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IPO AS AN INSTRUMENT FOR UKRAINIAN COMPANIES TO ACCESS EUROPEAN STOCK MARKETS

In this article, the features of Initial Public Offerings (IPO) of the Ukrainian companies are considered in the conditions of globalization of stock market, which show up through intercommunication of advantages and disadvantages of the use of alternative funding processes of capitalization the capital. It is defined that in the IPO process, there are three major players: the issuing firm, the bank, and investors. Many factors play a role in determining the cost of an IPO, but in all cases, these costs are significant. The process of going public is studied, including listing requirements of major European stock exchanges. The placement of the newly issued stocks is conducted on the primary market. Most of the corporations enter the primary market with the help of investment banks. A firm that goes public is required to publish a prospectus. Ukrainian companies are overwhelmingly moving towards the integration in global economy and already have made the initial public offerings on European Stock Exchanges. New challenges and issues are being involved, requiring a new set of solutions and theoretical approaches.

Keywords: public placement, shares, stock markets, issuers, investments, capital.

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IPO ЯК ІНСТРУМЕНТ ДОСТУПУ ДЛЯ УКРАЇНСЬКИХ КОМПАНІЙ НА ЄВРОПЕЙСЬКІ ФОНДОВІ РИНКИ

У статті розглянуто особливості первинного публічного розміщення акцій (IPO) українських компаній в умовах глобалізації фондового ринку, які проявляються через взаємозв'язок переваг і недоліків використання альтернативних джерел фінансування процесів капіталізації власності. Визначено, що в процесі IPO є три основні гравці: це компанія-емітент, банк і потенційні інвестори. Багато факторів відіграють велику роль у визначенні вартості первинного публічного розміщення акцій, і у всіх випадках ці витрати є значними. Процес виходу первинного публічного розміщення акцій вивчається відповідно до вимог лістингу основних Європейських фондових бірж.

Розміщення первинного публічного розміщення акцій здійснюється на первинному ринку. Більшість корпорацій розглядають первинний ринок за допомо-

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гою інвестиційних банків. Компанії, що здійснюють первинне публічне розміщення акцій, зобов'язані публікувати проспект емісії. Українські компанії в переважній більшості рухаються в напрямку інтеграції в світову економіку і вже здійснили первинні публічні розміщення акцій на Європейських фондових біржах. Розглядаються нові проблеми і питання, які потребують нових рішень і теоретичних підходів.

Ключові слова: розміщення акцій, цінні папери, фондові біржі, емітенти, інвестиції, капітал.

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ІРО КАК ИНСТРУМЕНТ ДОСТУПА ДЛЯ УКРАИНСКИХ КОМПАНИЙ НА ЕВРОПЕЙСКИЕ ФОНДОВЫЕ РЫНКИ

В статье рассмотрены особенности первичного публичного размещения акций (ІРО) украинских компаний в период глобализации фондового рынка, которые проявляются через взаимосвязь преимуществ и недостатков использования альтернативных источников финансирования капитализации собственности. Определено, что в процессе ІРО есть три основных игрока: это компания-эмитент, банк и потенциальные инвесторы. Многие факторы играют большую роль в определении стоимости первичного публичного размещения акций, и во всех случаях эти расходы значительны. Процесс выхода первичного публичного размещения акций изучается в соответствии с требованиями листинга основных Европейских фондовых бирж. Размещение первичного публичного размещения акций осуществляется на первичном рынке. Большинство корпораций рассматривают первичный рынок с помощью инвестиционных банков. Компании, осуществляющие первичное публичное размещение акций, обязаны публиковать проспект эмиссии. Украинские компании в подавляющем большинстве двигаются в направлении интеграции в мировую экономику и уже осуществили первичные публичные размещения акций на Европейских фондовых биржах. Рассматриваются новые проблемы и вопросы, которые требуют новых решений и теоретических подходов.

Ключевые слова: размещение акций, ценные бумаги, фондовые рынки, эмитенты, инвестиции, капитал.

Introduction. Financial markets, especially stock markets, have grown considerably in developed and developing countries over the last two decades. Several factors have aided in their growth, importantly, improved macroeconomic fundamentals, such as monetary stability and higher economic growth. General economic and capital market specific reforms, including privatization of state-owned enterprises, financial liberalization, the establishment of stock exchanges and bond markets, and an improved institutional framework for investors, have further encouraged capital market development. Financial globalization has also advanced in the last two decades with increased cross-border capital flows, tighter links among financial markets, and greater commercial presence of foreign financial firms in countries around the world. An important element of the globaliza-

tion trend has been the increase in the stock exchange activities that take place abroad, most notably for emerging markets, but also for developed countries. Many firms now cross-list on international exchanges, with depositary receipts being a particularly popular instrument to access international markets. Going forward, many expect these globalization trends to continue as access to information improves, standards (concerning corporate governance, listing, accounting, and others) become more harmonized, technology advances, and inter-market linkages further increase.

Analysis of recent research and publications. There is a wide range of Western as well as national researchers who have studied the topic of the efficiency of IPO. The outburst of research on this topic started in the nineties of the twentieth century, when the United States experienced IPO boom of information technology companies. In their recent work Ritter and Welch (2002) studied the IPO activity pricing and allocation, while Ann Sherman (1996) unveiled the international differences in initial public offerings. Among our scientists, Pavlo Gulkin (2006) issued a book on the initial public offering practices in emerging economies. Other scientists who wrote on the topic include Lowry (2002), Mishkin (2003), Aggarwal (2000) and others.

The main material. Initial public offering (IPO) is the process of offering securities – generally common or preferred stocks – of a privately owned company for sale to the general public. An IPO in which a company sells its newly issued shares and receives all the proceeds in the form of additional capital is called a primary offering. A securities sale in which securities held by the owners of the company are sold, and from which the owners receive the proceeds, is called a secondary offering. IPOs are almost always primary offerings, but may include a small number of shares held by the present owners. The placement of the newly issued stocks is conducted on the primary market. Most of the corporations enter the primary market with the help of investment banks. A firm that goes public is required to publish a prospectus. In general, this requirement is based on the governing regulations of the stock exchange where the firm is to be listed, on common law, and for European Union (EU) countries, on EU guidelines, which must be implemented in the legislation of the Member States of the EU.

In the IPO process, there are three major players: the issuing firm, the bank, and investors. Each will react rationally to preceding actions by other players and/or in anticipation of a rational response. The only meaningful way to model this situation is as an extensive form game. Furthermore, in IPOs there is substantial uncertainty and thus it is reasonable to model asymmetric, noisy information that is correlated among agents. Finally, the aftermarket price should aggregate information that the offer price could not – why else would we often observe substantial price-jumps? The nature of the problem therefore requires a model that incorporates three-player strategic considerations coupled with informational asymmetries. IPO is both the opportunity for a company to raise additional capital and an exit strategy for initial investors. The following Table 1 describes IPO alternatives. As it can be seen from the table above, debt financing has an advantage as it does not require the sharing of profits. On the other hand, it requires strict payment of interest and repayment of debt. For that the company should generate enough cash flow. Venture capital is a popular financing instrument on emerging markets. It can be simpler than IPO and focus on the future prospects rather than on current company situation. On the other hand, venture investors are more experienced and they allow extra discount for risk. Selling the company is another option of obtaining capital. However, it is suitable only for owners of the company and usually serves as an exit strategy for them. Selling the company may result in lower proceeds than an IPO.

Table 1. Analysis of Pros and Cons of IPO alternatives

Type	IPO Alternative	Pros	Cons
Debt	Commercial bank/lender	No sharing of profits	Dependent on sufficient net worth, income, or cash flow
Debt	Asset-based lending	No sharing of profits	Dependent on sufficient assets or cash flow – has higher borrowing costs
Debt/ Equity	Institutional	Can be simple – few parties involved	More sophisticated investors may negotiate a lower price
Debt/ Equity	Leverage ESOPs	An exit strategy or financing device with certain tax preferences	Company must have adequate security for lender (assets, income, or cash flow)
Converti- ble Debt/Equi- ty	Venture capital	Can be simpler; added experience and reputation is brought to the company; focus is more on future potential than on current security	More sophisticated investor-may result in lower pricing for the company, plus there is an expected 5 to 7 year exit
Other	R&D/Investment partnership or joint venture	Can result in favorably priced financing; could result in synergy and industry clout	Dependent on a viable technology or other intangibles; could result in a demanding partner
Other	Selling the company	Can permit a complete and certain exit by existing shareholders	May result in lower pricing than an IPO, loss of future upside tax considerations

Source: [5, 6, 11]

Each of the IPO alternatives has its specifics and can be implemented in particular situation. Ukrainian companies, which have decided to raise significant financing, are overwhelmingly high-growth companies, and their owners do not wish to exit the business, with average risk as for Ukrainian market and improved business model. As a result, for them traditional IPO will be an easier and the most beneficial way of raising capital.

Advantages of IPO:

- Prestige/reputation – the visibility for shareholders and their company is usually enhanced. For example, a regional company may more easily expand nationally following a stock offering due to the increased visibility.

- Ability to attract and keep key personnel – if a company is publicly owned, employee incentive and benefit plans are usually established in the form of stock ownership arrangements to attract and keep key personnel. Stock option plans, for example, may be more attractive to officers and other key personnel than generous salary arrangements due to the significant upside potential.

- Less dilution – provided the company and the market are ready, the former may achieve a better price that results in less dilution compared to other forms of equity financing for example on national markets.

At the same time we have defined some **disadvantages of IPO** as a form of raising capital: it is high expenses; another disadvantage is separate procedures are set out for admission to trading (without listing), which may be initiated by stock exchange members (brokers), the issuer, or the stock exchange itself; and listing, which may only be initiated by the issuer itself.

In order to issue shares for the **first level of listing should have the following requirements**: the issuer has been in existence for at least three years; net assets of the issuer are at least 100 mln UAH; annual sales for the previous financial year are at least 100 mln UAH; the issuer has been profitable for at least two out of the last three fiscal years; market capitalization of the issuer is at least 100 mln UAH; each month out of the last six

months at least 10 transactions were made and settled with the equities of the applicant on the stock exchange, and the average aggregate monthly value of such trades amounted to at least 1 mln UAH; the total number of the issuer's shareholders must be at least 500;

In order to issue shares for the **second level of listing should have the following requirements**: the issuer has been in existence for at least a year; net assets of the issuer are at least 50 mln UAH; annual sales for the previous financial year were at least 50 mln UAH; the issuer has been profitable in previous fiscal year; market capitalization of the issuer is at least 50 mln UAH; in each month of the last six months, at least 10 transactions were done and settled with the equities of an applicant on the stock exchange, and the average aggregate monthly value of such trades amounted to at least 0.25 mln UAH; the total number of the issuer's shareholders must be at least 100.

The comparative table of major company's expenses while conducting IPO on the European Stock Exchanges is shown in Table 2.

Table 2. Comparison of cost of listing on major European stock exchanges

Name of the exchange	First contribution	Annual contribution
Vienna Stock Exchange	1% of the placement	0.05% of the trade volume
Warsaw Stock Exchange	0.03% of the placement	0.02% of trade volume
London Stock Exchange (AIM)	180 pounds	4180 pounds

Source: [1,2,3]

Many factors play a role in determining the cost of an IPO, but in all cases these costs are significant. Outlined in the table below is the range of IPO costs that should be expected if you decide to go public.

Ukrainian companies are overwhelmingly moving towards the integration in global economy. New challenges and issues are being involved, requiring a new set of solutions and theoretical approaches. One of the everlasting needs of the company is the need for financing. With the opening of Ukraine's economy the variety of sources of finance is increasing, providing Ukrainian companies with the opportunity to benefit from the availability of new financing sources.

Peculiarity of pricing for Ukrainian IPOs, is the inclusion of their immense growth prospective, which are not available to companies in other countries. In order to reflect growth rates, Ukrainian companies should have higher multiples than their peers. In terms of pricing, choosing the moment to go public is an important timing decision. According to theoretical background stated above, the company should go public during its time of its growth maximization.

Ukrainian companies prefer European stock markets, such as Frankfurt Stock Exchange, Warsaw Stock Exchange, Alternative Investment Market (London Stock Exchange) and London Stock Exchange. It depends on different factors, like size of the company, conditions of preparation to IPO, costs of listing, location of stock market and so on. In Fig. 1 we can see the structure of the attracted money of the Ukrainian companies through IPO operations on the European Stock Exchanges. Ukrainian companies prefer to make placements on London Stock Exchange; it is near 1, 8 billion dollars of the USA attracted from IPO operations.

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financing. With the opening of Ukraine's economy the variety of sources of finance is increasing, providing Ukrainian companies with the opportunity to benefit from the availability of new financing sources. In Table 3 we can see the biggest sum of money attracted by Ukrainian companies through IPO operations on the European Stock Exchanges.

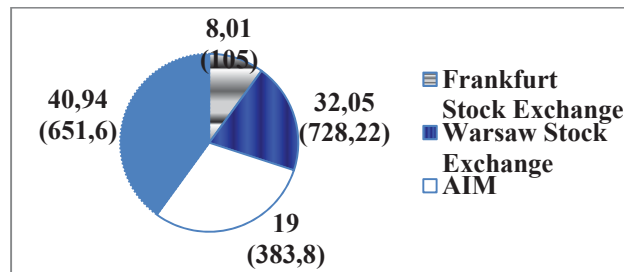


Fig. 1. The Structure of the attracted money of the Ukrainian companies through IPO on international stock markets % (million dollars of the USA)

Source: author's own modification

Table 3. The biggest sum of money attracted through IPO operations, million and dollars

Company	Sum of money attracted through IPO operations, million, dollars
Ferrexpo	424
Myronovskiy Hleboprodukt	371
Kerner	218
AvangardCo	208
KDD Group	143

Source: author's own modification

There are some very important procedure that companies should do in their activity for the successful placement on the European Stock Exchanges and follow the recommendations.

Recommendations for the companies:

1. Investors should know the company, the market, on which it operates, its operations and future strategy. And the strategy should be clear and consistent.

The compliance with this rule will allow the investors to adequately estimate company's value, growth opportunities and cost of capital. When the strategy and company structure is not clear, it suggests that the company is entitled to extra risks. In its turn, risk assumptions considerably lower company's value for investors.

2. The company should achieve the position of the absolute leader on the market.

As Shaus noted in his research the company should choose a right moment to conduct an IPO. The right moment includes the period, when the company reaches its maximum value and after which the growth rates of the company will start to slow down. It also includes the right current situation on the market where the placement is to take place. As IPO is a subject to investors' demand, a company should choose the moment, when there are enough funds available on the market and investors willing to invest in new companies.

3. Company's actions should be corresponded by its declared intentions regarding growth targets and other achievements.

When writing a prospectus of share issue the company should be extremely careful about the forward-looking information. On the stage of the placement overoptimistic company statements may result in successful company placement at the higher range of the shares offered. However the long-term implications of the deceiving in formations will be much more harmful to the company. Thus, the company should always state the realistic targets and do its best to achieve them. When a company states beforehand known unrealistic forecasts, the investors value company according to them. Thus, any difference in operating results will result in change in company's value and investors

4. The owner of the company should gather a team of highly-qualified professionals let them manage the company and prepare them for the IPO.

The value of a strong team of highly-qualified can hardly be overestimated. IPO is a complicated process involving the exact understanding of the functioning of the company, national and international market left alone the knowledge in economics. If the company owner decided to conduct an IPO, it is only then worthwhile when it is a high-quality IPO. In other case the IPO may be a bid disappointment for the company.

5. Offer investors more than they expect, motivate them to invest in the company.

Emerging markets are known for their immense growth opportunities. However, this idea is sometimes overused. Company management when conducting an IPO has to try to evoke investors' trust and win credibility.

Conclusions. New challenges and issues are being involved, requiring a new set of solutions and theoretical approaches. One of the everlasting needs of the company is the need for financing. With the opening of Ukraine's economy the variety of sources of finance is increasing, providing Ukrainian companies with the opportunity to benefit from the availability of new financing sources. In this research paper one of such sources, namely equity financing through initial share placement is studied.

The process of going public is also studied, including listing requirements of major stock exchanges. We determine major factors, which have influenced companies' performance on the stock exchange as well as correlation between the companies' share price trends with relevant indices and peer companies. Thus, the research of current IPO trends and identification of crucial items in IPO preparation and exercising in the future are highly valuable and relevant for current scientific discussion.

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