

## IPO as a Means of Attracting Financial Resources and Form of Privatization for Companies

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**Abstract:** In this work we defined the problems and conditions of Ukrainian companies entering the IPO; Explored the experience and the possibility of using an IPO in the privatization process of enterprises; Presented the procedure and the stages of preparation and release of the IPO; Reviewed the experience of small and medium-sized companies entering the western stock market, state-owned companies' approaches to IPO.

**Key words:** Financial resources % Innovative development % Investment % IPO % Privatization % Stock market % Stocks.

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### INTRODUCTION

Formulation of the problem. Material and technical base of most domestic factories is outdated and needs to be updated and their products are uncompetitive compared with imported analogues. The degree of fixed assets depreciation in Ukrainian companies in 2000 almost reached 75%, although it fell 30% within ten years, but still remains high - 43.7% in 2010 [1]. In some particular areas of economic activities over the past decade degree of fixed assets depreciation has tended to increase. Namely, in agriculture, hunting, forestry, fisheries, trade and consumer services, state administration, as well as in public and private services, cultural activities and sports. To restore the assets, to purchase innovative equipment and introduce innovative technologies, which were necessary conditions for competitiveness and sustainable development of domestic enterprises, they require significant investment resources.

Mindset of the majority of big companies' managers over the past few years has changed dramatically: to replace the standard stereotype investment through loans and debt obligations, comes understanding of opportunities of funding from capital market instruments. The need for development of practical principles of domestic state enterprises entering IPO will become the leverage in the process of privatization, since this mechanism will help to found effective owners for business.

**Analysis of Recent Publications:** Coverage for IPO in national scientific publications related to such areas as problems of capital market development in Ukraine, viewing IPO as an alternative tool to attract investments, defining features and advantages of the IPO compared to other investment sources. It is these aspects sufficiently covered in the works of G.D. Bodner, A. Ermolenko, K. Kost, O.M. Petukhov, G.V. Silakov, M.V. Soroka, S.U. Shynkarenko and others [2-6]. Given that the initial public offering is a relatively new tool of investment in Ukraine, the mechanism of development of national stock market still remains poorly understood, with the observed prevalence of the use of foreign experience without national specificity. In processed publications the attention paid to the justification of opportunities and prospects for the IPO of domestic state enterprises in the process of privatization is insufficient. Thus, the development of theoretical and methodological and practical principles IPO domestic enterprises is very important and necessary.

**The Purpose of the Study:** On the basis of national and international companies experience in attracting financial resources, we need to prove the effectiveness and feasibility of an IPO; to cover the main stages of the procedure of preparing and entering IPO; to analyze the prospects and possibilities of different sized companies entering the IPO.

**The Main Material:** Successful IPOs of domestic enterprises abroad and in Ukraine, creates a will among many business owners to go the same way. However, most of them do not even realize the complexity of the mechanism of obtaining funds through initial public offerings and quickly roll their IPO plans after facing the real process.

In addition, Ukrainian state companies yet have never entered the IPO market, therefore this mechanism for raising funds, which are successfully used by our closest neighbors - Russia and Poland - was never considered by us, although sale of shares of the state-owned companies will attract funding and keep them in state hands.

Privatization of state companies through initial public offerings of their shares on stock exchanges is the mechanism used in many countries. For example, in Poland only in the last three years, despite the global crisis, there was a number of large state-controlled companies offerings. Among them included PKO Bank Polski, the insurance company PZU, Tauron, PGE (both companies - electricity sector), KGHM Polska Miedz (ferrous metallurgy) and many others. The last few years IPO of state companies is actively engaged by Russians holding public offering on domestic stock market and on foreign stock exchanges. Through the procedure of "national" IPO ( shares were sold to Russian citizens) went state banks - Sberbank and VTB. With the IPO were also sold state shares in "Rosneft" and the Fifth Generating Company of wholesale market (JSC OGC-5). "Gazprom" also intends to hold an initial public offering of its subsidiaries.

Possibility of public placement of state shares was also discussed by Ukrainian authorities. In particular, government officials discussed the possibility of selling minority stakes of "Ukrnafta", JSC "Ukrtelecom" and the Odessa Port Plant on international stock exchanges. However, these plans were never realized.

There are several factors that prevent domestic state-owned companies from entering foreign stock exchanges:

- C Opacity of domestic enterprises. Some companies are now officially considered unprofitable work quite well. At the same time the largest state monopolies are functioning on state funding, so they simply cannot be the subject to market valuation and their securities are unattractive to investors;

- C Imperfect Ukrainian legislation. For example, a number of interesting from the perspective of investors Ukrainian assets at the moment are not to be privatized because of their strategic purpose, which makes it impossible even for minority entering of private investor;
- C Poor development of national stock market. Packet sale on domestic stock market is still impossible because of the small volumes of the market and its low liquidity. In Ukraine, for these transactions there's no enough number of investors. International funds, which still do not work here, are quite difficult to involve due to high currency risks and minority shareholders risks.

In addition, access of domestic companies to the resources through the stock market IPO is obstructed by number of internal problems:

- C Owners unwillingness to ease the control over the company;
- C Owners inability to fully realize the opportunities and benefits of an IPO;
- C Company's unpreparedness for an IPO, its incompatibility to specified requirements;
- C Significant company's risks (commercial, financial, industrial (decreasing production, rising costs, reduced profitability), market (reduced demand for its production, competition, loss of market share, etc.), investment);
- C The difficulty of assessing the value of the company;
- C Low transparency of the performance indicators of domestic enterprises and managers reluctance to transform the company into a public ownership type;
- C Unwillingness of the management to review strategy and management system.

Despite all these problems and obstacles in the coming years we will probably be able to see the initial public offering of state enterprises. On the world market there is a demand for assets of companies in the real sector of the economy and therefore it's possible to place shares of resource companies and companies from telecom sector onto the trading floors. The advantage of IPO as a mechanism of privatization would be the ability to save the state control over strategic assets. IPO provides minority stakes placing. It broadens the base of

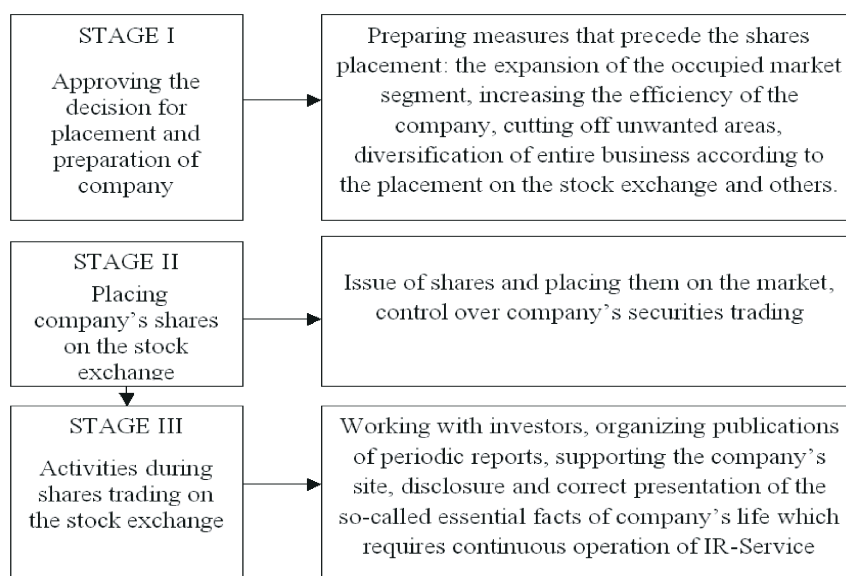


Fig 1: The procedure of preparation and entering IPO

Table 1: The actions of the company after the IPO

Period	Actions
1.	Preparation and approval by the Board of Directors report on the results of release, publication of information about important fact "Information on the issuance of securities by the issuer"
2.	Registering the report with summary of emissions
3.	Stabilization of the share price (within 30 days). Formation of the final price of the shares and determine predictive indicators regarding interest of stock exchange community
4.	Organization of secondary circulation of shares on the stock exchange (if necessary)
5.	Regular work with investors, preparation and publication of regular reports, support corporate website (investor's profile), disclose of the essential facts of company's life, issuing analytical reports, holding road-shows, organizing conference-calls between top-management and investment analysts, organizing appearance of the top management in international forums and discussion boards, organizing meetings of senior executives with major investors or fund managers, organization of press coverage of company's activities

investors. But many investors allow government to effectively monitor the activities of state-owned companies.

At the same time, if it's the sale of "strategic enterprises", there may be some conflicts of interest between the investor and the state.

Another advantage of this mechanism of privatization is the introduction of strict corporate management standards that accompanies the preparation and process of the IPO, which ultimately can improve its efficiency and profitability. At the same time, the sale of assets to strategic investor is often more beneficial for the country in terms of getting the maximum price.

The set of preparatory measures and procedures directly related to the organization and conduct of the IPO is essential for successful IPO. Lets look closer at the procedure for the preparation, organization and conduct IPO of the company that wants to attract investment through the stock market.

The most responsible is the first step in preparation for the IPO, on which extensive work is carried out in the following areas:

- С Forming credit history;
- С Transition of reporting systems to international standards;
- С Evaluation of sources of funding alternative to IPO in terms of the strategic goals of the company and owners;
- С Choosing underwriter bank and work with it to determine placement options, developing a project plan;
- С Preparation and implementation of pre-marketing;
- С The board of directors making a decision to issue (or an additional issue) of shares;
- С Forming project teams, choosing partners;
- С Preparing and approving the issue of securities prospectus;

- C Preparing analytical reports;
- C Conducting due-diligence;
- C State registration of documents;
- C Preparing prospectus with results of due-diligence;
- C Restoring valuation of placed package;
- C Disclosing information about the company to a wide range of investors;
- C Determine the range of prices;
- C Releasing preliminary prospectus;
- C Organizing introductory road-show;
- C Issuing the final prospectus, independent analysis of prospectus by auditor.

In general, before the IPO there should be development and step by step realization of company's long-term strategy, aimed at maximizing business value. At the same time one of the important issues is control over a company: during the public offering of shares, existing shareholders should be prepared for the fact that they will have less influence on the decisions made by the company; they will have to consider the interests of new shareholders.

In addition, following the company's gain of public status, its value will depend not only on the activities of the company, but also on the situation on the stock market, which will affect the company's policy to pay dividends and because of the publicity of the company, its internal problems will become public and will be openly discussed at the general meeting of shareholders.

After preparing and conducting IPO, work continues to monitor the efficiency of IPO and maintain appropriate state of the company (Table).

Experts believe that the criterion successful placement is the emerging of a liquid stock market and a sharp increase in the price of shares on the secondary trading. Obviously, on this matter, aims of the issuer and investors are opposite - investors and often underwriter are interested in high premiums for initial public offering, the issuer is interested in reverse.

It should be noted that the effect of "lowering placement price" is characteristic of all markets and IPO of Ukrainian companies are not an exception. On the other hand, one could argue that the sharp decline in share prices of the company clearly regarded as a negative sign, since even underwriter's actions failed to prevent a fall in prices.

Assessing the benefits of entering the western stock market for large companies, we can't omit companies with small and mid-capitalization, for which the standard, long and expensive way (starting from the release of the third level ADR) is unacceptable. For these companies we can

offer a more efficient and less costly program to attract foreign investment. This is the so-called "reverse takeover" of the shell company, i.e. accessing the western stock market through formal selling of business to western investors, who then attracts additional funding for it.

The above Shell Company is a European or American company, which one day entered the stock exchange, but later, due to adverse conditions suspended its core business, sold its assets to cover liabilities and suspended its business. In some cases, it's possible to create a new European joint stock company, which will be registered on the stock exchange, will receive quotes and then buys assets abroad and conducts additional issue.

If we look at the readymade company, it is usually not burdened by debt or litigation, public joint stock company, however, has not lost its place on the electronic stock exchange and even can be in "hibernation" on the NASDAQ or LSE for a few months. Its shares are still registered, have the official quotation (close to zero as it has no assets and no turnover) and theoretically can be bought and sold to the public. The acquisition of such a company gives owners of foreign companies a quick and inexpensive access to the stock market.

Each European country has its own stock exchange and even a few sometimes and if we consider the organization of IPO by reverse takeover if necessary to create a public image of a European company (actual purchase of additional shares shall be paid by the existing owners of assets and almost 100% shares will be placed on the stock exchange), for instance, Swiss Exchange in Bern or Zurich may be the best option.

Find a business in the EU, whose shares are listed on European stock exchanges, much simpler than the company directly from LSE, NYSE and NASDAQ. IPO on LSE, NYSE and NASDAQ can be recommended if the company really decided to raise funds from investors and willing to sacrifice some rights to control and manage the business in exchange for investment.

Clearly, it's easier to enter AIM, as this exchange positioned by LSE as an alternative market for medium and small businesses, but this way is unacceptable if the company does not plan to stay long in this category.

Conclusion. IPO helps companies to attract low-cost financing on long-term basis for their current and future projects, promotes the company and opens up new opportunities for business, especially innovative. Despite its limitations, IPO has significant growth potential and opportunities for innovations, which is very important for Ukraine, which set the strategic task of transition to innovative development path.

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