Area: finance, money and credit

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INITIAL PUBLIC OFFERING AS A WAY OF RETURNING INVESTMENT ATTRACTIVENESS TO UKRAINIAN MARKET

Ukraine's frontier economy has always been attractive for foreign investors. Penetration to the country's market promise high returns, which therefore imposes certain risks. As for today, political and social unrest combined with rising regional tensions has deepened the ongoing economic crisis and has resulted in a widening of the state budget deficit and a depletion of the National Bank of Ukraine's foreign currency reserves and, as a result, a further downgrading of the Ukrainian sovereign debt credit ratings. As a result, domestic business aimed to seek new financing opportunities to attack necessary volume of capital. One of the most effective instruments for companies operating on the frontier markers is initial public offering. As an offering of corporate rights, IPO on Ukrainian market created unique expected return for risk tolerant investors. Creation of new investment opportunities is a strong basis of long-run economic development.

An initial public offering (IPO) occurs when a security is sold to the general public for the first time, with the expectation that a liquid market will develop [1].

Most companies start out by raising equity capital from a small number of investors, with no liquid market existing if these investors wish to sell their stock. For example, Ukrainian practice is focused on engagement of strict number of investors creating “synthetic” public offering similar to private one.

At some point the company generally finds it desirable to "go public" by selling stock to a large number of diversified investors. Once the stock is publicly traded, this enhanced liquidity allows the company to raise capital on more favorable terms than if it had to compensate investors for the lack of liquidity associated with a privately-held company.

A lot of pros and cons associated with initial public offering considering all costs delivered from the complicated processes of underwriting and due-diligence. Under frontier economy, as Ukrainian, due-diligence is one of the most important stages of placement. Publicly-traded companies faces lot of requirements before initial public offering which should be covered by management. Nevertheless, the main reasons of going public for Ukrainian companies are:

- Greater market value compare to private companies due in part to increased liquidity, available information, and a readily ascertainable value.
- Growing cash and long-term capital obtained to support growth, increase working capital, invest in plant and equipment, expand research and development, and retire debt, among other goals.
- Public companies can usually get better rates when issuing debt caused by increased scrutiny.
- M&A deal became easier, because, public company can always issue more stock based on market demand.
- Trading in the open market means liquidity. Shareholders may achieve improved liquidity and greater shareholder value.

- Increased prestige and reputation based on visibility for shareholders and their company is usually enhanced.
- Ability to attract and keep key personnel.

Due to MSCI Index, Standard & Poor's classified Ukraine as a country with frontier market presenting adjusted market capitalization of 89 million dollars [2]. Frontier markets (FMs) are investable, but have lower market capitalization and liquidity than the more developed emerging markets. The frontier equity markets are typically pursued by investors seeking high, long term returns and low correlations with other markets.

The implication of a country being labeled as frontier is that, over time, the market will become more liquid and exhibit similar risk and return characteristics as the larger, more liquid developed emerging markets.

The key-note features for frontier markets are:

- high barriers for foreign investors, relatively inaccessible to foreign investors, high restrictions on foreign ownership, low protection of investors rights;
- high volatility, low stock market liquidity, low market capitalization;
- less mature economy, developing capital markets;
- low correlation with developed economies, huge potential for growth.

All mentioned above show the attractiveness for risky investments with potential growth of expected return for investors. Frontier markets present opportunities for diversification of asset allocation by exceed return and low correlation with developed economy providing balanced asset portfolio for risk tolerant investments.

The Investment Attractiveness Index of Ukraine shown in figure 1 is conducted by European Business Association (EBA) and calculated as a simple average assessment based on five aspects indicating the investment climate as expectation of 82 CEOs of EBA members companies. Hence, investment attractiveness is expressed by the opinion of the companies engaged in investment processes.

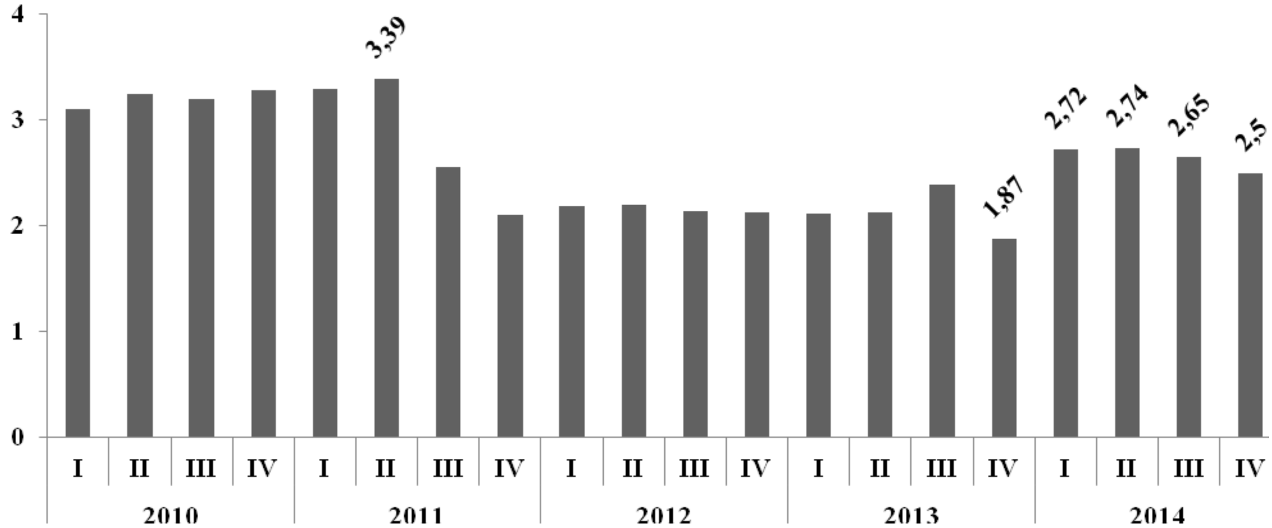

Figure 1. Investment Attractiveness Index of Ukraine conducted by the EBA [3]

As we can see on the figure 1, the index of IV quarter 2014 is 2,5 which is highest than the alternative index in 2013. The data shows that investment attractiveness of Ukraine has grown from 2013 albeit political and social uncertainty in the country. Such figures could be explained by positive expectations from foreign investors based on reforms potential and anticipation of IMF stabilizing credits.

Table 1

IPOs in Ukraine over past 5 years [4]

Year of placement	Company	Price, $ mln.	Exchange
2015	Ukrgasbydobuvannia	12 000	WSE
2013	Cereal Planet	0,2	WSE
2013	Arricano	24	LSE
2012	KDM Shipping	8	WSE
2011	Coal Energy	80	WSE
2011	Ovostar Union N.V.	33,4	WSE
2011	Westa	46,3	WSE
2011	Industrial Milk Company	29,7	WSE
2011	KSG Agro	40	WSE
2011	Black Iron	35	WSE

*WSE – Warsaw Stock Exchange; LSE – London Stock Exchange

Reforms of Ukrainian capital markets should be followed by high exhilaration of the domestic economy attracting new investment. Table 1 shows that 2015 was opened by Ukrgasbydobuvannia company that caused 12 billion dollars of investments placing on Warsaw Stock Exchange. It was one of the biggest IPO deals in Ukraine. The volume of financing shows the interest to Ukrainian market, and, as a result, potential to grow.

Companies engaging additional financing via IPO create investment attractiveness of the whole country. New reforms of capital markets lead to encouraging of participation in the global markets. Increasing number of IPOs open global capital markets to Ukrainian issuers. Considering extreme potential and high return opportunities domestic market remains attractive for risk-tolerant investors. Increasing investment attractiveness is strong basis for the economy growth in long-run. Hence, development of Ukrainian stock market is highly important for building new economy and recovering after struggling financial crisis.

References

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