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THE PROCESS OF CAPITAL MARKET RESTRUCTURING AS A DOMESTIC POST-CRISIS UKRAINIAN ECONOMIC POLICY MAKING DETERMINANT

Resume *Stock market is the inalienable and important element of the financial system of market economy. Consequently, efficient and effective stock market development is the important stage of completion of domestic economy transformation. The process of the institutional development and acquisition of necessary high-quality market characteristics is far not completed yet. Research objectives are to analyze securities market and methods of improving efficiency of its performance in a post-crisis period.*

Анотація *Фондовий ринок є невід'ємним та важливим елементом фінансової системи ринкової економіки. Відтак, становлення ефективного та дієвого фондового ринку є важливим етапом завершення трансформації вітчизняної економіки. Процес інституційного становлення, набуття необхідних якісних параметрів ринку ще далеко не завершений. Метою дослідження є аналіз вітчизняного ринку цінних паперів та способів покращення ефективності його функціонування у посткризовий період.*

Аннотация *Фондовый рынок является неотъемлемым и важным элементом финансовой системы рыночной экономики. Следовательно, становление эффективного фондового рынка является важным этапом завершения трансформации отечественной экономики. Процесс институционального становления, приобретения необходимых качественных параметров рынка, еще далек от завершения. Целью исследования является анализ отечественного рынка ценных бумаг и способов улучшения эффективности его функционирования в посткризисный период.*

Key words: stock market, capitalization, shares, Internal Governmental Bonds (IGB), corporate bonds, FSTS (First Stock Trading System).

Used techniques: empirical methods, such as empirical treatment and empirical observation, also graphical and statistical methods.

Stock market is the inalienable and important element of the financial system of market economy. Consequently, efficient and effective stock market development is the important stage of completion of domestic economy transformation. Stock market in Ukraine exists already over 15 years, since the Act of Ukraine «About securities and exchange stock» was passed. But the

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process of the institutional development and acquisition of necessary high-quality market characteristics is far not completed yet. Economists and politicians analyze the problems of domestic stock market development, find out barriers which hinder this development, search possibilities to reorientate the stock market to fulfill new tasks in the process of economic development, to design the measures of economic policy, that remove obstacles of forming of high-efficiency stock market.

On the modern stage of Ukrainian economy development it is necessary to set up new tasks for a stock market. These tasks are supposed to focus on the problem of providing economy with investment resources in a post - crisis period. Tremendous market development, beginning from 2005 year which ended up with an «overheat», and its passing towards crisis position in autumn of 2008 proved that reformation of regulation, infrastructure, introduction of innovative technologies are necessary.

Analyzing capitalization oscillation of Ukrainian equity market one can come to the conclusion, that imperfect legislation and infrastructure lead Ukrainian stock market to becoming the instrument of abnormal profit earning. Not simply profit but excess profit earning for foreign investors, especially international investment funds. At the same time it induced domestic companies to use different charts artificially to overvalue their performance results. In order to become more attractive for the foreign investor Ukrainian companies came up with such efforts, as an artificial overstating of trade volume, manipulation share quotations, etc. By the way, manipulation of share quotations was also used by asset management companies in order to get higher fees for the Co-investment institutes assets management, and also for the sake of amplification of the real cost of company which is for sale.



Chart 1. The dynamic of FSTS capitalization and trading structure

In other words the positive capitalization dynamics of domestic shares reflected economic reality very poorly, and euphoria of pre-crisis 2007 was just a “bubble, exaggerated by speculators”. Share prices on FSTS stock market were growing at incredible pace from the beginning of 2004. As the result at the beginning of 2008 for incomplete period of four years FSTS index has increased 1278 % (see chart 1). Although 2009 turned out to be one of the most severe years for the Ukrainian economy, share index of the Ukrainian stock market expanded at pace of 94 % by December, 21 and FSTS index - of 92 %. Significant price drop in January-February was replaced by active growth at the beginning of March. Market already grew approximately by 30-40 % in 2010. Furthermore on the basis of the results of activity it is now possible to state that shares of banks and electric power sector enterprises of the first and second FSTS listing levels remain considerably over-estimated (see chart 2).

	Financial sector	Power industry	Metal-lurgy	Car construction	Machine-building	Ore mining	Gas/Oil	Coal production	Chemical industry
P/E (Price-to-Earnings)	87.2082	Гра-98	Лип-30	12.1647	Грг-17	Кві-16	Чер-70	6.1839	Лис-51
P/S (Price-to-Sales)	Бер-84	0.98	0.39	0.65	0.45	Січ-63	1-Лип	Січ-59	0.95

Chart 2. Average indexes P/E and P/S on 23.03.2010

As to Internal Governmental Bonds, they became the only source financing general government deficit in 2009. However, the situation on the market was illogical, when government bonds with the half-year term are accommodated with practically 30 per cent annual yield. That deprived banks with free funds any motivation for searching for alternative investment sources not only at the credit market but also in debt creation (extending credit). As a matter of fact, a few auctions on which national debt sold under unsustainable percents compelled to start speaking about possibility of government default. But even after active borrowings of 2009 the volume of national Ukrainian debt will not exceed 25 per cent of GDP that is far below the level in the developed countries. And it doesn't influence the indexes of those developed countries either. Thus, concerning the government bonds default, it is necessary to remember that the major part of these bonds belongs to NBU. Situation changed in March, 2010, when long-term Internal Governmental Bonds took place already under 16-17 per cent annual.

We hold the opinion that nowadays Ukrainian stock market does not fulfill its basic functions in relation to accumulation and redistribution of investment resources between different industries of economy and enterprises, formation of reasonable market value of enterprises, formation of informative indicators for investors, indication of the general condition of economy for all market participants, creation of the effective system of protection of investors rights and interests, assistance to the development of the system of the non-state pension fund and Co-investment institutes. But it also remains the effective speculating instrument to get profits.

The main task of stock market on the current stage of transformation of Ukrainian economy must be mobilization of temporally free resources of population and resident entities, secondary distribution of this money in those economy sectors, which require additional financing for further development. For the purpose of implementation of targets concerning attracting investments and providing with steady development growth it is necessary to remove number of obstacles which prevent further stock market development and high-quality implementation of all the functions laid on it:

1. Psychological non-acceptance and underestimation of stock market potential as an important element of the financial market economy system. A second-rate role is given to the stock market in comparison with the other sectors of financial system, in particular with banking sector and it is evidenced underestimation of stock market potential in reference to the possibility of investment resources of population and entities accumulation. The underestimation of fund market potential is observed both from the side of the government and from the side of entities and households.

2. Some details of stock market upon the whole, and special features of its structure in particular: substantial predominance of unorganized market over organized one, what negatively affects the transparency of market which deters foreign investors; presence of a few trade grounds where securities bidding takes place that complicates control over investment business and distribution of informative indicators in relation to the quantity and high-quality criteria of investment business; low level of stock market liquidity; lack of papers to trade on capital market, limited amount of market instruments; the participants of market manipulate the prices with the

view of overrating investment funds net assets; noncompletion of stock market institutional infrastructure and its bottom quality.

3. Low specification level of ownership rights which predetermines numerous corporate conflicts. Weak protection of shareholders rights, especially minority interests, low level of corporate management are nearly the biggest problems which slow down capital market development and restrain both internal and external investor. Among the most common violations of investors rights we mark: failure to adhere to the norms of the law, that estimates the order of share placing, violation of investors interests during issuing additional shares; delayed and incomplete release of information about issuers performance; discrimination of rights for investors during insolvency proceeding, bailouts, reorganization or liquidation businesses, which are the investment objects; nonobservance of general shareholders meetings schedule; acceptance of regulation norms that limit investors rights and interests; acceptance of regulation norms which limit rights and interests of investors; changing order and terms of dividend payments.

4. Weakness of internal institutional investors, presented by mutual funds, non-governmental pension funds and insurance companies, low activity of retail investor at equities market. The mutual funds market has appeared relatively recently – framework law that constitutes functions of mutual funds was adopted only in 2001, and the activity of non-governmental pension funds was established only at the end of 2003. The first asset management companies and investment funds obtained licenses at the end of 2003 – at the beginning of 2004, and non-governmental pension funds - only in 2005. There are seven different kinds of mutual funds functioning in Ukraine, some of which work with a population. There are three sorts of non-governmental pension funds and also asset management companies of different level in Ukraine. These institutes operating at mutual investment market allow satisfying the requirements of individuals and legal entities in mutual investing.

However, exceptionally formal and quantitative indexes are referred to above. Upon that the quality of mutual funds and non-governmental pension funds services, professional skills and population readiness are not taken into the account here. At this point nowadays the first thing to think about is the quality of asset management companies and non-governmental funds services, gaining experience, increasing professional management standards, and trust of potential investors, economy readiness, etc. It is not about quantitative growth of mutual funds and asset management companies any more. One of the most urgent tasks in relation to institutional investors development at Ukrainian market is diminishing of motivation for them participating in shadow schemes and prosecution of illegal transactions connected to money laundering.

Development of mutual funds and non-governmental pension funds must be a powerful impulse for capital market development activation and also for filling it with some internal investment resources. However growing personal income and free legal entities resources considerably stayed away from the mutual investment market. Since pension funds are main clients of investment funds, money, invested in non-governmental pension fund can be easily regenerated into investment expenditures with the help of capital market. Activation of private pension business is also possible due to individuals. However, at this point no special interest in non-governmental pension funds is being noticed. The reason for it is people being suspicious of long-term payments and also lack of knowledge about all the possibilities the system of the non-governmental pension provides. Only 0.28 per cent of Ukrainian population is attracted to the system of the non-governmental pension coverage. The possibility of use of the non-governmental pension system's potential for the purpose of investing depends on further development of the corporate non-governmental pension coverage and also on advertising and expository work among population and companies.

5. The weak personal interest of strategic foreign investors in Ukrainian stock market. The presence of strategic foreign investors at national stock market depends on such factors, as: macroeconomic and political stability; national legislation stability; precise rights support for shareholders, high level of corporate management; absence of barriers towards free capital movement (both to and from Ukraine), predictability of currency policy; transparency of both stock market and domestic companies disclosure. Majority of these factors are under satisfactory level which restrains international capital flows to the national stock market.

6. Not high rates of adjusting to a normative base which regulates financial relations to the requirements of international standards. The question is about implementation of international standards of information disclosure: International Accounting Standards of International Accounting Standards Committee (IASC) and international standards of information disclosure of International Organization of Securities Commissions (IOSCO). Harmonization of internal legislation allows to integrate the international stock market deeper and quicker and to promote the attractiveness of home capital market for strategic investors.

In the scope of investment potential increasing, along with the use of internal financial resources it is necessary to use possibility of participating in an international capital transfers. Procurement of foreign investments exactly through a stock market seems to be the most attractive form of international capital movement. It is caused by market providing mobility of capital movement and liquidity of holdings. Under such conditions of current Ukrainian economic performance a liquidity of assets is likely to be one of main factors that influence investment activity. Especially it concerns foreign investors who got used to economic and political stability, and as a result are very sensible to instability, that is usual for the countries with a transitional economy.

One of the powerful instruments of procurement of investments is procedure of initial public offering on international capital markets (IPO). This mechanism did not purchase the proper popularity among the most domestic companies, as it requires the high level of corporate management, transparency of company and accordance of its accounting to international standards. As an example for domestic companies can be Russia, where during 2006-2010 number of powerful companies hold an IPO enough successfully. Successful procedure of holding an IPO by leading domestic companies is going to increase the interest of external investors both to these particular companies and Ukrainian stock market in general.

Further stock market development depends on specific government actions concerning building-up the financial system. The effective restructuring of the financial system, further development of stock market, exceptionally on the basis of self-regulation is impossible. We hold the opinion that market relations at recently formed markets are not finally formed. Therefore the pace of stock market development, its high-quality aspects, and also opening of its investment potential, depend on specific actions of public policy and reformation of financial sector.

Thus, further stock market development is impossible without reformation of most market components and removal of obstacles which interferes this development. The role of stock market must be reconceived and substantially enhanced in investment resources procurement and in addressing these resources on renovation of industrial potential, creating conditions for establishing powerful institutional investors.

The successful stock market functioning requires existence of number of various institutes. In particular, presence of the following assumptions for market aims realization is necessary: freedom of capital movement; liquidity of securities, presence of the developed infrastructure of capital market, clear specification of ownership rights, information transparency of market; macroeconomic stability, high degree of confidence to the government, its institutes, and also be-

tween market participants, which makes nameless exchange possible. The presence of mentioned conditions in combination with an efficient capital market forms attractive and beneficial investment climate which provides additional financial resources flow to the economy.

For the purpose of high-quality restructuring of the Ukrainian capital market and its concentration on realization investment-innovative tasks the governmental policy in relation to it must be concentrated on the following: development of capital market and its infrastructure, in particular creation of effective depositary-clearing system which will assist development of trade at the organized market; concentration on securities trading on the organized market, introduction of international standards; adjustment of financial services market in accordance with world standards; consolidation of stock markets and other trade facilitators, improvement of property rights specification; popularization of trading among population; introduction of development strategy of new financial instruments.

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