

## **Genesis and prospects of the Ukrainian stock market**

### **Introduction**

Ukrainian stock market contains elements which are typical for markets in many countries: availability of state control over the circulation of securities; regulation of their total list, licenses for professional participants of transactions; licenses for stock-exchange and non-stock-exchange turnover; state regulation of securities issues; disclosure of indicators of financial reports.

However, high development of the financial market in Ukraine should not be affirmed on the basis of quite high development of its components. It is characterized by features that distinguish it among others, such as: the advantage of the primary market, issue of shares, small proportion of the stock market, lack of awareness of investors about the debt securities, low guarantees on income payments on securities.

Therefore it can be argued that the Ukrainian stock market is not currently an available source of funding for economic development. Its infrastructure is immature due to the insufficient development of institutional, legal and information environment in the country.

### **Information transparency of the Ukrainian securities market**

Most Ukrainian companies-participants of the stock market are closed informational areas which submit limited information about their activities, the accuracy and reliability of which is difficult and sometimes impossible to verify. The amount of information that is subject to mandatory disclosure by the State Stock Market and Securities Commission (SSMSC) is insufficient to detect problems and prospects of stock market participants' development. As Ukrainian enterprises generally do not disclose the established accounting policy which determines the methods of accounting and approaches to evaluating individual items of financial

statements. Such situation allows to manipulate financial reports during long periods of time to achieve the best visible results, which actually might not be true.<sup>1</sup>

Implementation of national accounting standards (NAS) only partially solves the problem of information transparency of companies because of great differences in approaches to assessment items of financial statements, changes of companies' value and scope of disclosure by NAS and IFRS. As a result, the value of assets reflected in balance sheets of Ukrainian companies is often significantly underestimated, and profits are inflated.<sup>2</sup>

In addition to problems of reliability and completeness of the disclosure of the financial condition and performance of the companies, there is also a problem of access to it by interested users. Due to a lack of access of individuals to the commercial and financial information, they are actually not members of the financial market, although the savings rate in Ukraine is quite high in relation to GDP (Table 1).

Table 1. Household savings share in GDP of Ukraine (quarterly indexes of 2007–2009 and 1st and 2nd quarters of 2010) [%]

2007				2008				2009				2010	
I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II
14.3	23.8	23.2	21.4	15.4	18.8	19.1	20.2	20.7	25.8	17.3	21.2	19.5	20.4

Source: *Macroeconomic Review of the National Bank of Ukraine*, November, 2010.

Because of imperfect legislation SSMSC has no real access to companies' accounting and information system, is not capable to verify the completeness, accuracy of information submitted by companies, which reduces the confidence of market participants in its reliability and causes the presence of a significant number of OTC securities transactions.<sup>3</sup>

## Genesis of the Ukrainian stock market

Since its inception in the early 1990s, Ukrainian stock market went through several stages of development.

The formation of Ukrainian stock market was started by the following factors: gaining independence in 1991, privatization of companies and the formation of an

<sup>1</sup> H. Nashkers'ka, *Metodolohiia i praktyka otsiniuvannia u finansovomu obliku*, Lviv 2009, pp. 115–120.

<sup>2</sup> *Ibidem*, pp. 273–278.

<sup>3</sup> O.P. Kornijchuk, *Kliuchovi problemy v diial'nosti fondovoho rynku Ukrainy ta ikh vplyv na realizatsiiu natsional'nykh interesiv u finansovij sferi*, "Rynok tsinnykh paperiv Ukrainy" 2006, No. 11–12, pp. 18–19.

appropriate legal framework. This was the stage of conception, in which characteristic was the presence of only one type of primary market of securities — shares of corporatized enterprises, the almost total absence of regulation of securities by the government, lack of trade organizers.

The 1995–1999 period is characterised by the growth of securities trading, creation of regulatory body — State Stock Market and Securities Commission and improvement of the legal framework of securities circulation. Completion of privatization of most enterprises in 2000–2005, adoption of certain laws have caused a significant increase in the stock market. Control of securities traffic was accomplished by SSMSC, National Bank of Ukraine and Ministry of Finance of Ukraine. At this stage the market of debt securities and secondary securities was launched.

The biggest success in stock market development in Ukraine has been achieved in 2006–2008. Ukraine's economy growth, improvement of macroeconomic indicators had positive impact on the development of the stock market. There was also observed an increase in amount and value of exchange agreements, which determined the leader of individual trades — PTFS. In addition to this, there were decreased turnover of OTC securities, increased regulatory role of government in controlling the circulation of securities and disclosure of information about transactions involving them and their consequences.

### Current state of Ukrainian stock market

The development of Ukrainian stock market was significantly affected by the global economic crisis. The number of registered transactions of securities buying and selling has significantly decreased, the amount of transactions has been reduced, and the emphasis has shifted from primary to the secondary market.

Ukraine is one of the leaders of negative rating countries by the level of devaluation of national currency and economy recession. The greatest decline is observed in the following segments (Fig. 1): construction (–45.9%), machine building (–45.1%), production of other non-metallic mineral goods (–38.4%), and metallurgy and metal working (–26.6%).

The main national factors that have intensified the impact of the global economic crisis are the following: credit expansion of the Ukrainian National Bank, foreign banks' policy, aimed at increasing quantity of consumer credits on imported goods, monostructural export dependence of economy (export of ferrous metals in total exceeds 30%), uncontrolled accumulation of external debt, a speculative development of the construction industry, which exceeded the effective demand of consumers.<sup>4</sup>

<sup>4</sup> M.I. Syvul's'kyj, *Natsional'ni osoblyvosti finansovoi kryzy*, "Finansy Ukrainy" 2009, No. 7, pp. 3–4.

One of the reasons for such a negative situation is the lack of competitive models of the Ukrainian stock market that has a negative impact on the opportunity to attract investment resources for economic development.

Insufficient development of the Ukrainian stock market had been observed before the crisis and had been caused by the following interrelated factors:

- the influence of non-market mechanisms on financing of enterprises;
- market monopolization by national finance and industry groups and foreign multinational corporations;
- lag of the national economy restructuring enterprises and industries;
- opacity of enterprises' financial and economic activity and its results;
- shadow financial system;
- violation of rights of minority share holders.

Table 2. Dynamics of the value of exchange agreements on financial instruments in Ukraine, 01 February 2008–03 December 2010 [in % over the previous year]

Financial instruments	Companies' stocks	Companies' bonds	Government bonds	Investment certificates	Local bonds	Derivatives	Total
2009	−51.76	−75.44	−59.36	−2.99	−94.55	−87.50	−65.70
2010	478.07	−14.19	1116.41	1519.56	329.15	28594.64	482.96

Source: State Stock Market and Securities Commission of Ukraine.

Because of these factors' influence, the volume of trading in the stock market of Ukraine in the crisis year of 2009 decreased by 65.7% (Tab. 2). The greatest decline is observed in the following types of securities, including companies' bonds — 75.44%, local bonds — 94.55 and government bonds — 59.36. During 11 months of 2010, there has been substantial (by 4.82 times) increase in the Ukrainian stock market, including government bonds market increasing by 11.2 times.

Indexes of the largest Ukrainian stock exchanges correlate with the volume of trading in the stock market. In particular, Figure 2 shows the dynamics of PFTS index for the period from January 2006 to December 2010.

The crisis made a significant negative impact on the already weak stock market, resulting in PFTS fall four times from March 2008 to early February 2009.

The reason for its fall, which began in March and April 2008, was the rapid decrease of foreign investors, exposed to the global economic crisis in their countries. The immediate “dump” of shares increased supply, which during the absence of demand for these equity instruments, led to a sharp fall in their prices.

As shown in Figure 2, the lowest level of prices was in February 2009.

Another important factor that led to the fall of the Ukrainian stock market is the lack of its development, which, combined with the world and national economic crisis, political instability and expectations of a sharp increase in the exchange rate, led to a decrease in stock prices, provoked by brokers.

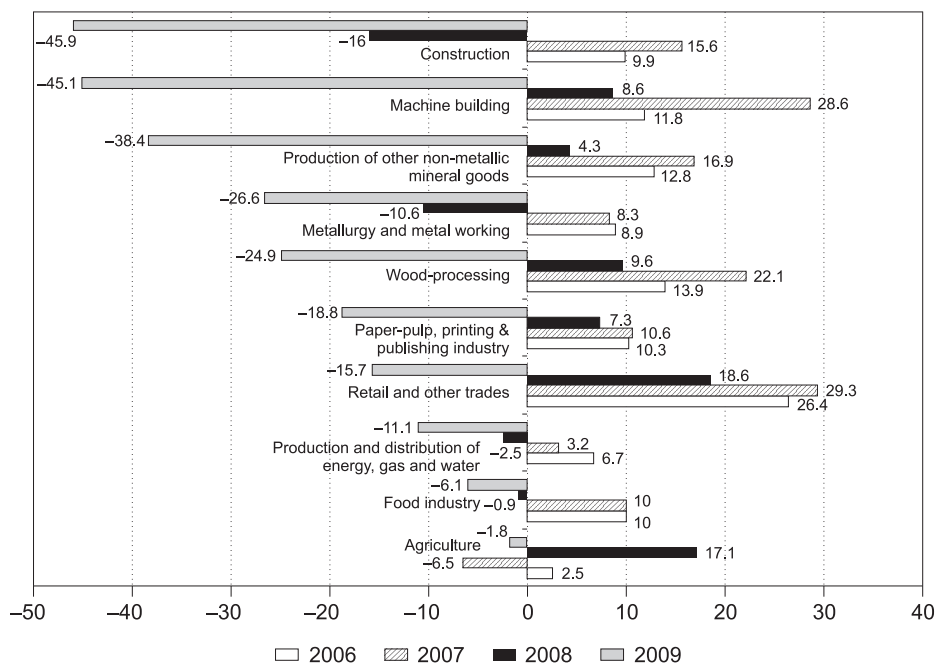


Fig. 1. Dynamics of leading segments of the Ukrainian economy in 2006–2009 [%]

Source: The Ministry of Economy of Ukraine, State Statistics Committee.

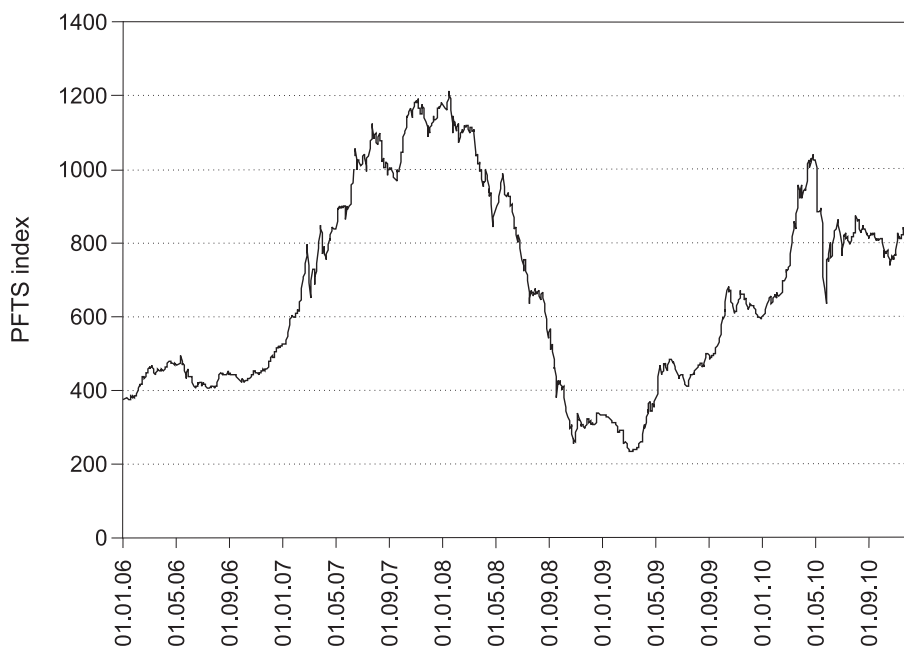


Fig. 2. Dynamics of PFTS index, 1 January 2006–1 December 2010

Source: PFTS Stock Exchange.

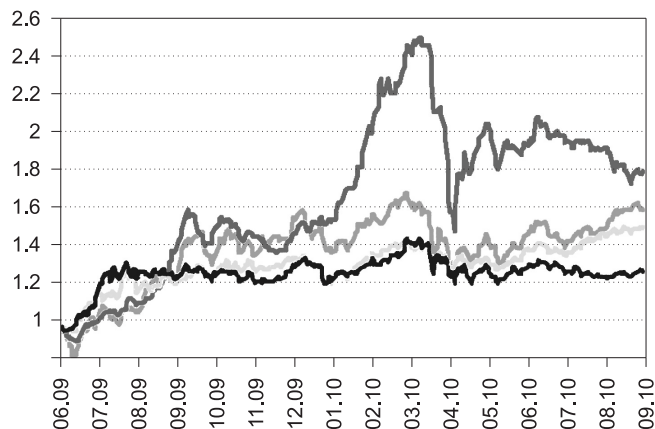


Fig. 3. Dynamics of stock indexes of some Central and Eastern Europe economies (index, 30 June 2009 = 1)

Source: Reuters EcoWin, "Macroeconomic Review of National Bank of Ukraine", November 2010.

Analysis of the schedule shown in Figure 2 suggests that the PFTS index is moving in the same direction as the indexes of American Dow Jones, British FTSE and therefore its dynamics is quite predictable. Although its level of decrease significantly exceeds the mentioned indexes, it is still lower than the fall level of the stock markets of Iceland, Bulgaria and Cyprus.<sup>5</sup>

If we consider the dynamics of some economies' stock index in Central and Eastern Europe, there could be observed a similar trend of changes in PFTS index (Fig. 3).

## Conclusions

Despite the low level of the stock market development in Ukraine, it is a true indicator of national economic development.

Thus, the development of Ukrainian stock market, its focus on the minority shareholders, will provide the high level of Ukrainian economy capitalization and will be an important factor in financial and economic stability and further development of Ukrainian economy.

The conducted research suggests that the Ukrainian stock market is relatively young. It is rapidly developing.

To increase the capitalization of Ukrainian economy and Ukrainian stock market following steps should be taken:

<sup>5</sup> M.I. Syvul's'kyj, *Natsional'ni osoblyvosti finansovoi kryzy*, "Finansy Ukrainy" 2009, No. 7, pp. 5–7.

- develop a comprehensive national strategy of economy capitalization of priority industries and enterprises;
- amend the current legislation to ensure effective state regulation of companies and industries and the formation of transparent property rights;
- develop a realistic long-term strategic plan for the economy and its individual sectors and enterprises for 15–20 years. At the same time, establish innovative model of development to set priority areas with regard to WTO accession and requirements to adapt to EU standards;
- ensure transparency of companies' financial reporting, timely publication and disclosing all required information on their activities;
- improve implementation of agreements and track the ownership of securities.

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## Genesis and prospects of the Ukrainian stock market

### Summary

The article examines the formation and development of the Ukrainian stock market from 1991 to present. The author defines specific characteristics of the stock market in Ukraine, such as: the advantage of the primary market, issue of shares, a small proportion of the stock market, lack of awareness of investors about the debt securities, low guarantees on income payments on securities. The dynamics of financial instruments trading and index PFTS in recent years are analysed. The author

also suggests ways of strengthening the competitiveness of the Ukrainian stock market: development of a comprehensive national strategy of economy capitalization of priority industries and enterprises; amending the current legislation to ensure effective state regulation of companies and industries and the formation of transparent property rights; development of a realistic long-term strategic plan for the economy and its individual sectors and enterprises for 15–20 years. At the same time, establishment of innovative model of development to set priority areas with regard to WTO accession and requirements to adapt to EU standards; ensuring transparency of companies' financial reporting, timely publication and disclosing all required information on their activities; improvement of the implementation of agreements and tracking the ownership of securities.