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## **INVESTMENT POTENTIAL OF THE POPULATION AND THE FINANCIAL MARKET OF UKRAINE**

### **ABSTRACT**

The paper assesses available investment potential of Ukraine's population. It is shown that in Ukraine recently appeared and is growing a group of the population, which owns financial resources that can be invested in the economy. Insignificant participation of the population in the investment processes caused by distrust in the institutions and limited choice of savings capitalization instruments on the country's financial market. Stimulation of investment activeness of citizens can be achieved by extending the securities market instruments and only in the case when there is strict state control over the use of mobilized on the stock market funds.

**Keywords:** *Deposit agreement; Informal income; Internet trading; Investment potential of the population; Joint investment institutions; Stock market; Types of individual foreign investment; Underground economy.*

The development of investment activity of the population of Ukraine and the rational use of its financial capacity can play a crucial role in the economic development of the country. Moreover, the involvement of financial savings of the population in the investment process promotes economic growth and at the same time has a significant positive impact on the corporate sector and the stock market of Ukraine.

Under the present conditions the state benefits from involving population savings in the economic turnover through various financial instruments of the securities market.

Firstly, it will help the state to attract significant financial savings of the population into the national economy.

Secondly, the involvement of people's savings in the economic turnover through securities market instruments creates a new class of private investors, which in its turn moves it to the corporate governance model based on the 'shareholder capitalism' and the securities market, based on the model of population 'wide participation'.

All the same, level of investment activity of the population is largely determined by the level of its revenues and the development of market relations.

According to the State Statistics Service of Ukraine [1], starting from 2008 among the population of Ukraine has appeared a group of the working population, whose average income per capita exceeds \$240 per month (Table 1). At the same time during the undertaken period their share in the total working-age population grew more than two times. This group is mainly represented by young families either without children or having a child. The calculation of the data shows that the total monthly household income of this population increased from \$259.4 million in 2008 to \$616.3 million in 2011. Consequently, these calculations show a minimum investment potential of Ukraine's population just under four years, at the time as each household generates savings in years. It should be emphasized that this is the investment potential, calculated on the basis of official incomes.

**Table 1: Distribution of population by per capita equivalent overall income per month, USD, %**

Year	2008	2009	2010	2011
Less than 37,5	0,2	0,2	0,1	0
37,6 – 60,0	2,3	1,7	0,6	0,2
60,1 – 82,5	6,9	5	2,4	1,3
82,6 – 105,0	14,3	12,1	5,6	3,7
105,1 – 127,5	16,5	15,9	11,1	7,4
127,6 – 150,0	15,6	16,1	14,9	11,3
150,1 – 172,5	11,9	12,3	14,2	13,8
172,6 – 195,0	9,2	9,8	12,8	12,9
195,1 – 217,5	6,8	7,4	8,7	11,2
217,6 – 240,0	4,4	5,1	7,7	8,8
More than 240,0	11,9	14,4	21,9	29,4

On the other hand, the analysis of data in the context of household deposits from the National Bank of Ukraine (NBU) for the period under review reveals a slightly different picture (Table 2) [2].

**Table 2: Characteristics of deposit investments of the Ukrainian population\***

Year	2008	2009	2010	2011
Total deposits at year end, million USD	27232,5	26762,3	34386,6	44509,9
The volume of the deposit per employee at the end of the year, U.S. dollars	1414,55	1457,24	1865,14	2403,83
The share of deposit agreements for up to one year,%	44,3	64,8	60,4	52,1

\*Calculated by the author according to data from the site [1,2]

Proceeding from the analysis of the data in Table 2, we can make some interim conclusions.

Firstly, the amount of financial resources that are located by the population at commercial banks on deposit agreements has been

steadily growing. However, the volume of placed financial resources significantly exceeds the revenues of the population, which are reflected in official statistics.

Secondly, more than 50% of the population while placing their savings in commercial banks prefer short-term deposit agreements.

The first assumption enables to conclude that there is a significant unofficial income of Ukrainian citizens. According to a survey conducted by portal 'rabota.ua', the official status of their wages can be confirmed by only 37% employed Ukrainians; in other cases their salary is a combination of official and unofficial payments. It is compelling that 33% of Ukrainians receive 'combined' wages: a smaller part which is obtained officially, but main portion – unofficially.

According to various experts, the size of the underground economy in Ukraine ranges from 30 to 70% of the official figures. In addition, the assessment of the underground economy has been started long ago and particularly been published since 2002 (Table 3).

**Table 3: The dynamics of the shadow economy according to the experts**

Year	2002	2003	2004	2005	2007	2009	2010
Underground economy, %	30 – 70	35 – 40	50 – 60	32 – 40	30 – 45	40 – 65	50 – 60

The percentage ratio between official and unrecorded by the state sectors of Ukraine's economy does have considerable variation and differs depending on the industry or activity. According to experts, in Ukraine all industries has a shadow turnover, but more often it prevails in such as trade (80%), construction (67%), real estate (60%), gambling (55%), catering (55%), industry (50%), media (47%), transport and shipping (47%), agriculture (46%), banks (26%). [Underground economy in Ukraine [3]

The second assumption enables to conclude that, after the crisis of 2008, the Ukrainian population refers to commercial banks with a great suspicion.

Under conditions when the National Bank of Ukraine has maintained stability of national currency, it has become economically feasible for the population to keep their savings in local currency. As studies showed, up to the start of October 2008 the level of confidence in banks and the national currency undoubtedly grew. Due to the growth of real incomes, the banking system has attracted quite active contributions of the population that have become a significant source of resources in conditions of limited liquidity in the global markets.

However, the permanent political instability in the country that was strengthened by the world financial crisis, as well as reckless statements of politicians, provoked immediate growth of distrust to the banking system and actually put it in danger of collapse. The citizens of Ukraine instantly began to exchange their savings from the national currency into an existing foreign one (Table 4). [2]

Savings of the population can be considered as investment resources if a household decides to invest their savings in the objects of business or other activities in order to increase their value. Thus, citizens who store valuables in national and foreign currency beyond the financial and credit system and do not invest them in the economy does not take part in the investment process.

It is necessary to mention a significant difference between the Western and European practice in relation to domestic investment. On the West, due to the fact that most of the payments and transactions carried out by bank transfer, and the income of the population are mostly stored in banks, state and commercial banks are able to accumulate a substantial part of the population funds and widely use them for short-term investment in the future. Besides, the short term funds and savings accounts are used as long-term investments. [4] Thus, in Western countries, the funds of the population are almost entirely involved in the economic turnover.

**Table 4: Turnover of cash currency in Ukraine, millions USD.\***

Year	Jan.	Feb.	March	April	May	June	July	August	Sept.	Oct.	Nov.	Dec.		
2008	the amount of cash currency	purchased from the population	2402,9	2800,7	3494,9	2736,9	2467,9	2706,7	3423,8	2702,7	2534,8	2106,2	1646,6	
		sold to the public	2730,2	3468,9	3365,8	2867,0	2636,1	2482,1	3369,8	3271,6	3855,8	3044,4	3367,1	1695,6
	the amount of cash currency	household bank deposits	447,7	508,8	326,4	248,8	233,1	497,8	376,0	131,4	301,6	-1780,1	196,6	-410,7
		the remains among the population	-120,4	159,4	-455,5	-118,7	-64,9	-722,4	-430,0	437,5	1019,4	2718,3	2145,8	459,7
2009	the amount of cash currency	purchased from the population	767,5	754,0	909,4	1127,7	1165,8	1212,3	1384,3	1382,5	1313,8	1249,9	1148,5	1114,8
		sold to the public	1342,3	2178,6	1476,4	1293,4	1088,4	1725,2	2545,9	2180,8	1879,5	2043,5	2124,5	2036,1
	the amount of cash currency	household bank deposits	-623,3	-811,2	-311,4	17,5	182,9	408,6	397,9	392,0	-49,8	302,3	295,1	43,2
		the remains among the population	1198,1	2235,8	878,4	148,2	-260,3	104,3	763,7	406,3	615,5	491,3	680,9	878,1
2010	the amount of cash currency	purchased from the population	716,6	970,9	1327,2	1409,2	1399,7	1512,1	1750,4	1718,3	1374,4	1344,2	1442,2	1616,6
		sold to the public	1553,0	1681,9	1629,3	1471,5	1428,7	1623,9	1899,4	2116,2	2985,0	3218,0	3170,6	3537,9
	the amount of cash currency	household bank deposits	-57,7	86,1	398,9	362,3	-65,3	91,6	510,9	5,3	521,2	203,9	17,5	329,1
		the remains among the population	894,1	624,9	-96,8	-300,0	94,3	20,2	-361,9	392,6	1089,4	1669,9	1710,9	1592,2
2011	the amount of cash currency	purchased from the population	1283,1	1308,0	1552,1	1588,5	1549,0	1689,7	2058,0	2209,2	1500,0	1042,6	1093,5	1375,2
		sold to the public	2146,6	2612,7	2656,0	2350,7	2445,1	2901,8	2923,4	3033,4	3593,4	2451,6	2463,2	2115,5
	the amount of cash currency	household bank deposits	354,6	223,4	224,4	194,2	32,7	419,8	176,9	247,4	13,5	310,2	-123,8	56,1
		the remains among the population	508,9	1081,3	879,5	568,0	863,4	792,3	688,5	576,8	2079,9	1098,8	1493,5	684,2

\*Calculated by the author according to data from the site [2]

In countries with developed market economies, the household is one of the important suppliers of financial resources for the economy, where much of the national reserves are formed by citizens' savings. The latter is an essential resource for the investment process at country's economic activity. Regrettably, insignificant participation of the population in the investment processes in Ukraine caused by a substantial distrust to the investment institutions and a limited choice of capitalization instruments of savings through the lack of financial markets development.

According to experts estimations the population carried at their hands between \$40 and \$50 billion on 01.01.2012. Mass storing of funds by the population in the form of cash can be explained by the natural personal sensation of possible losses risk. Moreover, it reinforces by an extremely negative experience from the time of hyperinflation, certificate authority privatization, creation of pyramid schemes and financial crisis.

In this context it necessary to develop an effective financial markets infrastructure, which would have helped to ensure transparency in the process of making important financial and investment decisions, and serve as an additional incentive growth in organized population savings.

Highly relevant is the stimulation of organized citizens' savings, including the creation of favorable conditions for non-bank financial institutions development. These conditions can only be achieved through the use of securities market tools and only with strict state control over the use of funds mobilized in the market.

Nowadays, the population of Ukraine has three possible ways of investing in the domestic securities market:

- Buying from asset management companies (AMCs) securities of mutual funds;
- Invest in brokerage services;
- Internet-trading.

Choosing the investment instrument from these three possibilities today, each individual investor should evaluate his abilities and needs. Thus, mutual funds are focused on that segment of the population that wants to invest in a fixed portfolio of securities for the long term. At the same time, he gives them into management of AMC experts. Brokerage services are targeted on individual investors who occasionally want to participate independently in the purchase of securities and form individual portfolio. Finally, Online Trading in Ukraine exists for those who want to keep track of daily changes in the market, carry out numerous transactions of buying and selling and react to changes flexibly and quickly.

The first of the considered by us ways of individual investment in the securities market of Ukraine related to the activities of collective investment institutions (CII). Table 5 shows the data of the National Commission on Securities and Stock Market of Ukraine (NCSSM) [5], which refers to the amount of funds invested by the population in this kind of financial institutions.

**Table 5: The par value of CII, which are traded on the market (cumulative), millions USD.**

As for:	Legal entities		Physic individuals	
	Residents	Non residents	Residents	Non residents
31.12.2007	1610,0	581,25	66,25	1,25
31.12.2008	3636,25	661,25	78,75	2,5
31.12.2009	3813,75	778,75	98,75	2,5
31.12.2010	4988,75	1080,0	148,75	5,0
31.12.2011	6127,5	1238,75	203,75	5,0

The table shows that the opportunities provided by the CII, are attractive enough for a certain segment of the population. It is observed a stable growth in the acquisition of securities that are issued CII. Nonetheless the actual volume suggests that mutual funds do not have a mass market. Additionally, the comparison of the data in Table 2 and Table 5 shows that the most preferable for the Ukrainian population are short-term deposit agreements.

The analysis of returns on short-term CII and deposit agreements brings the clarification to the current situation. The average annual return of CII (Top 15) for the period under review ranged from -30.6% in 2008 to +11.49% in 2011. The average yield on short-term deposit agreements in Ukrainian commercial banks for the same period was +11.51%. We should also add the historical memory of the population with respect to various

types of financial pyramids, the difficulties that arise when returning funds, lack of state guarantees on the activities of such organizations and non-aggressive policy of CII to attract free cash deposits.

The second method of individual investment – through the brokerage service in the Ukrainian securities market, currently is focused on VIP-clients. The number of accounts for brokerage services is extremely low. Thereon do not even have the official statistics. According to experts from 3000 to 5000 accounts is currently served for brokerage services [6, 7]

The third way of individual investment on the securities market of Ukraine is characterized by the following data. On 01/01/12, there 11,265 individual trading accounts have been registered. The number of accounts is steadily growing, but growing at the expense of students and people with little money. Therefore, technically speaking, everything indicates growth of client base. However, if we talk about the monetary component, then all is seem not to be so good. The analysis shows that the amount of money for trading on the exchange decreased significantly (for the period from 01.01.2011. To 01.07.2012 year), and the volume of trading on the stock exchange also falls. General instability, including political do not conduce the activity.

It all related to the fact that Ukraine is starved of money supply, the NBU 'sterilizes' money mass in order to keep the US dollar. This leads to the fact that there is not enough money in the real sector of the economy and the banking sector. Consequently, if there is no money in the real sector, it starts to take away from other (less important) sectors. Thus, this leads to an outflow of liquidity from the stock market.

Besides decrease Ukrainian stock indices, it can be distinguished several more reasons for the slowdown influx of new traders:

- Reduction of turnover and liquidity for large customers and speculators;
- General pessimism in terms of recovery of the world, and hence the ukrainian economy, which is a decisive factor for long-term investors;
- Complex political situation in Ukraine, the weak protection of minority shareholders.

Nowadays, new financial instruments are extremely needed in order to stimulate significant interest of individuals to trade. Existing "blue chips" are not attracting many private investors. Though, futures market instruments cause greater interest, in particular, futures on the USE. However, only one futures or option contract cannot provide the mass. Therefore, besides the advertising and promotional activities to attract private investors new tools are needed: futures on gold, oil, currency pair, the admission of foreign securities.

Conversely, the innovations on the securities market are largely dependent on the financial market regulator – NCSSM and NBU. The last of them is not too bothered in support the launch of new tools on the stock market. It should be noted that on September 5, 2012 the Ukrainian Cabinet of Ministers has adopted a decree № 836, which ordered the Treasury Department to issue treasury bonds to bearer in certificated form with the total volume of \$ 200 million and with maturity of 24 months, face value \$ 500, different series. Placement of the first series was fast and at the entire volume.

On 30<sup>th</sup> of November 2012, a new batch of certificates arrived at banks. Anyone can buy them for \$500 at 8% per annum for two years. Interest on deposits can be taken twice a year, or at the end of the term and the treasuries can be redeemed earlier to the term of maturity. It seems that this is a measure of success, and the first steps in filling the market with new investment tools.

As a result, in the Ukrainian reality formed a kind of paradox. On the one hand, the Ukrainian state has no financial resources for the implementation of various investment projects to restructure the economy. On the other hand, the population of this country comprises over 40% of GDP in the form of cash. In this case, commercial bank or the stock market does not have the tools or mechanisms to involve savings in the investment turnover and send them in the most efficient sectors of the real economy.

In this context, the task of the state should be to strengthen the role of domestic retail investors, bringing their market share to 20-30% of the market, raising the stock market at least 15-20% of savings that are inside the country in foreign currency.

Experience of other countries shows that the implementation at the national level of only one solution, such as the 'People's IPO' for one of the state banks, is pushing to public decision-making. In addition, such attempts are ensuring the conditions of free access of retail investors to the stock market and creating the possibility of guarantees at any time freely buy or sell securities. In essence, it is about rebuilding the infrastructure market to its focus on the middle class of the population of Ukraine.

'People's IPO' pushes the state to the solution of several key tasks in the securities regulation. It becomes necessary to ensure public safety from fraud, to prescribe rules for IPO, since issuers are obliged to provide citizens with adequate information about the financial instruments and the risks that arise in the case of acquisition. The creation of a system of protection of investments in the securities of the population through the establishment of a special fund guarantees private investment.

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