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Market for Corporate Control in Ukraine

Alexander Kostyuk*

Abstract. The paper considers the recent trends at the market for corporate control in Ukraine. As a result of the undertaken original research, some very important conclusions have been made. First of all, during 1998-2001 corporate ownership structure in Ukraine became more concentrated, in contrast to such country in transition as Russia. Second, the more concentrated is the ownership structure of Ukrainian companies the lower corporate market performance happens to be. Besides, the group of controllers, who are most efficient in corporate governance, are foreign institutional investors. Finally, the most active players at the market for corporate control in Ukraine are financial-industrial groups, but their activity in buying shares of Ukrainian companies is not correspondent to the lower degree of efficiency in corporate governance.

Key words: corporate control, institutional investors, financial-industrial groups, ownership structure, corporate governance.

According to the founders of the process of privatization in Ukraine, privatization will lead to appearance of effective owners. Political compromise of voucher privatization was much better than leaving corporate sector of economy under the control of the State beurocracy. Meanwhile, voucher privatization gave a lot of shares of Ukrainian companies to a big number of Ukrainian private shareholders. Few of them were informed and educated enough to use their rights as owners of corporations. That is why voucher privatization can hardly be considered successful.

Despite arguments towards negative impact of mass privatization on the market for corporate control, economic theory still supports mass privatization. R. Coase states: "Those owners who are not effective in corporate controlling, will sell their corporate rights to those who can do this. By doing so, the market will care about itself".

This theory is based on the supposition that the market must be perfect for executing such transactions. But this can be fully rejected in practice.

Black, Kraakman and Tarasova (1999) were the first who argued the myth about the perfect state of the market for corporate control in the countries, where the process of mass privatization takes place. They mentioned that mass transfer of assets from ineffective to effective owners was not so mass as the process which gives birth to transfer of assets – the process of massive privatization. They stated that there were a lot of barriers for efficient transfer of rights for corporate control. Pinto (1995) supports this idea too. He proved that effective transfer of rights for corporate control is possible only in the perfect markets. Markets where the process of mass privatization takes place are far from being in a perfect state.

La Porta (2000) gives various evidences of the point of view that mass privatization has not led to establishing a perfect market.

First of all, there were a lot of cases of assets and revenue tunneling in Ukraine. Such cases are popular not only in Ukraine. They are common for Czech Republic, Bulgaria and Russia

* Candidate of Sciences in Economics (Finance), Chair of Management & Foreign Economic Relations, Ukrainian Academy of Banking of National Bank of Ukraine, tel.: 38-542-21-99-45, e-mail: alex_kostyuk@yahoo.com

(Claessens, 1999, Djankov, 1997, 1997, Frydman, 1996). After tunneling is completed a company turns into a bankrupt.

Second, ownership rights are not secured. Thus, after privatization of the state property, the state authorities argue ownership rights of new owners. The state authorities deprive new owners of their property not only in case the owners do not follow their investment obligations. Very often such cases have political and even criminal ground. In such cases the state authorities are executors of orders, made by business circles with uncertain reputation.

Third, it is very difficult to apply "due diligence" if investor wants to buy shares of a Ukrainian company. In general Ukrainian companies do not have any system of financial statements which would meet all requirements of international standards. That is why, there are a lot of cases when new owners find huge uncovered loans made by the companies they own. Buying the Ukrainian company which is not listed on the stock exchange is like "buying a cat in a sack". Weak informational transparency of Ukrainian companies, and not only of those having no stock tradable at the stock market, destroys all intentions of foreign investors to come to Ukraine.

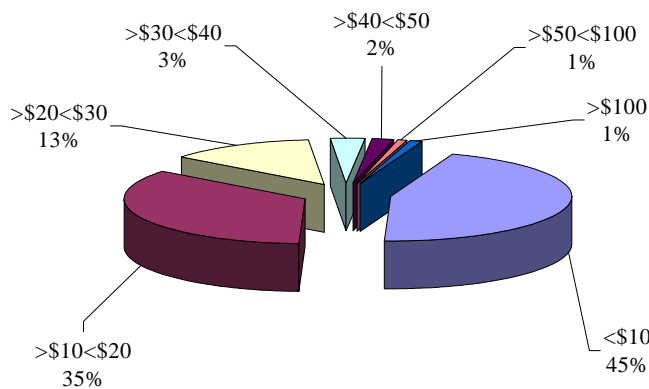


Fig. 1. Structure of corporate ownership (by amount of shares owned), which belongs to Ukrainian individual investors

Fourth, it is very difficult for the state to influence primary issue of shares in the transparent manner. There exists no developed infrastructure of institutions which would be facilitating the process of primary issue of the shares. The only way is tender offering. But high level of corruption in the state authorities in Ukraine does not let pass the right of ownership to the most efficient owners.

Fifth, about 40 % of corporate ownership in Ukraine belongs to individuals, who are residents. A lot of them own very small number of shares. The structure of corporate ownership which belongs to Ukrainian individual investors is pictured below.

Taking into account that services of brokerage companies in Ukraine vary from \$50 for a single transaction, which is higher than the average value of shares Ukrainian investors own, it is hardly possible to hope for smooth development of market for corporate control.

The above mentioned examples of barriers found on the way of development of the market for corporate control in Ukraine sound very convincing. Let's find out how these barriers shaped the profile of the market for corporate control in Ukraine over 1998-2001.

During the above mentioned period of time the most active players at the market for corporate control were Ukrainian financial-industrial groups (FIG). FIG purchased shares of Ukrainian companies, following the aim to obtain a corporate control.

With reference to results of trades at PFTS (secondary market), FIG obtained corporate control through purchasing large blocks of shares (more than 10 % of shareholders equity).

In comparison to them, management of Ukrainian companies used a different strategy to obtain corporate control. They purchased shares from private shareholders, mainly employees, at a low rate.

The following piechart (Fig. 2) represents the structure of participants of transactions at the market for corporate control in Ukraine. The number of transactions held at volume of not lower than 10 per cent of shareholders' equity for the period of time from 1998 to 2001 is pictured.

With reference to the following piechart it is possible to conclude that FIG turned out to be the most active players at the market for corporate control in Ukraine. More than a half of all the deals at the market for corporate control (54 per cent) were made by Ukrainian financial-industrial groups.

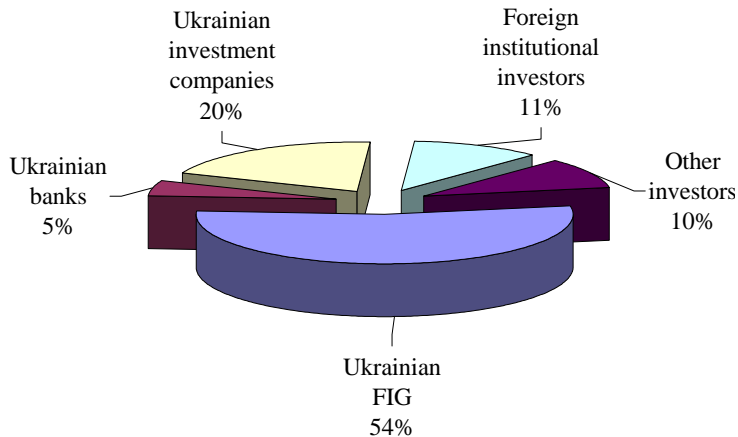


Fig. 2. Structure of participants of transactions at the market for corporate control of Ukraine by the number of transactions held at volume of not lower than 10 per cent of shareholders' equity for the period of time from 1998 to 2001

The main industries which FIG focused on, were energy generating industry, metallurgy and machine building.

Figure 3 contains the structure of deals aimed at FIG purchasing large (more than 10 per cent of shareholders' equity) stock of shares of the companies of the most attractive industries.

Concentrating attention on the companies of metallurgy and energy generating industry, FIG obtain control not only over the companies of the above mentioned companies but also over the economic situation in Ukraine in general. It is because metallurgy and energy generating industry contribute about 45-50 per cent to GDP of Ukraine.

Besides this, metallurgy is a strong export oriented industry. More than 45 per cent of export of goods and services from Ukraine belongs to companies of metallurgy. High market performance of companies of metallurgy is a strong factor, contributing to stability of national currency, budget execution and high employment rate.

Energy generating industry has strong impact not only on economic but also politic development of Ukraine. Through obtaining control over energy generating companies, FIG simultaneously obtain a mighty lever for political control in Ukraine.

It should be mentioned that efforts of FIG to obtain corporate control over the companies of the above mentioned industries contribute very much to deteriorating equity liquidity of controlled companies.

Thus, having bought a large stock of shares, FIG do not trade it later even despite very comfortable situation for selling shares. Such passive behavior of FIG at the market for corporate control leads to decrease in Ukrainian stock market liquidity and the stock market turns into the market for corporate control with strong controllers but weak traders.

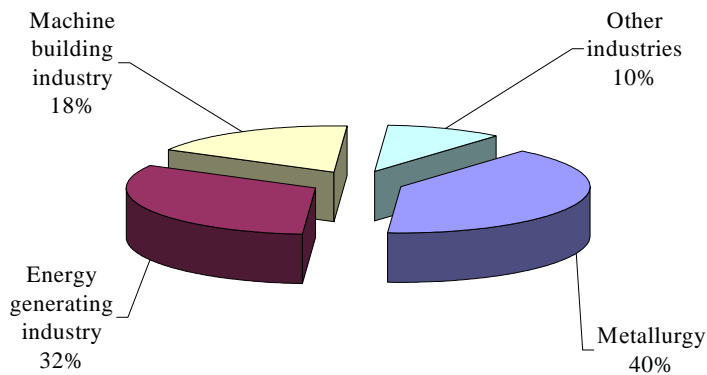


Fig. 3. Structure of deals of buying by FIG big (more than 10 per cent of shareholders equity) stock of shares of the companies of the most attractive industries during 1998-2001

Negative impact of development of market for corporate control on the performance of the stock market of Ukraine can be proved by the dynamics of stock price spread (see tab. 1).

Table 1

Spread of price of equity of companies under control of various groups of investors *

Groups of controllers	Stock price spread, %		
	1999	2000	2001
Ukrainian FIG	54	59	68
Ukrainian banks	44	55	52
Employees	48	58	56
Management	51	52	58
Ukrainian investment companies and mutual funds	36	42	39
Foreign investors	37	36	34

* the ones in possession of more than 50 per cent of shareholders equity are treated

Data from the table support the view that market for corporate control in Ukraine is still not effective because its development hampers development of market for corporate investments. The most popular insiders in the structure of corporate ownership in Ukraine - FIG and management - behave very actively at the market for corporate control, but their further passive behavior at the market for equity capital influences the market opportunities of the companies, controlled by them, in a very negative way.

As a result of the above mentioned behavior of insiders, those companies which are under their control, experience stock price spread which is much higher than the one at those companies, which are controlled by less numerous groups of insiders - foreign institutional investors and Ukrainian investment companies and funds.

It is exact activity of large owners at the market for corporate control in Ukraine that explains positive correlation between stock indexes of a lot of industries. Under such circumstances portfolio investors have troubles with diversification of investment risks, trading shares of Ukrainian companies. Active trading in the shares of popular companies is almost impossible.

This has let us come out with hypothesis about the market for corporate control under asymmetry of information.

“Development of market for corporate control under asymmetry of information hampers improvement in liquidity of market for equity and creates a serious barrier on the way of improving market opportunities of the companies.”

Table 2 contains results of correlation analysis of industrial stock indices in Ukraine.

Table 2.

Coefficients of correlation of industrial stock indices (index SPBU-30 over the period of time from January 1999 to January 2002)

Industries	Correlation coefficients				
	Metallurgy	Energy generating	Chemistry	Oil-gas refinery	Others
Metallurgy		0,91967	0,813741	0,922194	0,240541
Energy generating	0,91967		0,63049	0,912997	0,213611
Chemistry	0,813741	0,63049		0,80285	0,285549
Oil-gas refinery	0,922194	0,912997	0,80285		0,195045
Others	0,240541	0,213611	0,285549	0,195045	

Under the circumstances when the stock market in Ukraine cannot perform efficiently its basic function - providing companies with financial resources and turning into the market for corporate control - those efficient outsiders who have a well diversified portfolio, are not able to contribute to increase of investment opportunities of the companies through purchasing and trading their shares actively. Presence of such insiders such as FIG and management of the companies as well as outsiders like foreign institutional investors in the structure of corporate ownership will undoubtedly provoke conflicts of interests between insiders and outsiders due to different approaches of these owners to corporate governance. Insiders are inclined to provoke increase in asymmetry of information. Outsiders aspire to improve informational transparency of the companies.

The recent trends at the market for corporate control in Ukraine are an excellent evidence of the situation when insiders push efficient outsiders out from the ownership structure of companies. This has negative impact on corporate governance efficiency and destroy the most prospective market opportunities of Ukrainian companies.

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