be implemented), however, it had to be fulfilled as quickly as possible, although the state administration was not prepared for these fundamental changes.

The Ministry of Finance belongs – together with the Ministry of Defense and the Ministry of Interior – to key institutions of the state administration, the behavior of which has an important impact on the behavior of other institutions. After November 1989, the situation in Czechoslovakia was very serious because of relations between the central government in Prague and the Slovak national institutions. This situation was not possible to be solved sooner than during the year 1992 (see Chapter 2) after the split of Czechoslovakia into two independent states – the Czech Republic and the Slovak Republic after a series of serious and difficult negotiations.

During the year 1992, the agendas implemented by the central Czechoslovak Ministry of Finance and the “national” (Czech) Ministry of Finance in a short time fused together.

This part of Chapter 13 discusses the new tasks that were delimited to the Czech Ministry of Finance (further on: MFCR) on the field of the financial market new structure, i.e. the transformation of all financial relations according to the market economy principles.

The experience of industrially developed Western European states served as a basic model; however, in the Czech Republic many real solutions – especially in the legislation – in many cases substantially differed from the above standard model.

Already before the split of the former Czechoslovakia, a series of laws was approved, which - in the next - years had a serious impact on the further development of the Czech financial sector and financial market as a whole. However, it is necessary to remind that a majority of all most important laws enacted before 1993, have been amended many times.

For example, the Securities Act in the period of 1993–1997 changed several times (*sic!*) every year. This was inevitable because of the necessity to suspend unsuitable regulations to adapt this Act to the European standards.

It was necessary to adapt The Stock Exchange Act as well, which had a fundamental impact on the foundation of the PSE and its development. The Czech government decided to give a priority of the so-called “Coupon privatization”, and to its speeded implementation. (See: Chapter 2.) Many journalists almost “deificated” the Coupon Privatization as a transformation paradigm. They pretended that “conceptual originality” was a specific Czech way of privatization representing the “best practice”. It has been preferred to other possible ways of privatization (for example, to the restitution of nationalized property), allegedly because of its “democratic character”.

### **13.1.1 Dichotomy of the Czech capital market**

The Stock Exchange Act opened the way to the dichotomy of the Czech securities market, i.e. to enacting of the two so-called “market organizers”.

As the process of setting up the PSE protracted almost for two years without having a visible effect (PSE was finally set up as late as in November 1992), the Czech press spread serious doubts, whether Prague Stock Exchange would ever exist.

In the meantime, it was officially decided that the basic (“first”) institution in charge of coupon privatization implementation will be a new company RM-S (See 13.2) – one of the two “market organizers”. This company main role consisted in exchange of coupons (created by privatization) for dematerialized shares.

This “information” was interpreted by several journalists in the sense that PSE would not be able to fulfill this task (because of exchange of millions of pieces for shares, and the so-called French system of trading used by the PSE, allegedly was outdated).

The situation of the Finance Ministry was rather difficult, because the RM-S received an official “blessing” as the first organizer, however, in-between the PSE was already set up and prepared for trading in a real time. (See: Chapter 3.)

The result of difficult negotiations which of the two “market organizers” would be allowed to start trading as first, was a compromise: they would start on the same day, namely on the April 6, 1993, shortly after the split of Czechoslovakia. By this pragmatic decision, a competition between the PSE and RM-S started. In two years, it was clear that investors decided in favor of the PSE.

### **13.1.2 Relations between Ministry of Finance and PSE**

In the first part of nineties, the PSE – as an institution of financial sector – was subordinated to the Czech Ministry of Finance.

The Ministry of Finance role (as of a supervisor) consisted in supervision of all the PSE activities connected with securities trading, securities issuance, clearing, and settlement, i.e. of the PSE as a “market organizer.” The PSE was obliged to inform the Department of Supervision of the Ministry of Finance on all its activities regulated by the Czech capital market legislation, and by other legal acts concerning the PSE as a private enterprise (i.e. a company by shares). The Ministry of Finance (Department of Supervision) evaluated, whether the PSE activities and their results corresponded to its approved scope registered by the State Business register, and to the relevant regulations as well. Department of Supervision was in charge of performing control activities according to relevant regulations (for example accounting, taxation etc.)

One of specific features of the Czech Stock Exchange Act was the existence of the so-called “Stock Exchange Commissioner” (in Czech: “burzovní komisař”). His role was very important, as he represented the Ministry of Finance directly “on the spot”. He had, for example, the right to take part in the Stock Exchange Chamber sessions (without a voting right), Supervisory Council, and all Stock Exchange Committees’ sessions as well, to control the trading, the activities of the Stock Exchange staff, etc. We can compare the commissioners’ role to the role of Ministry of Finance as an “ambassador” to the Stock Exchange. Lawyers who (in 1991–1992) prepared this Act and who draw on the German and Austrian capital market

legislation and securities trading experience implanted this specific element to the Czech Stock Exchange Act.

Before the PSE started trading, the Czech Minister of Finance nominated the first PSE Commissioner *Ing. Karel Ulrych*.

During the first part of nineties, the delimitation of supervisory agendas between the Ministry of Finance and Czech National Bank (CNB) was not precise, and in the case of PSE supervision, it was a question of mutual understanding. Many PSE founders and Stock Exchange “other members” (See: Chapter 8) were banks; they were under supervision of the CNB.

Mutual contacts between the Ministry of Finance and the CNB were based on the principle of cooperation between the entities of the state administration, although CNB was not in a position of a direct state administrative entity because of its specific role in the financial sector. During the period of 1993–1998, which is analyzed in this monograph, opinion, and approaches of both institutions to the measures of financial sector supervision were not always the same, especially in cases when the interests of both institutions were different.

In cases related to the governance of financial sector, such problems were quite frequent. This was, for example, the case of frequent amendments to the Securities Act. For the CNB, the priority always was to evaluate the potential effect of changes on the Czech currency. For Ministry of Finance, however, the priority was the tax impact of legislative changes on the state budget.

In 1992, for example, the Ministry of Finance intervened in case of the PSE assets, and postulated a rise of its equity. Majority of Stock Exchange members protested against this measure, however the reason for this change was correct: it should contribute to the PSE credibility in the eyes of investors.

The Czech Ministry of Finance supervised the preparation of the inner PSE regulations as well, for example, PSE Statute, and other documents.

The Ministry of Finance also examined the PSE accounting in connection with the PSE fees for trading and other fees.

The examination and analysis of agreements between the PSE and with Paris Bourse in 1992, preparation of other agreements, for example, the joint team composed of Czech and French staff members and the French support of the new clearing and settlement system was of a high priority for Ministry of Finance as well.

Although The Stock Exchange Act enacted the right to self-government of the market organizers, Ministry of Finance was not inclined to agree with any practical measures leading to the practical application of the relevant paragraphs of the cited Act. According to the Ministry of Finance *de facto* decision, the PSE should be waiting until some experience in trading and in the PSE governance is available.

The Ministry of Finance never set the PSE under pressure (with the exception of the forced rising of PSE equity in 1992), fair mutual relations of both institutions were existing during the examined period.

### **13.2 PSE and RM-S: a strange symbiosis**

In the nineties, the Czech Republic was the only central European state where two parallel “market organizers” (alias “stock exchanges”) existed, and which neglected internationally recognized securities market standards. This fact and the non-existence of a Securities Commission were the main reason why to the PSE, a full membership in the Federation of European Exchanges (FESE) and membership in the World Federation was denied for many years.

#### **Block 6**

#### **Characteristics of the advantages and disadvantages of the OTC Markets**

##### Advantages:

1. Anonymity
2. No fee of cost of entry
3. Professionals only market
4. Time available to match orders
5. Ability to work large orders
6. Settlement terms negotiable to suit all parties
7. Trading rules made by convention and not by third parties
8. No limitation as to available products
9. Ability to speedily introduce new types of investment products

##### Disadvantages:

1. Lack of public awareness
2. Stricter regulatory reporting requirements
3. Limited distribution networks
4. Non-centralized market place
5. Standards of competence not assured
6. Complexity of assured confirmations
7. Non-conformability of “fair” price values
8. Customer flight to quality

Source: Bird (1995)

#### ***PSE versus RM-S***

In 1990–1991, PSE versus RM-S story emerged. The Czechoslovak government defined the RM-S’ role as role of a servicing organization for coupon privatization.

The adherers' and supporters' allegations of the RM-S exclusiveness and a better efficiency stemmed from their conviction that the PSE would not be able to manage the trading with electronic securities created by coupon privatization.

We can find the origin of the above allegation in the Czech press that commented, on one side, on the preparative works connected with setting up the PSE, and on the other side, on the coupon privatization. However, journalists employed with newspapers of different political and economic interests described important decisions and events – both about the PSE and about the coupon privatization – and analyzed them. The PSE organized regular press conferences with an open access to everybody. So did the Government and relevant Ministries as well. However, it was evident that many questions remained without any answer. Exactly this was the major reason of publishing speculative views. It is clear that there were the PSE supporters, neutral observers, and adversaries.

### *RM-S objections against the PSE*

In the course of discussions about setting up the PSE, the RM-S friends' presented the following objections (usually without any reasonable argumentation):

1. The "French system" is outdated.
- 2 The "British system" is much better.
3. The 'gradual approach' planned by the PSE, is false; it is better to start an electronic system to continual trading "right now" without any out-cry system.
4. The Stock Exchange system existing in Lyon is an archaic exchange system; Paris Stock Exchange is trying to sell the Lyon system as a "used" product for a high price.
5. RM-S is a top system, invented by top Czech professionals that suits best to needs of the coupon privatization with its flexibility, speed of trading etc. etc. RM-S through its role will be playing the leading role on the newly created Czech securities market as a true "Exchange".

The above allegations frequently appeared in private discussions. The Czech press did not use such allegations publicly.

The PSE did not react directly, refused to discuss the above pseudo-arguments and positively explained the reasons why the system perfectly working in France was a good choice. The reason why this approach was preferred to unnecessary quarrels about unnecessary "problems", "disadvantages" etc. was very realistic and corresponded to the real situation concerning the necessary condition for running an electronic stock exchange. In other words, the capital market infrastructure necessary for running an electronic stock exchange did not exist. For example, the telephone lines necessary for securities trading were obsolete; a modernization was impossible. The lines remained unprotected; no securities depositary existed; no skilled technical personnel existed etc. It is possible to continue this list of technical barriers.

The supporters of a "big leap" did not know that several foreign consultancy companies thoroughly studied the pre-requisites for securities trading as early as in 1990–1991. One of

these companies was the Coopers and Lybrand Company. (See: Chapter 3.) The results of their preliminary analyses in many respects corresponded to the results of the similar Czech selective analysis. This coincidence was one of the reasons why the British company services were accepted.

### *Deeper reasons existed*

However, there were much deeper reasons in play than the publicly disclosed reasons. The Government program contained – inter alia – a few sentences about the necessity to set up a Czechoslovak capital market. By this general declaration, a dichotomy was built-in according to the organizational structure of state authorities and institutions. The Ministry of finance was responsible to take care of financial sector development as a whole, except for banking. It was the Czechoslovak State Bank, which was responsible for banking. As for financial market development, Ministry of finance had to co-operate with the Czechoslovak State Bank (CSB). However, CSB took the lead in setting up the PSE as early as in 1990. The Ministry of Finance did not interfere with these activities till the moment when the coupon privatization was approved by the Czechoslovak government. Shortly after this event, the Ministry of Finance started to prepare the capital market legislation. This was the first “battle-field” where the conflict between the “true Securities Exchange” and the RM-S, practically an OTC (i.e. off-exchange system by its substance) as a newcomer on the scene, burst out.

However, clever and skillful lawyers have found a compromise. The new Securities Law “innovation” consisted in creating TWO “market organizers which had to play the role of stock exchanges. This solution completely ignored the international standard of recognizing the different role of exchange-trading and off-exchange trading on all financial markets. The “problem” was successfully solved, and – *eureka* – the durable peace officially installed simply by a pragmatic play of words.

The Ministry of Finance declared and confirmed a permanent cease-fire. Ministry - as a reliable watchdog – stopped any potential quarrels between the PSE and RM-S: any disputes *de facto* were a taboo. Public discussion in the Czech press continued without invectives or direct attacks.

Let us cite the opinion of one of the public discussion participants who proposed a “division of labor” between the PSE and RM-S: “Historical development has led to a parallel inception of the Exchange and RM-S. The Exchange demonstrated more vitality, partially because computer experts [...] who had no idea of capital market requirements set up the RM-S. It is not my task to analyze here the strengths and weaknesses of the RM-S, but it appears that a consolidation of the Exchange and RM-S and division of powers between them (for instance, the Exchange would take care of the top 100 companies and RM-S of the remaining companies) would be beneficial to both of them.” (Tůma, 1995.)

The Czech Ministry of Finance role consisted in conflict prevention and intermediation of potential conflicts. In 1993, before the start of securities trading, the Ministry of Finance decided that – instead of a “race” for a more advantageous start – both institutions have to start securities trading on the same day, i.e. April 6.

The “peaceful co-existence” of the PSE and RM-S, or – better to say – *a strange symbiosis* lasted for a couple of years, without any serious conflict. However, due to a free access of investors to the two trading channels – the PSE and RM-S – created opportunities for speculative trading and arbitrage. After a very short time, majority of the trade volume was concentrated on the PSE, leaving some percent to the RM-S.

However, through a circumvention of market regulations, the SCP became a substitute of real trades. This way, a new form of OTC trade channel through SCP came to existence. Market participants re-directed a growing part of trades to SCP at very advantageous conditions: the SCP fees were very low (in comparison with the PSE and RM-S fees). (See: 13.2.)

Because of the mere existence of the two market organizers – the PSE and RM-S – an opportunity for a rise of speculative trading and arbitrage emerged. Under these circumstances, the setting up of the Securities Commission as a top state institution responsible for securities market regulation was inevitable. Its existence was one of the most important events for the Czech securities market further development in the following years.

### **13.3 Relations between PSE and the Czech press**

The purpose of sub-chapter 13.3 is to evaluate the opinions, critical remarks, and proposals published by the Czech press as a reaction and reflection of current events on the Czech emerging capital market, the PSE and RM-S trading and emerging unsolved questions in connection with a needed reform of existing Capital Market Laws and other regulations.

During the first year of trading (i.e. since April 1993 until the end of 1994), the Czech daily press and most of the weeklies have been playing a positive role: almost all of them informed the public about the daily trading and other events on the PSE. What is very positive, they have been doing it in an objective way (with a few exceptions, mainly caused by a low level of financial education).

In 1994, the situation was changing and the market development was no more so “sunny” as it was in 1993. The securities market became “cloudy”, as the title of one of the numerous newspaper articles stated.

The second part of Chapter 10 (10.2) which deals with the events of the year 1995 is less optimistic: the press started to criticize different market deviations, market behavior of the market participants etc.

Statistical data for 1995 (See Table 13 in Chapter 10) based on 40 selected articles of a high importance indicate that during the given year, relation between informative articles has changed in favor of discussion articles and polemics: 24 articles of this categories and only 16 informative articles were published.

This change reflects the growing criticism and discontent with the situation of a market decline (a fall of prices).

*Role of the PSE – information dissemination*



During the first two years the main role of the PSE consisted primarily in information dissemination through the PSE own channels, i.e. the PSE publications.

Since 1994, for a couple of following years, it was the daily “Stock Exchange” (in Czech “BURZA”; see Chapter 1) where exchange rates and other topical information on daily trading (5 times a week) were published in the printed form. During the 1994, daily BURZA was one of the basic sources not only for the PSE members, but for a growing group of professionals employed in companies created by coupon privatization and for journalists as well.

Contact of interested users with the staff of “Burza” was friendly and on daily basis. The PSE Journal published a great number of brief interviews on topical questions with representatives of the emerging financial sector; it was a mosaic composed of different – and sometimes controversial – opinions from which something as a “main stream” of thinking and behavior on the Czech capital market was gradually formed.

In 1995, “Burza” started to publish full Prospectuses of interested companies: this contributed to the market transparency that was still missing. Time to time, shorter consultation articles were published to highlight “financial market basics”. There were quarterly and bi-annual surveys of trading as well. In spite of the fact that sometimes such articles were more descriptive than analytical, they represented a reliable information for many readers.

Starting from the year 1994, the PSE published its Information Monitor (in Czech “VĚSTNÍK”). This weekly contained official information on activities of the Exchange Committees, Stock Exchange Register Ltd., information from the PSE departments (for example of the Trading department) and other information on weekly events (except for exchange rates solely published by daily “SE Journal” (“Burza”) addressed to the Stock Exchange members. The “Monitor” (“Věstník”) was published by the PSE Secretary General on behalf of the PSE Chamber, i.e. it was an semi-official document of the PSE which contained only facts and data without any comment or evaluation. However, some information duplicity was quite frequent. The scope of “SE Journal” (“Burza”) users – in comparison with the “Monitor” (“Věstník”) – was broader.

Let us remind that the number of information issued by the PSE was – especially during the first two years of trading – limited by availability of information techniques and technologies. The PSE transmitted most information by telephone and/or fax; printed or mimeographed documents were prevailing. The telephone communication-net in the Czech Republic available for public use was archaic. The PSE had to solve many technical questions to make available a quick information transfer with its members and other institutions.

With the gradual improvement of the IT services, especially thanks to the internet – the impact of the PSE information in the period of 1993–1998 not only on financial market and financial sector, but on general public – was significantly growing.

Nevertheless, the information transparency – measured by the world standards – was still lower than in countries with advanced financial markets. However, PSE was not able to surpass the barriers given by the CzCM legislation. In spite of the growing discontent, the Czech Press did

not object to the PSE information quality, because the PSE did not hide any information and communicated with journalists in a fair way; the practice of press conferences was a part of the PSE general policy. (See: 13.4.)

To conclude: during the given period of 1993–1997 the PSE fulfilled its role in the field of information dissemination successfully, in a fair way and with a growing transparency.

### **13.4 Dilemmas of the PSE general policy**

The purpose of this Chapter is to describe and analyze the PSE general policy composed of partial parts corresponding to the PSE functions, activities, agendas, and processes.

The further analysis is based on the description of the above components of the general policy. One of the most important general policy components is the PSE government structure and its quality. This chapter analyzes only selected agendas because of lack of reliable data. It was not possible, for example, to analyze the PSE IT system, statistics, financial indicators, accounting, decision process etc. The role of individual persons (PSE functionaries and staff) and evaluation of their merits is missing because of the personal data protection. As far as individual persons are concerned, only open sources are used.

The PSE policy has been as a pragmatic policy, based on a high flexibility and adaptation. However, most decisions considered in an empirical way; they were not based on theoretical basis, as the level of financial literacy of PSE functionaries and staff, on average, was low. Later on, since mid-nineties, the situation was improving and a substantial progress achieved. Anyway, PSE Chamber took many of its decisions under interests of banks that – from the very beginning – were playing a dominant role. At the same time, the biggest banks represented a distinct group in the PSE Chamber, the interests of which most members usually respected. However, some occasional tensions between bigger and smaller banks existed. In the PSE Chamber, the role of traders was very limited; however, they were freer in the way of their thinking, and they learned and acted quickly, although – in most cases – not independently but under influence of other bodies.

The first part of this chapter comments on positive sides of the PSE policy, i.e. results and impact of the PSE decisions; the second part deals with negative results and impact of the PSE decisions.

#### **13.4.1 Positives**

The evaluation of the PSE general policy is based primarily on one main criterion: the long-term impact on the further development of the PSE. The impact of PSE general policy is positive, if the PSE functions are fulfilled in a way that guarantees the future PSE existence and development.

The PSE activities are regulated by legal regulation: on one side, it is a set of specific rules that are connected with the PSE functions performed in the economic system; on the other side, it is a set of rules connected with the PSE as a legal entity.

The general PSE policy is composed of partial policies such as PSE activities' planning, budget policy, employment policy, etc. The general policy is more than a "sum" of partial policy: it reflects the interconnectedness of partial policies.

From the point of view of legal regulation of a stock exchange as a legal entity, i.e. a company by shares, stock exchanges general policy reflects many partial processes that have to be regulated by the PSE General Meetings' decisions. These decisions implemented the leading PSE body – the PSE Chamber – under the control of PSE Supervisory body.

To be able to evaluate the PSE general policy, several questions have to be answered: 1. Did the PSE (in the given period of time) fulfill its specific functions as a part of the Czech national economy? 2. Did the PSE fulfill its legislative role? 3. Was the PSE trying to achieve a higher transparency level? 4. Was the PSE trying to plan its long-term development? 5. Was the PSE successful as an economic entity?

Let us try to answer the above basic questions according to the information, facts, data, and findings in this monograph.

Ad 1. The period of transition from the "socialist" economic system to the "capitalist" economic system (or a "market economy") in the Czech Republic has been started because of political changes of 1989. (See: Chapter 2). A stock exchange (as an entity enabling securities' trading) represents the existence of the market economy.

However, there were many barriers to the implementation of all SE functions (for example, a lack of liquidity etc.). However, the basic function of securities' trading which was necessary for the economic transition from "planned socialist economy" to the capitalist market economy the PSE successfully implemented. The PSE and its system of securities' trading became a part of the Czech national economy and of the emerging financial market. In spite of the fact that the PSE could not develop all its functions, the PSE role – during the given period – was positive.

Ad 2. The PSE foundation corresponded to the general policy line of the Czech Republic. However, it is a recognized fact that the first steps of the new Czech economic legislation did not fully reflect the real economic situation. The PSE had to accept the new capital market legislation without any real possibility of correcting the existing deficiencies.

PSE had to create its "inner legislation" fully on the base of the new legislative structure. However, it is true that after the first two years of securities' trading, PSE was trying to amend some of the empirically identified deficiencies. During the given period of 1993 to 1997, most of the PSE rules were several times amended.

Ad 3. Information transparency belongs to the basic principles of securities' trading. The transparency level should correspond to a given level of information technique and technology. Since its foundation, the PSE has been trying to develop its information system as a transparent system. Although the questions of the PSE information level were not included in this monograph, the general trend of the PSE information policy had an upward tendency. It is true that the PSE information transparency level has been lower than the information transparency

level of the advanced European Stock Exchanges. However, it corresponded to the technical, technologic, and financial possibilities of the PSE. This is the reason for a positive evaluation of the PSE information policy.

Ad 4. The PSE activity – since its very beginning – was based on the basic principles of company planning. The short-term, middle term and long-term planning (in the form used by banks in the Czech Republic) prepared the PSE staff, and approved the PSE Chamber. The planning belonged to the positives of the PSE policy.

Ad 5. During the first two years of the PSE existence, its financial results were not very inspiring. Although no dividends were paid out to the shareholders, the PSE shareholders expected to be more successful in a short time. With the growing trade volumes, the PSE financial situation was substantially improving and the PSE existence and future development was no more at stake.

All answers to the above five questions were positive. Therefore, it is possible to conclude that – in the given period – the PSE general policy had a positive influence on the securities markets in the Czech Republic.

#### **13.4.2 Negatives**

Although the Czech press did not fully play the role of a “capital market watchdog”, its role should not be underestimated: Czech journalists carefully followed the financial market “temperature” and were trying to explain its changes; however, not always fully professionally. The information in Chapter 11 is a proof of the above words.

The driving forces of a distinct PSE policy that materialized in the PSE Chamber decisions were limited by two barriers: firstly, by the barrier of valid Czech legislation (not only capital market legislation) on one side, and by needs of the PSE existence and “survival” on the other side. These barriers represented the true “Scylla and Charybda” – a corridor inside which the PSE decisions had to be moving. Every pace out of this corridor was potentially dangerous and potential sanctions were imminent.

The PSE has been well aware of this permanent dilemma. It had to try to find the right way (by method of “trial and error”) how to defend its vital interests with a minimal risk.

On one side, there was always the risk of breaking the legislation. There were several powerful institutions protecting this barrier: The Czech government (through the Ministry of Finance), and the Czech National Bank. This barrier was very strong.

On the other side, there was always a risk of taking false or inefficient decisions that could be harmful for vital interests of the PSE. At the same time, it would not be correct to evaluate the PSE on the base of false criteria.

Let us enumerate, describe, comment on, and analyze the main PSE “pitfalls”. The range of questions is not important; it would be very difficult to define it, as it was changing during the given period.

The following list can be set up:

- *Overestimation of the number of listed securities*

At the beginning of coupon privatization, a myth existed: the power of every SE primarily depends on the number of listed securities; it is unimportant, whether all of them are traded or not. (“The longer is the list, the better!”) In 1993, the PSE decided to list all shares issued in the first “wave” of coupon privatization. The PSE expected that otherwise all securities RM-S would exclusively trade.

However, the above risk no more existed in case of the shares created by the second wave of privatization. In 1995, the PSE position on the Czech capital market taken as a whole was dominant. The “best” shares were traded on the main stock exchange market, and the remaining shares were traded on the second market.

- *Overestimation of “SE capitalization” indicator*

For a certain time, this indicator was a favorite indicator for Czech analysts;

- *Underestimation of the PSE markets’ low liquidity*

There were attempts to prove that the negative effects of a low liquidity could be more than compensated by a growing trade volume (Brada, 1995);

- *Underestimation of the “market quality”*

There were no serious practical attempts to analyze the market quality. Neither Czech academicians, nor professionals analyzed it because a lack of information on this question.

- *Underestimation of a governance analysis, and of its impact on the SE efficiency*

Cost analysis was supposed to be the main aim of Corporate Governance. There was a simple rule: in case of “high administrative cost”, the reduction of staff is necessary. The growing scope of SE administration was a signal to employ more the staff. In fact, no objective analysis based on a theoretical concept of governance existed.

- *Underestimation of the indicator of “equity” for the PSE credibility*

Majority of the PSE shareholders (the so-called founders) prepared a minimum amount of equity, as they would have to spend more in a risky business with uncertain results. The Ministry of Finance was well aware of the fact that by low PSE assets potential foreign investors would not be inclined to come. This was the reason why the Ministry of Finance (in 1992) forced the PSE to a substantial increase of its equity. (See: Chapter 3.)

- *PSE could not to prevent the “equal treatment” of PSE and RM-S*

The Ministry of Finance was trying to treat both so-called “two market organizers” in an equal way. Unfortunately, majority of the PSE Chamber did not fully understand the practical consequences of this false legal arrangement

The fact is that many foreign potential investors evaluated the Czech capital market as a non-standard, suspect, “strange”, and risky until 2004 (Czech Republic entry to EU entry).

- *The PSE did not actively react on the clearing and settlement problem since 1992 to 1996*

(See Chapter 3 and 12.3.) Although the PSE – as early as in 1992 – protested against the disadvantages of the clearing and settlement structural arrangement in the Securities Law which favored the position of RM-S, the situation was changing and a free discussion about a substantial capital market legislation in 1995 was started (See: Chapter 12). As a result, a change of the PSE register was approved.

- *PSE was unable to change the privileged position of Centre for coupon privatization*

SKP, in spite of hard critique in the Press (tax evasion, structure of fees, low reliability of operation etc.) did not change its behavior.

- *PSE had a relatively high degree of tolerance to members' breaking the PSE legislation*

During the first two years, the PSE was not able to apply necessary sanctions against its members breaking the rules. Only in the most striking cases, the culprits were sanctioned. Starting from the year 1995 the situation was improving and more sanctions were applied. (See: SE Fact Books, 1995, and 1996.)

- *Deeper analysis of the shares' price quality and the quality of the price mechanism practically did not exist*

All PSE statistics of price development were based on a hypothesis that the real market prices corresponded to the “fair value” prices, i.e. on a price-mechanism that – in fact – could not exist. (Barabas, 1995; Brada, 1995, and other authors.) According to a limited number of academic research papers, the PSE markets' prices were distorted by many factors (character of legal regulation, three different price-creation channels' existence, taxation system etc.). In 1995, 57% of total securities turnover represented off-exchange trades (i.e. direct trades), 38% - the PSE and 5% – RMS trades. According to the *ex post* analysis of the World Bank, the off-exchange market through KCP was “opaque”, i.e. not transparent (The World Bank, 1999, p. 15–16.)

- *A lack of a distinct and more elaborated line of the PSE membership policy*

The membership policy was one of the significant negatives. Criteria for this policy were changing; they were not based on a clear understanding of the Czech emerging financial sector structure's formation. The differences between the concepts of financial sector, financial market, capital market, stock exchange market were *terra incognita* for most “market professionals”. The practical consequences of the above theoretical basics' ignorance were reflected in numerous discussions whether the PSE membership of a certain subject (legal entity) should be approved or not. For example, should such entities – like insurance companies,

investment funds, Czech National Bank, or other state owned entities (Fund of National property) be allowed to be accepted as the PSE members? The road of the PSE decisions was rather arbitrary: at the beginning, there was a tendency to restrict the number of “entities”; later on, the PSE accepted too many members only a few candidates were rejected. (See: Chapter 8 on Governance.)

- *Absence of a transparent analysis of the PSE accounting, dividend policy*

The absence of these analyses belongs to the “negatives” as well. A look into the Prague Municipal Court Collection shows many irregularities in the process of the PSE balances’ disclosure; this behavior was rather strange, however, not incomprehensible.

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The reason why the list of “positive” sides of the PSE policy is shorter than the list of “negative” sides of the PSE policy does not mean that the PSE role in the development of the Czech securities’ market was negligible: on the contrary, it was decisive and in many respects dominant. A mere description of this process, i.e. real information, facts/data, is a proof of it.

However, just seeing the situation through the lenses of an ‘ex post’ (with a distance of more than 20 years) it is possible to understand which decisions were correct and which were false. The findings of the prepared analysis show that – after all – the PSE successfully survived.

In my opinion, the positive trend of the PSE decision making and its general policy was prevailing through the researched period.

### **13.5 The PSE international position**

Every Stock Exchange is vitally interested in its evaluation by the existing investors and/or by potential investors as well. Credibility, trustworthiness, and reliability are the most frequent qualities needed by every Stock Exchange. However, there are many other features as well, such as the history of a Stock Exchange, the range and cost of its services, the adaptability to the change of investors’ expectations, the markets’ quality, etc. In addition to the qualitative features, many quantitative features used to be applied for SEs’ evaluation – the volume of trading, market capitalization etc.

All these features are relevant for an evaluation of any Stock Exchange efficiency and position in a given national economy and financial sector structure, and for an evaluation of a SE international position.

A higher quality of a Stock Exchange depends – in the investors’ eyes – on a length of a Stock Exchange history: the older, bigger, experienced, and successful SEs is characterized by a higher quality, than the recently set up SEs.

In general, the Stock Exchanges quality operating on the highly developed markets of the developed countries’ group are *ex definitione* higher than the SEs’ operating on developing markets of the developing (or underdeveloped) countries.

### **13.5.1 Barriers to the evaluation of the PSE international position**

The PSE belonging to the former group of “socialist” countries in the Middle Europe (i.e. Poland, Slovakia, Hungary) – in a comparison with other countries’ SEs – had a special position given not only by different economic parameters of the former Czechoslovakia (See: 4.1), but by different features of the transition to the market economy as well (See: Chapter 2). One of the most decisive factors for the Czech financial market development was the so called “coupon privatization” (See: 5.3). Another important factor was a low level of financial education that represented a specific individual and social psychological barrier to the Czech financial market growth. In the Czech Republic practically only few financial professionals existed; the “men in the street” were almost financial illiterate (See: Chapter 10). Although the Czech press relatively well informed the public on current events in the financial area, the information value of most data did not correspond to the normal average value of articles published in the West European financial press. More than that, the interest of the Czech public was oriented on the coupon privatization by the Czech journalists (See: Chapter 11).

As far as we know, no deeper analyses about the Czech financial sector development (based on the economic theory) were published as open sources during the relevant years (1993–1997). No relevant cross-country analysis of the Central European countries was published in the Czech Press. The information availability on stock exchanges in the neighboring countries (i.e. Poland, Hungary, and Slovakia) was occasional and descriptive more than analytical. (See: Chapter 9.)

In 1993–1995, the PSE development was – time to time – compared with the Warsaw SE, Budapest SE and Bratislava SE. The cross-country comparison was not based on standard criteria and/or benchmarks applied in such analyses in the West.

The bulk of information on the Middle European Stock Exchanges development and problematic sides of their activities was based on Western Press articles translated into the Czech language.

Attempts of Czech journalists’ highlighting the PSE international position in some cases were based on incorrect criteria; one of such criteria was the number of listed companies on Stock Exchanges. According to this criterion, a Stock Exchange by which more companies were listed was “better” than a Stock Exchange that listed a lower number of companies was “worse.” Evidently, this approach reflected the specific Czech situation caused by the coupon privatization, namely the listing of all privatized companies without necessary selection. The initial reason for this nonsensical approach was the hidden “competition” between the PSE and RM-S – the fight for a larger market share.

In 1994–1995, many Czech financial professionals – according to a widespread opinion – evaluated the PSE as the “best” one from the Middle-European Stock Exchanges. The Warsaw Stock Exchange was the second one, being the potential competitor. The contact with Hungary was difficult, because by the Budapest Exchange most information was traditionally available only in Hungarian language.



During the first years of the Czech securities' markets, many Czech professionals and investors have been frequently asking one identical question: "For how long will it last to reach the level of developed markets?" Let me cite the brilliant answer of one of the British professionals after his presentation in Prague: "only a few light-years". He evidently did not want to discourage the Czech participants by saying the word "never". In connection with this episode, it is necessary to stress that any cross-country comparison is very difficult because of different political, social – economic, and historical development of the compared countries. It is important to consider these differences. A meaningful comparison of financial sectors and markets of the developed countries with emerging markets is hardly possible. Emerging markets have to go their different way – they cannot simply "copy" the developed markets' way.

The International Monetary Fund and the World Bank elaborated criteria and benchmarks for cross-countries comparisons. Analyses of these two international institutions are based on recognized comparative methods. During the last two decades, both institutions elaborated many analytical reports. They discovered, for example, the interdependency between the economic growth and/or the sustainable growth of the financial sectors and markets. These research works had a substantial impact on the modifications of the financial markets' theory and on the international finance policy. The IMF accumulated a great number of data on international markets' growth. Unfortunately, the IMF data and its experience is not yet fully exploited, neither for the Czech financial market formation, nor for the PSE policy. (See: 13.4.)

For all the above-mentioned barriers, any potential *ex post* analyses of the international position of PSE would probably be unreliable, if not almost impossible. One of the reasons for this opinion is a lack of data, a low comparability of data and methodological questions. From the theoretical point of view, a wide international cross-country research would be necessary. From the practical point of view, the potential research results probably would be negligible.

## Block 7

### **Selected capital market indicators**

- *Total value of stocks traded (in percent of GDP):*  
The total value of shares traded during the period. This indicator complements the market capitalization ratio by showing whether market size is matched by trading. In the literature, it is also used to measure the market depth, in terms of its liquidity or the easiness to buy and sell shares.
- *Market value/market capitalization:*  
The share price times the number of shares outstanding. Most countries with a high share of market capitalization also have a higher value of stocks traded in percent of GDP. Stock market capitalization is one of the most commonly used indicators of financial market development. With the increasing trend towards globalization, stock market capitalization has improved significantly after the 1990s, especially in developing countries. Despite continued growth, the share of market capitalization in GDP is lower in developing countries.

- *Capacity of a country for market capitalization:*  
Predicted value of the market capitalization-to-GDP ratio, calculated using the estimated coefficients of empirical regression specifications, which takes into account country specific characteristics.
- *Effort for market capitalization (at a country level):*  
Market capitalization effort refers to an index of the ratio of actual market capitalization to a country's capacity for market capitalization. A high effort for market capitalization corresponds to the case with the effort index above 1, indicating that this country utilizes its market capitalization opportunities beyond their capacity. This may indicate overheating of markets. A low effort for market capitalization occurs when the effort index is below 1, implying that this country may have a potential to increase market capitalization further. In this group if the effort index is very low, sub-capitalized markets are shallow. Using this index, we can divide the countries into four different groups: (i) low market capitalization, low effort for market capitalization; (ii) high market capitalization, high effort for market capitalization; (iii) low market capitalization, high effort for market capitalization; and (iv) high market capitalization, low effort for market capitalization.

### 13.5.2 Long-term analysis of the Visegrad countries financial markets' features

Anyway, a number of long-term cross-country capital markets' analyses based on internationally recognized IMF and the World Bank methodology were prepared (See: 13.5.1 above). The scope of these analyses surpasses the purpose of our monograph. Nevertheless, it is useful to present main data about the Visegrad countries financial markets to demonstrate the complexity of existing academic research analyses. The data presented in the table No. 16 are based on academic research (2012). For a better understanding of capital market features see Block 7.

One of the new approaches typical features is the application of more complex analytical tools; many of them are multi-criterial, not mono-criterial indicators.

In the table 17, 5 indicators are applied: 1. Indicators of stock market development (averages over 1990–2012): GDP per capita (constant 2005 US\$); 2. Listed domestic companies' total number; 3. Listed companies' market capitalization (% of GDP); 4. Stocks' traded total value (% of GDP); 5. Traded stocks' turnover ratio (%). These indicators serve as a basis for comparative analyses of market quality.

The new indicators, i.e. *market quality*, *market capitalization capacity* and *market capitalization effort* are usually applied for international cross-country comparisons.

In the table 15, the blue indicators indicate the highest values. Only the Czech Republic and Hungary have 2 "blue" indicators; Poland has one blue indicator, Slovak Republic none.

Table 17

**Capital Market Indicators of Visegrad Countries**

	CR	HU	PL	SR
1. GDP per capita	<b>11,313</b>	9,319	7,116	10,331
2. Listed domestic companies, total	292	<b>45</b>	<b>45</b>	314
3. Market capitalization of listed companies (% of GDP)	<b>22,95</b>	19,20	19,04	5,77
4. Stocks traded, total value (% of GDP)	11,74	<b>14.55</b>	8.00	1.99
5. Stocks traded, turnover ratio (%)	51.96	<b>65.74</b>	60	38.75

Source: World Bank (2013); Byractor, N. (2014)

The above Table 17 is based on American academic research. *Byractor* calculated the indicators for 74 developing countries and 30 developed countries between 1990 and 2012. (Byractor, 2014.) They reflect not only the size of compared Stock Exchanges' capital markets, but they result from the different economic structures of the compared countries as well. Several authors calculated data series on the base of different capital market models described in the cited Byraktar paper.

The above indicators reflect characteristic capital market features of the Visegrad countries Stock Exchanges. Their application for given countries' ranging is possible. However, the ranging given by individual indicators is not relevant for a global evaluation of capital markets position of the compared countries. This is the reason for the introduction of several new concepts (such as the *market capitalization capacity* and *market capitalization effort*). (See: Block 7.)

It is evident that the market quality of a country is something else than market quality of a Stock Exchange. At the same time, it is evident that the market quality of a Stock Exchange is one of the factors that are relevant for market quality of a country. A higher SE market quality may contribute to a higher financial market quality of a given country.

There is another conclusion as well: the international comparison of national Stock Exchanges localized in different countries depends on the financial market quality of the given country.

Nevertheless, the evaluation of an international position of a given Stock Exchange many other factors have to be taken in consideration as well – for example, the governance structure of the given Stock Exchange, because this structure may have an impact the economic parameters and on the behavior of the given Stock exchange. (Krishnamurti, Ch., Sequeira, J., Fangjian, F., 2003) proved that „organization structure of a stock exchange matters”. V. Pavlát (2013, p. 19) enumerated 23 capital markets' relevant features which can be used to identify the market quality.

The above reasoning is an illustration of modern advanced analytical methods that contribute to a better understanding of international securities' markets comparisons.

## Conclusion

The purpose of conclusion is to summarize the main findings of the monograph to be able to present a final evaluation of PSE activities during the researched period 1993–1997.

This book does not present an all-embracing, comprehensive view of the Czech capital market in the period of 1993 to 1997. Its main goal is to highlight the important role played by the Prague Stock Exchange in the whole process of transition with all its difficulties, positive and negative effects. The author attempted to concentrate as much information as it has been possible to squeeze to less than 200 pages to illustrate manifold aspects of the PSE impact on the growth of financial sector and the development of the Czech capital market, and to present selected partial analyses. The authors' goal was to point out the potential orientation of future research as well.

The period of 1993–1997 was a decisive time for creation of the Czech financial sector with its markets and infrastructure. Within this period, the Prague Stock Exchange started securities trading. This period is important because of two main reasons: firstly, a successful elimination of all barriers that prevented the establishment of the PSE; secondly, it has been recognized very soon that the emerging Czech capital market will have to be – as soon as possible – reformed and regulated according to international standards.

In the monograph, the author exploited open sources, and selected unpublished sources from his private archive as well. Full citation of original documents is not possible because of legal and technical reasons. The author cites relevant parts of such documents in a way to comply with the Czech Authors' Law. (Srstka, J. et al., 2017.)

The research period has been limited to a period of 1993–1997 and subdivided into three sub-periods (Chap. 4). Phase one (1990–1992): the legislative basis for capital market was set up, the foundations for capital market institutions existed, and the start of securities trading was prepared. Phase two (April 1993 to mid-1995): the securities trading started. Phase three (mid-1995 till 1997/8): correction of the identified anomalies was discussed and prepared.

In spite of the fact that the research objective has been limited to the PSE role in the Czech national economy, it was necessary to show the PSE activities in connection with the general political and economic development of the Czech Republic, and with the events which had preceded the PSE foundation before 1992 (Chap. 2). On the other side, it was necessary to highlight the continuity of the political and economic events limiting the PSE role (Chap. 3).

Chapter 5 identifies the specific and unique features of the emerging Czech Capital Market. The main tasks of the PSE in the first two years were successfully implemented (Chapter 6.). The PSE capitalization and its trade volumes confirm the primacy of PSE on the emerging Czech capital market.

The analysis of the PSE role on the field of investment funds showed a series of deficiencies on the side of the PSE. The PSE was obliged to follow the investment companies' and funds' legal regulation valid since 1991. This regulation was very liberal so that it was impossible to

eliminate its circumvention and/or misuse. The PSE itself was unable to prevent potential negative impact of such regulation.

Although it was clear that block trading through the SCP in fact enabled tax evasion, nobody cared. Even the three biggest PSE members were not inclined to take any positive measure except for application of ethical rules. The Exchange Chamber missed the opportunity of confirming its moral authority (Chapter 7.4).

Stock Exchanges' Governance belongs to very important issues from the point of view of efficiency, effectiveness, and performance. Chapter 8 presents selected partial description and basic analyses. The main findings deal with the development of main PSE bodies' personal structure. Starting from 1992, the founding members (especially the biggest banks) were interested in keeping their majority position. With an exception of only one year, they succeeded in this strategy. However, the membership policy was rather pragmatic (time to time arbitrary and confused), not based on any theoretical principles which would have to be implemented in a professional way. During the first two years, discussions at the Exchange Chamber meetings quite often were not professional; the cause was an insufficient information supply and/or by a relatively low level of professional experience of participants. There was a certain tension between the big banks representatives and smaller bank players; the same was true about the banks' representatives' behavior and behavior of the non-bank representatives. Majority of decisions were voted unanimously, no opposition existed. The vote of majority of decision was unanimous. The verification of data about the ownership structure was very difficult because of differences in documentation. In principle, this practice corresponded to the low transparency level in banking of that time. The analysis of territorial deployment of non-bank PSE members refers to the "old question" of the supposed potential local stock exchanges existence (discussed in 1991–1992). The findings prove the high concentration of securities' trading in Prague and a low economic power of non-bank securities dealers out of the Czech Capital.

*Summa summarum*: the role of the PSE corporate government (1993–1997) has been underestimated; its level did not correspond to the state of theoretical knowledge of that time.

The basic analyses of the PSE role in the field of financial education and in the field of the PSE publishing (Chapters 9 and 10) confirm the positive PSE impact on the professionals and the broad public as well. Under the PSE influence, the level of financial education has been continuously growing.

Chapter 11 describes and comments on the main events of the year 1995. The ODA initiative in favor of a comprehensive reform of the Czech capital market legislation was a serious support factor for practical measures.

The evaluation of the PSE publication activities was of special interest (Chapter 11). The purpose of the PSE sources' special analysis consisted in a credibility verification of the sources that were at the author's disposal. The analysis objective is the following: firstly, whether the documents (sub above numbers) are still registered in the Commercial Register of the Municipal Court in Prague (see: column "c"); secondly, whether the PSE Sources (sub above numbers)

are still available to readers in the National Library in Prague. Every PSE source (compared in relevant tables) had a different significance for PSE activities on one side, and for perception of these differences by professionals and public on the other side.

Chapter 12 evaluates positive and negative impacts of PSE on the Czech financial sector and capital market.

The following thesis (Chapter 1.3) is a basic research hypothesis: *“during the period of 1992–1997, the PSE activities showed an upward trend, and implemented measures’ impact on PSE results was positive* (except for situations when the PSE could not surpass the barriers given by the legislation).

In order to verify the above hypothesis, the author evaluated partial parts of the PSE general policy corresponding to the PSE functions, activities, agendas, and processes.

With the aim to evaluation of the PSE general policy, the author five questions had to answer: 1. Did the PSE (in the given period) fulfill its specific functions as a part of the Czech national economy? 2. Did the PSE fulfill its legislative role? 3. Was the PSE trying to achieve a higher transparency level? 4. Was the PSE trying to plan its long-term development? 5. Was the PSE successful as an economic entity?

Based on the partial research findings in the monograph, all answers on the above five questions were positive. Therefore, it is possible to conclude that – in the given period – the PSE general policy was positive.

The negatives – based on research findings are – the following:

1. Overestimation of the number of listed securities;
2. Overestimation of “the PSE capitalization” indicator;
3. Underestimation of the PSE markets’ low liquidity;
4. Underestimation of the “market quality”;
5. Underestimation of a governance analysis and of its impact on the PSE efficiency;
6. Underestimation of the indicator of “equity” for the PSE credibility;
7. Incapability to prevent the “equal treatment” of the PSE and RM-S as “market organizers”;
8. The PSE late and unsatisfactory reaction on the clearing and settlement question;
9. The PSE was unable to change the privileged position of the Centre for Coupon Privatization (SKP) in spite of hard criticisms from PSE members;
10. A relatively high degree of tolerance to members, breaking the rules of the PSE;
11. A lack of a deeper analysis of the shares’ price quality and the price – mechanism quality;

12. A lack of a distinct and more elaborated line of the PSE membership policy;
13. Absence of the PSE transparent analysis of accounting, dividend policy, profit and losses etc.

The research findings (mainly because of a lack of reliable information) did not allow for a quantitative measurement and a comparison of the relation between “plusses and minuses”, however, at an estimation based on qualitative the positives prevailed: in my opinion, *the trend of the PSE development in the research period was – in spite of many negatives – positive.*



## Epilogue

During the last three decades, financial markets all over the world have been substantially changing. Professionals expected many of these changes as early as in 1987 – the year of the famous Big Bang on the London Stock Exchange. However, the quantitative and qualitative changes highly surpassed the expectations.

The world trade volume of securities trading has been growing until the world financial crisis, and during the last post crisis years, it is growing again.

The main qualitative changes are related to the growing speed of trading (both Stock Exchange and OTC), the scope of information, and its quick availability, the rise of algorithmic (automated) trading as a new type of trading, new types of financial derivatives and structured products etc.

Because of these changes, financial infrastructure has been growing and changing as well to be able to meet the needs of securities trading globalization. Hand in hand with these processes, the financial regulation power – national and international – has been growing as well. Today, the role of the national and international regulatory authorities is more significant than ever.

The driving force of these irreversible changes – and maybe a main cause - of these irreversible changes - has been the technical and technological progress, nowadays understood as a transition from Industry 3.0 to Industry 4.0 – financial industry included.

According to IOSCO (2013), the impact of new IT techniques and technologies on securities trading has been very important in the field of (a) algorithmic trading, (b) market fragmentation and dark liquidity, (c) direct electronic access, (d) co-location, (e) tick size, and (f) fee structures.

The high market volatility, higher risks and a limited capability of market predictions are the price for the growing speed of trading; these factors are partially compensated by a stricter regulation, which is more and more complex and costly.

However, to the above list of questions, we have to add further problems such as the cyber-criminality as one of most imminent dangers. It is a real menace for the further development of financial markets, Stock Exchanges, financial infrastructures and for all investors as well.

Current international political situation and topical events (such as economic and financial sanctions, local wars, migration etc.) contribute to an increasing uncertainty all over the world. Anyway, all these factors are distorting the normal economic relations and have a negative impact on sound business decision taking.

The phenomenon of crypto-currencies is one of the new financial factors, which (unless it is not regulated) might disturb the normal payment system in a not very distant future.

In order to find a way out of a permanent state of chaos, with a menace of war, a stabilization of international relations based on recognized international political and economic agreements it will be needed to make the securities trading much safer.

The experience of the PSE from the transition period of the Czech Republic – positive and negative as well – seemingly represents little practical use for actual securities trading. However, those who are not willing to learn from the Past will not be able to change the Future.

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# Annex

PSE Founding Contract (zakládací listina BCCP) - November 1992

1 9.4.92

## Zakladatelská smlouva

- 1) Československá obchodní banka, a.s., se sídlem Praha 1, Na příkopě 14, zastoupená ing.Radovanem Tlamsou, vedoucím oddělení správy a úschovy cenných papírů,
- 2) Investiční banka, a.s., se sídlem Praha 1, nám.M. Gorkého 32, zastoupená ing.Jiřím Tesárem, CSc. a ing. Jindřichem Kapounem, CSc., členy představenstva,
- 3) Všeobecná úvěrová banka, a.s., se sídlem Bratislava, nám. SNP 19, zastoupená panem Miloslavem Ivanem,
- 4) Česká spořitelna, a.s., se sídlem Praha 1, Václavské nám.42, zastoupená ing.Jaroslavem Klapalem a JUDr.Karlem Kotrbou, členy představenstva,
- 5) Poštovní banka, a.s., se sídlem Praha 5, Plzeňská 139, zastoupená ing. Jaroslavem Vopaleckým a ing.Jindřichem Matéjkou, členy představenstva,
- 6) Banka Bohemia, a.s., se sídlem Praha 1, Havlíčkova 3, zastoupená ing. Arnoštem Kleslou, generálním ředitelem a ing.Pavlem Koštěkem, ředitelem odboru,
- 7) Ekoagrobanka, a.s., se sídlem Ústí nad Labem, Dvořákova 2, zastoupená ing.Miroslavem Adancem, generálním ředitelem,
- 8) Agrobanka Praha, a.s., se sídlem Praha 1, Ve smečkách 33, zastoupená panem Ing.Stanislavem Labounkem a ing. Pavlem Jandou, členy představenstva,
- 9) Komerční banka, a.s., se sídlem Praha 1, Na příkopě 33, zastoupená ing.Františkem Vejmolou, ředitelem odboru obchody s cennými papíry,
- 10) Živnostenská banka, a.s., se sídlem Praha 1, Na příkopě 20, zastoupená ing.Alešem Barabášem a ing.Tomášem Zralým, členy představenstva,
- 11) Interbanka, a.s., se sídlem Praha 1, Washingtonova 25, zastoupená ing.Karolem Tölgyesim, generálním ředitelem,
- 12) Creditanstalt Securities,a.s., se sídlem Praha 1,Voršilská 5, zastoupená ing.Michalem Větrovským a ing.Romanem Babkou, členy představenstva,



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## List of Abbreviations

ABK – monthly journal “Shares, Stock Exchange, Capital”  
AR – Annual report  
Coll. – Collection (of legal acts)  
CNB – Czech National Bank  
CP – Coupon Privatization  
CMI – Capital Market Institute  
CR – Czech Republic  
SR – Slovak Republic  
CSFR – Czecho-Slovak Federative Republic  
CSSD – Czech Social Democratic Party  
CzCM – Czech Capital Market  
CZK – Czech Crown  
EU – European Union  
FESE – Federation of European Stock Exchanges  
FS CSFR – Parliament of the Czecho-Slovak Federal Republic  
GM – General Meeting  
GNP – Gross National Product  
IOSCO – International Organization of Securities Commissions  
IMF – International Monetary Fund  
IPRFT – Institute for financial market development support  
IPF – Investment Privatization Fund  
KCP – Centre for Coupon Privatization  
KDS – Christian Democratic Party  
LSE – London Stock Exchange  
NYSE – New York Stock Exchange  
OTC – Over-the-Counter  
ODS – Civic Democratic Party  
ODA – Civic Democratic Alliance  
PSE – Prague Stock Exchange  
SBCS – Czechoslovak State Bank  
SBF – Société des Bourses Françaises  
SC – Securities Centre (Středisko cenných papírů – SCP)  
SICOVAM – Société Interprofessionnelle de Compensation des Valeurs  
WFE – World Federation of Exchanges  
WB – World Bank

# Vocabulary

ENGLISH	CZECH
Associated Professor	Docent
Centre for Coupon Privatization	Středisko kuponové privatizace
Collection	Sbírka
Company Law	Obchodní zákoník
Committee for Trading	Výbor pro obchodování
Constitution of the Czech Republic	Ústava České republiky
Control Council	dozorčí rada
Exchange Court of Arbitration	Arbitrážní soud burzy
Exchange Court of Arbitration Statute	Řád rozhodčího soudu
Exchange Guarantee Fund	Garanční fond burzy
Exchange Register of Securities	Burzovní registr cenných papírů
Founding agreement	zakladatelská smlouva
Information from Periodical Press	informace z periodického tisku
Joint Stock Company	akciová společnost
Ltd.	společnost s ručením omezeným
Membership Committee	Výbor pro členství
Memos	zápisy
Monitor	věstník
Municipal Court	Městský soud
Securities Centre	Středisko cenných papírů
Stock Exchange	burza
Stock Exchange Chamber	Burzovní komora
Stock Exchange Law	Zákon o burzách
Stock Exchange Palace	Burzovní palác
Stock Exchange Statute	Burzovní řád
Trading Committee Memos	zápisy z výboru pro burzovní obchody

## Reviewers C/Vs

### *Assoc. Prof. Ing. Lubomír Cívín, CSc.*

Assoc. Prof. Ing. Lubomír Cívín, CSc., MBA, economist, the graduate of School of Economics, in Bratislava (Slovakia) and Hochschule St. Gallen in Switzerland. He has worked in the academic sphere at several public and private universities in the Czech Republic as well as abroad as a senior lecturer or a visiting professor of world economics. He also dealt with the practical economy as an economic consultant in projects for both domestic and international institutions (World Bank, European Commission, Phare Program), later in the senior management positions of business entities operating in the field of international finance in Central Europe.

His entire professional career is in the area of international economic relations, particularly in the field of international finance, trade and foreign direct investment. He has been studying global economic processes on a theoretical level for a long time but has also devoted himself to the management of entrepreneurial subjects in the field of factoring companies.

He also served as Chairman of the Boards, or as a member of the leading boards of various professional associations, The Czech Association of Business Advisors, the Czech Factoring Association and the Czech Financial and Leasing Association.

In particular, he publishes professional articles, participates in professional discussions in traditional and new media, and actively participates in international conferences at home and abroad. As a co-author or editor-in-chief, he joined in several expert publications, conference proceedings and teaching aids on the topic of the global economy, business, and finance.

### *Ing. Miroslav Hrnčíř, DrSc.*

Miroslav Hrnčíř graduated from the University of Economic Sciences in Prague (Vysoká škola ekonomická, Praha), and received the title of Ing. In 1967 he defended his doctoral thesis, and obtained the title Candidate of Science – CSc., and the title Doctor of Science later on.

After his studies, he worked for a Foreign Trade Company. Since 1963 he worked as a research worker in the Economic Institute of the Czechoslovak Academy of Science in Prague. Since 1991 he was employed with the Czechoslovak State Bank as advisor, and later on as expert for banking of the Economic Institute of the Czechoslovak National Bank.

In 1992 he spent his sabbatical leave at the University of Cambridge. Since 1994, he was advisor to the Governor of the Czech National Bank. In the period of 1996–2000, he was a member of the Council of the Czech National Bank.

He is a specialist in the macro-economic policy and financial regulation. He participated in several international projects as a member and researcher. He published many research publications, conference, and research papers, especially on the field of foreign trade. During the last years, he participated in different projects on monetary policy and financial stability in the Czech National Bank.

Since 2001 he co-operated with the Department of Banking at the University of Finance and Administration in Prague (Vysoká škola finanční a správní v Praze). He gave courses on monetary policy for graduate students, consulted students of doctor studies, and reviewed Masters' theses.



***Assoc. Prof. RNDr. Přemysl Záškodný, CSc.***

Assoc. Prof. RNDr. Přemysl Záškodný, CSc., graduated from the Mathematical-Physics Faculty of Charles University, CSc. in the physics education, and Assoc. Professor of physics education. As a university teacher, he is affiliated to the University of South Bohemia in České Budějovice and to the University of Finance and Administration in Prague.

He is active in scientific work in cooperation with the International Institute of Informatics and Systemics in U.S.A., and the Curriculum Studies Research Group in Slovakia. In his scientific work, aimed at science and statistics education, he deals with structuring and modelling physics and statistics knowledge and systems of knowledge and also data mining and curricular process.

In addition to support from his faculty and university, the projects granted to the author by the Avenir Foundation in Switzerland and the Curriculum Studies Research Group in Slovakia brought a considerable contribution to the results achieved.

The conception of the last books “Survey of Principles of Theoretical Physics”, “Curricular Process in Physics”, “Fundamentals of Statistics” (with co-authors), “From Financial Derivatives to Option Hedging” (with co-author), “The Principles of Probability and Statistics” (monolingual and bilingual version), “Curriculum Research and Development in Physics Education”, “Methodology of Scientific Research” (with co-author), “Selected Chapters of Science History” (with co-authors) and last monographs “Educational and Didactic Communication 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016” are based on the scientific work of the author. Some of the further works published by the author can be found in the bibliography.

Assoc. Prof. RNDr. Přemysl Záškodný, Ph.D. has been active as general chair of international e-conferences OEDM - SERM 2011 and OEDM -SERM 2012 (Optimization, Education and Data Mining in Science, Engineering and Risk Management). The e-conferences OEDM - SERM 2013-2014 and OEDM - SERM 2015–2016 were successfully finished as well.

## Author's C/V

***Assoc. Prof. Ing. Vladislav Pavlát, CSc.***

Vladislav Pavlát completed his studies in economics at the University of Economic Sciences in Prague, later receiving the Candidate of Sciences (CSc.) degree at the University of Economics in Prague and becoming an Associate Professor (Docent) in economics. For many years, he worked at the Research Institute of Engineering Technology and Economics, focusing on management and organizational management research.

In 1990, he participated in the preparation for the establishment of the Prague Stock Exchange. As a Vice Chairman of the Preparation Committee for the Stock Exchange Establishment, he underwent foreign internship at the US Security Commission in Washington and in Morgan Stanley in New York.

For several years, he was a member of the Exchange Chamber and Chairman of the Trading Committee. In the nineties, he worked as a manager of several companies, later as financial advisor.

He published several books, *inter alia*: Financial Markets and Stock Exchanges throughout the World (1992), Financial Derivatives (1994), Global Financial Markets (2013), Financial Markets' Infrastructures (2016). Moreover, he has published essays and papers in various Czech and international publications, particularly in proceedings of many international conferences, both in the Czech Republic and abroad. He was the Chairman of the Editorial Board and Editor-in-Chief for the *Akcie, burza, kapitál* magazine (Shares, Stock Exchange, and Capital).

He currently works at the University of Finance and Administration, in the Department of Finance. He has been a guarantor of the Banking specialization for several years.

As an editor, he has published and co-authored the following publications: Capital Markets Regulation and Supervision (2004), Capital Markets (2005), Financial Markets Regulation and Supervision (2010), on selected banks in the Czech Republic: Situation, financial results and outlook (2015).

As an expert guarantor, he took part in the organization of international conferences of the University of Finance and Administration in the area of financial markets and their regulation in 2005, 2007, 2009, 2011, 2013, 2015, 2017 and editor a co-editor of Conference Proceedings from these conferences.

## Summary

PRAGUE STOCK EXCHANGE (1993–1997). Publisher: Institute of Finance and Administration. Prague. Czech Republic. 2018. 155 pages.

The main goal of this book is to highlight the important role played by the Prague Stock Exchange in the whole process of transition with all its difficulties, positive and negative effects. In writing this monograph, the author has done his best to base it on objectively existing documents and without surpassing the boundary of objectivity necessary for scientific research. In the monograph, the author exploited open sources, and selected unpublished sources from his private archive as well.

The period of 1993–1997 was a decisive time for creation of the Czech financial sector with its markets and infrastructure. Within this period, the Prague Stock Exchange started securities trading. This period is important because of two main reasons: firstly, a successful elimination of all barriers that prevented the establishment of the PSE; secondly, it has been recognized very soon that the emerging Czech capital market will have to be – as soon as possible – reformed and regulated according to international standards.

The book contains 13 chapters.

Chapter 1 (Introduction) defines the concept of monograph, its purpose, and contents. This book does not present an all-embracing, comprehensive view of the Czech capital market and its creation. The structure of monograph was highly dependent on available sources and their quality which had a serious impact on the level of selected questions' description, analysis and solutions. The sources were categorized into eight categories and described. Their relevance was commented in the paragraph on methodology. A microeconomic analysis was not included into the monograph. Economic results were not analyzed because of incomplete information/data and/or a lack of necessary data. The monograph does not contain an analysis of legal documents; they are used only for illustration of the legal *status quo*.

Chapter 2 contains a brief survey of the political and economic development in the Czech Republic (1993–1997).

Chapter 3 re-capitulates the main events and actions which enabled to set up the Prague Exchange. The main activities of the Preparative Committee, the help of foreign Stock Exchanges, and consulting companies are explained. The role of the French Aid and of the contract on putting the PSE into operation is highlighted.

Chapter 4 gives a characteristic of the three phases of the Czech capital market evolution. The regulatory framework of the Czech capital market, the clearing and settlement systems and the questions of multiple trading channels are dealt with.

Chapter 5 analyses the specific and unique features of the emerging Czech capital market, as seen through the optics of 1993–1994.

Chapter 6 deals with the structure of PSE organization, with the description of the PSE trading system and gives a survey of the PSE regulatory documents issued in 1992–1994.

Chapter 7 gives selected facts on investment companies and funds position in 1994. The negative impact of the funds' liberal regulation and a lack of an efficient supervision is criticized. The PSE role in trading the privatization funds' shares is analyzed.

Chapter 8 contains the analysis of PSE governance. The role of the Exchange Chamber, of the Supervisory committee and of the Exchange members is described and evaluated. The territorial deployment of non-banks and the PSE ownership structure is analyzed.

Chapter 9 describes the level of the financial education in the Czech Republic the nineties. PSE activities on the field of financial education and PSE role in brokers' professional education are evaluated.

Chapter 10 provides a comprehensive survey of the Czech press information and comments on the Czech capital market and PSE in 1994 and 1995.

Chapter 11 contains a detailed classification of sources published in the book and explains the applied evaluation criteria. One of the main research findings confirms that the broad scope of PSE sources was one of the important factors that supported the start of reform measures and legislative changes of the Czech capital market.

Chapter 12 represents one of the substantial parts of the book, as it explains many deep reasons why a comprehensive reform of the Czech market basic legal Acts was absolutely necessary. Results of important conferences and seminars on the main Czech capital market problems are evaluated.

Chapter 13 is another of the important parts of the book which contains the analyses of the positive and negative features of the PSE general policy and of PSE relation to the Ministry of Finance and other capital market institutions. According to the author's opinion, the positive impact of PSE on the Czech financial and capital market prevailed: *"... during the period of 1992–1997, the PSE activities showed an upward trend, and implemented measures' impact of PSE was positive"* (except for situations when the PSE could not surpass the barriers given by the legislation).

In the Conclusion of the book the main research finding are summarized.

The author of the book is a former member of the Prague Stock Exchange Chamber and first Chairman of the PSE Trading Committee. At present he is member of the Department of Finance at the University of Finance and Administration in Prague.