

# **STOCK MARKET OF UKRAINE AT THE PRESENT STAGE: ANALYSIS AND PROSPECTS OF DEVELOPMENT**

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## **1. Introduction**

The process of market transformation of economy, globalization and integration of economic relations contribute to the development of the stock market as a precondition for sustainable development of economic and financial system of Ukraine. Continuous development and productive activities of financial institutions in the stock market is an important driver of economic growth that ensures the country's national economic security. Efficient asset management of investment funds, pension funds, broker companies and generally of the whole stock market improves activity of business entities, eliminates problems of financial resources shortage, expands opportunities for investment in various sectors of the economy, and positively affects the level of real economy and welfare of the population. Strengthening of stock market requires the research of its modern state, detection of problems, because the efficiency of the economy as a whole depends on the timely determination of the main directions of market development.

## **2. Recent research and publications analysis**

The theoretical basis of formation and development of the stock market in the globalization environment were revealed in the works of the following foreign scientists: G. Bekaert [1], U. Bhattacharya [2], Levine Ros. [3] etc. The studies of domestic scientists, economists and practitioners: S. Biryuk [4], M. Burmaka [5], D. Leonov [6], Z. Lutsyschyn [7], Yu. Makogon [8], O. Mosgovyi [9], M. Gaponyuk [10], V. Radievska [11], were dedicated to conceptual issues of establishment and functioning of the stock market of Ukraine. However, most of domestic and foreign authors considered mainly the common conceptual basis for the development of the stock market, its infrastructure, components and laws of formation. But a number of problems related to the functioning of an integrated system of stock market in specific economic conditions are left behind. Given the fact that the assessments of the current state of the domestic stock market with its influence on the economic environment are important, they need further thorough investigation.

The article aims to identify the characteristics of the stock market of Ukraine and study the ways of its development considering priorities of the national economic development strategy and trend of financial globalization.

## **3. The analysis of Ukraine's stock market**

Stock market takes extremely important and special place in the structure of the modern market economy, due to unique properties of securities in the context of the objectives and priorities of economic development and motivates objective tendency of securitization of economic relations. Its structure in functional and instrumental terms is constantly evolving within fundamental segments: primary and secondary; organized and unorganized; stock shares, bonds, derivatives securities. It is constantly evolving especially in terms of enhanced internationalization and globalization [12, p.10].

From the standpoint of modern economic theory the stock market is the most amplitudinous and dynamic segment of the financial market. The stock market is a structured organizational and legal system within which placement, circulation and accounting of securities and their derivatives with the direct participation of professional participants are carried out. Through the mechanisms of the

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stock market the supply and demand for investment funds are formed, their institutionalized accumulation and redistribution with the goal of the economic growth occurs.

At present stage of development the current macroeconomic figures indicate a continuing high level of exclusiveness of the stock market. In particular, according to SSMNC, the total trading volume on the stock market of Ukraine in 2013 totalled \$1.68 trillion against \$2.53 trillion in 2012, while the structure has undergone significant changes in transactions with financial instruments, including transactions with bills, whose volume decreased from 412.1 billion to 3.4 billion [13]. This trend is explained by the introduction of tax (excise duty) on disposal of securities outside the organized trade. Bills that have been used mainly for implementation of financing schemes is a specific tool and cannot be traded on the stock exchange, so the deals with them in such conditions have become too expensive, which significantly reduced possibilities of companies to attract working capital in conditions of acute shortage of credit and investment resources.

As a way out of the current situation the market has found an alternative to the bills in the form of investment certificates, operations with which are not burdened by taxes and is used by industrial and financial groups to adjust the parameters of the financial statements of commercial banks, in particular, in 2013 the volume of transactions with securities ISI increased from UAH 1377 bln. to UAH 496.5 billion, and their share in total transactions increased from 5,44% to 29,61% (Tab. 1).

**Tab. 1. The structure of securities transactions in the stock market in Ukraine (2005–2013)**

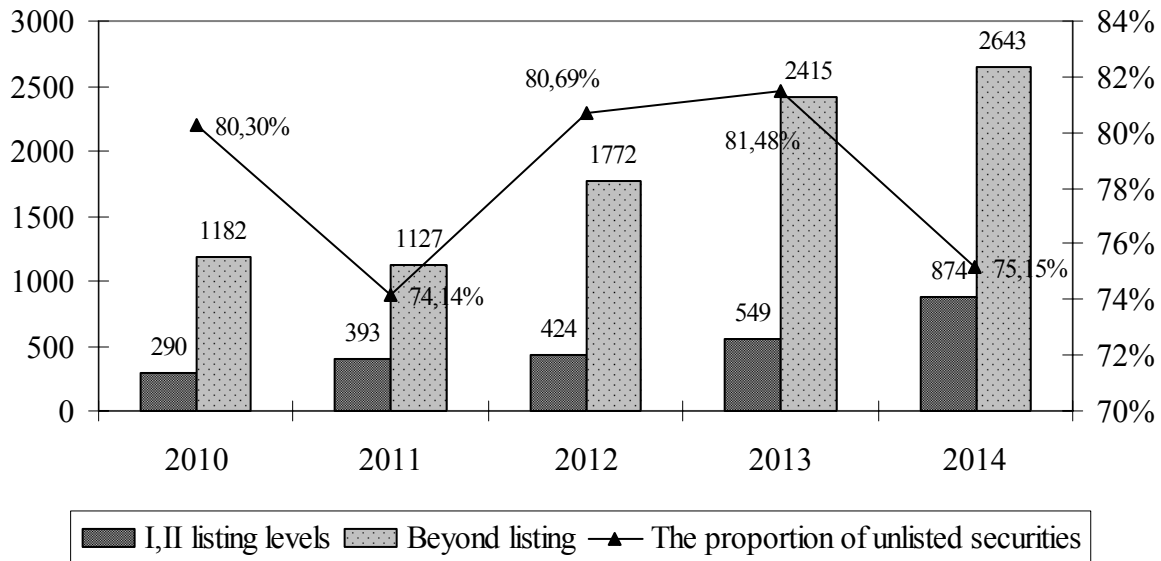
Years	The total volume of transactions (in billions UAH)		Volume of transactions made by organizers of trade (in billions UAH)		Years	
		Rgr. %		Rgr. %		Rgr. %
2005	404		16		4,07	
2006	754	52,9%	35	20,7%	4,66	-21,0%
2007	883	17,1%	38	8,6%	4,27	-8,4%
2008	1067	20,8%	36	-5,3%	3,37	-21,1%
2009	1538	44,1%	131	263,9%	8,52	152,8%
2010	2148	39,7%	235	79,4%	10,84	27,2%
2011	2531	17,8%	264	12,3%	10,42	-3,9%
2012	1677	-33,7%	475	79,9%	28,3	171,6%
2013	754	52,9%	35	20,7%	4,66	-21,0%

Source: calculated by author based on [14]

Reducing the number of professional market participants in 2014 by 106 units can be explained primarily by the introduction of amendments to the depository system, due to the reduction in the number of licenses for depository activities of depository institutions that registrars and custodians had to get to continue their activities. Besides, it should be noted that completed during 2012 and planned for the current term increased requirements for listed securities kept the relatively small share of listed securities in the stock registers auction.

Nowadays, not a lot of companies are interested in raising funds through public offering of the securities that is why spending money on listing with making efforts to improve transparency and corporate standards generally is ineffective in such circumstances. Despite this, in Ukraine, the ratio of capitalization of listed companies in terms of GDP is growing, and the number of securities included in the stock register of trading at the end of 2014 amounted to 864 units, despite the fact that the proportion of unlisted securities that are not meeting the exchange requirements for the instruments of level I and II listing decreased to 75.15% during 2014 [14]. We believe that this dynamics is associated with extensive expansion due to exchange lists of minimum liquidity requirements for listed shares and is not conducive to the extension of attractive range of investment

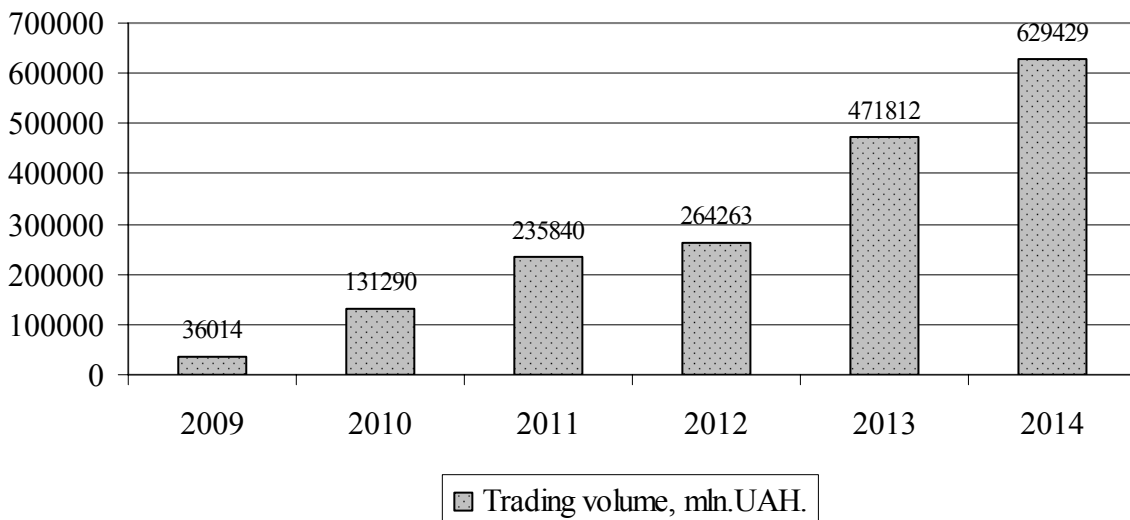
instruments. Issuers undergo listing mainly to reduce the tax burden – tax rate for OTC securities that are listed at least at one stock exchange, is 0,1% instead of 1,5% (Fig. 1).



**Fig. 1. Number of securities included in the exchange lists of organizers**

Source: Author’s Computational work based on [14; 15]

Past observations and calculations show that despite unfavourable economic situation, the national stock market in recent years demonstrates positive dynamics, in particular, trading volume on the stock exchanges in 2014 increased by 32,61% (Fig. 2).

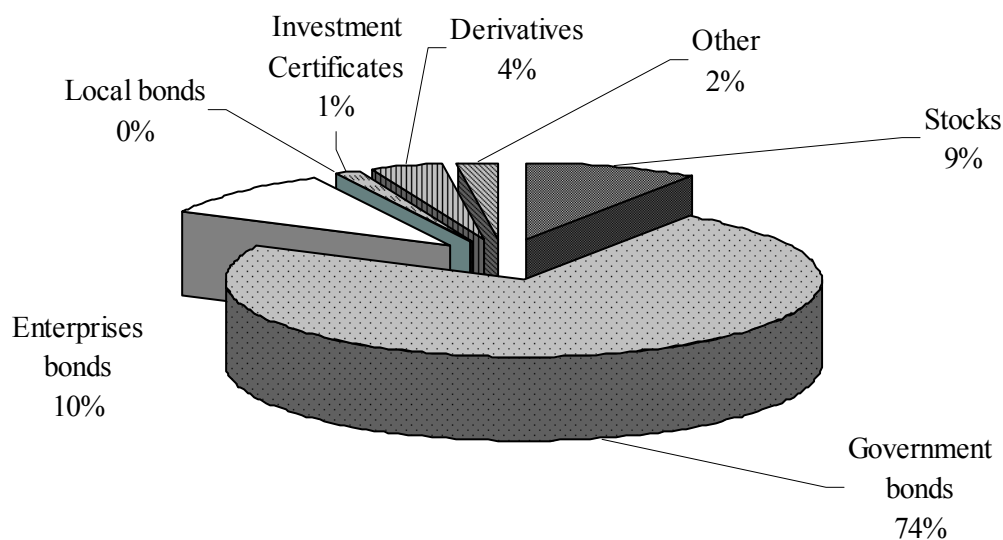


**Fig. 2. Volumes of exchange contracts on securities, mln. UAH**

Source: Author’s Computational work based on [14; 15]

Despite the fact that in recent years at the national stock market expanded instruments the structure of securities trading indicates a growing segment of the debt and reduction the market share of equity instruments. Of course, this has a negative impact on the economy, reducing the volume of industrial production, devaluing the national currency and increasing risks. However, only a small number of companies interested in raising funds through the issue of shares as a form of public offering since it is quite expensive and under unfavourable business climate is not always justified, and the key shareholders are unwilling to allow investors to take part in company management as

the proportion of shares in free circulation is negligible. So in the market of financial instruments the interest in the shares of public companies disappears because of low liquidity, high volatility, low levels of protection of the rights of minority shareholders, and the relatively long term investment in Ukraine in the absence of stable long-term resources [14]. As a result of the analysis the question arises: why has the volume of exchange trading increased if the general situation in Ukraine is not stable and investors have taken the “waiting” position? The answer to this question can be found by analyzing the 2014 volume of transactions in the context of securities as illustrated by Fig. 3. This growth is explained by increased activity in the government bond market, the share of transactions for which was 88% in 2014.



**Fig. 3. The structure of securities transactions on exchange in 2014 (%)**

Source: Author's Computational work based on [14; 15]

Overall in 2014 the stock market in Ukraine was working in conditions of devaluation, reduction of basic indicators of the real economy, which has undergone significant cost escalation due to political and military conflict in eastern Ukraine. Despite the unstable political and economic situation, current market participants are characterized by the introduction of new technologies in management techniques and forms of service of corporate and individual clients. At the same time the new types of financial services based on the new technologies are formed. Currently, the services in the stock market have become quite complex, with the appearance of a significant number of derivatives. The main reason for innovation was the rapid development of information technology that reduced the cost of computing resources and communication resources. At the same time there appeared the securitization process and the formation of the market of derivatives, the structure of the underlying assets of which is based not just on securities and currency, but also on commodities and indexes, verbal data etc.

#### **4. Problems of stock market development in Ukraine**

Analytical review shows contradictory dynamics of the stock market. On the one hand, one could see an increase in the total volume of securities trading and increase of the types of financial instruments, on the other hand, the State developed emission activity and issued T-bills, contradictory to a significant reduction of the volume of shares of corporate bonds and investment certificates of mutual funds. Exchange segment of the stock market plays a secondary role in the economy of Ukraine, as evidenced by poor performance and the lack of correlation between the dynamics of the stock market exchange and processes and trends of the national economic complex functioning and development.

The main problems that hinder the development of the stock market, and limit their participation in socio-economic development are the following:

- low level of institutional support;
- absence of effective pricing of underlying assets because of the low level exchange trading in the total transactions in the stock market;
- lack of information provision and the inability to effectively assess the financial condition of domestic business investment for foreign investors;
- lack of confidence in financial institutions, which negatively affects the accumulation of financial resources in the non-banking sector;
- high risk of financial transactions, insufficient volume and a variety of non-banking services;
- the absence of competition in some segments of the stock market, that would encourage institutions to improve their professional activity;
- constant change in statutory tax rules and investment regime in Ukraine;
- high administrative burden and unfounded judicial decisions.

Thus, the development of the stock market of Ukraine during 2009–2014 was complicated by the lack of effective legislation, systems of regulation and prudential supervision that led to a significant number of captive financial institutions and “financial pyramids”, hampered the development of the financial services market and led to a deepening of the crisis of mistrust to the financial sector as a whole. Internal shocks, mainly military conflict in the East of Ukraine, have adversely affected the economy, reduced consumer confidence in the non-banking financial services sector and unbalanced stock market. The reduction in economic activity, trade imbalances and depreciation caused inflation to accelerate to 30% per annum. This development has led to a deterioration in the quality of portfolios of financial institutions. The situation with troubled balances of investment institutions is complicated by the lack of effective protection of consumer rights, especially property rights and impartial justice. Financial stock market that provides effective accumulation and optimal redistribution of financial resources, their further transformation into investment capital are the basis of a balanced flow of the economy in any country. The depth and systemic nature of the crisis processes that unfolded in the global financial markets have shown the inadequacy of current approaches and the system of state regulation of the stock market. The emergence of “bubbles” and a wave of bankruptcies actualized the task of radical revision of approaches to market regulation.

## **5. Prospects of development for the stock market in Ukraine**

Nowdays it would be wrong to remain pessimistic, especially as the developed in 2014 trend still gives hope for positive expectations of the investors for some market growth in the future in terms of its liquidity and capitalization. First of all, the consolidation of efforts of all participants of the stock market and the state regulator, particularly in the improvement of the legal framework, the revitalization of the professional participants, upgrade of infrastructure, reform of state influence and introduction of European standards of regulated markets organization taking into account latest technology should contribute to such development. The strategic goal of economic system reform on a market basis is to ensure conditions for its stabilization, consolidation and development trends of non-inflationary economic growth through more efficient use of resources. The latter is largely determined by the efficacy of financial mechanisms that can enhance the mobilization and ensure optimal redistribution of financial resources of the economy. Therefore, the development of the stock market as an integral part of the financial market and an important element of the national economy becomes of paramount importance.

## 6. Conclusions

Ukraine has sufficient economic potential to enable development of the national stock market, which growth contributes to positive dynamics of gross domestic product growth. The stock market should function as an integral element of the regulated financial system, synchronized with the banking sector and state finances. That is why its varied and unsystematic development is impossible. In order to streamline this process there must be prepared a clear program that should determine the main directions of further significant reform and modernization at all levels – legal, institutional and technological. The development of the Ukraine's stock market should correlate with the process of the final stage of the Association Agreement with the European Union and its ratification, which involves close cooperation between relevant regulatory and supervisory authorities, including the exchange of information and expertise on the financial markets through the exchange of personnel and joint training.

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### **Summary**

Based on the key quantitative and qualitative indicators calculated by the author, the article offered the analysis of the stock market of Ukraine, and revealed the specifics of its development. The author researched the question of trading volume change on the stock exchanges in recent years. The main problems that hinder the effective functioning of the stock market development were uncovered, particularly the lack of effective legislation, systems of regulation and prudential supervision, the military conflict in the East of Ukraine, and a low level of consumer confidence in the non-banking financial services sector. To solve problems and to stimulate further development of the stock market the consolidation of efforts of all participants of the stock market and the state regulator are needed, particularly in the improvement of the legal framework, the revitalization of the professional participants, upgrade of infrastructure, reform of state influence and introduction of European standards of regulated markets organization, taking into account the latest technology. It was proved that the efficiency of the national stock market can be achieved only with clearly defined strategy of development.

**Keywords:** the stock market; financial instruments; stocks; bonds; stock exchange.

**JEL classification:** G100

**UD classification:** 336.761