

## THE FEATURES AND PROBLEMS OF EXCHANGE TRADE DEVELOPMENT (A CASE OF UKRAINE)

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### SUMMARY

*The survey of the specific characteristics of exchange trade in Ukraine is provided in the research. Using the experience of the world's exchange trade three classes of exchange commodities (material commodities; financial instruments; foreign currency) are divided into three groups. The top 10 problems of the Ukrainian exchange market based on the results of authors' observations and generalization of the ideas of the Ukrainian scientists are established. The analysis of statistical information relating to exchange trade market of Ukraine is carried out.*

Exchange trade is an integral part of the modern business processes. Foreign exchange trade has been forming in the course of several centuries resulting in the creation of a powerful basis for certain rules, principles and traditions. Ukrainian exchange business is still in a formative stage in spite of the significant number of positive changes present in the domestic exchange activities. The exchange trade statistics confirm this statement being significantly lower both in volume and trade intensity in comparison with developed countries. This requires researching effective mechanisms of exchange business management in the Ukrainian realities.

Theoretical and methodological framework for exchange trade are covered mainly in the teaching materials by Ukrainian and Russian authors (A.I. Berlach, N.A. Berlach, Yu.V. Illarionov; G.Ya. Rezgo; V.V. Rarovska, L.A. Ostankova, S.E. Akopov; O.M. Sokhatska etc). Practical methodologies are outlined in a number of scientific works by Ukrainian and foreign authors (for example, D. Starenko and O. Sukhorukov, B. Steenbarger, E. Nayman etc.)

As a form of organized market, exchange has become a driving force for economic processes in any country and business sphere. That is why it is extremely important to highlight specific features and characteristics of exchange trade that set it apart from other forms of exchange.

The literature review provided by the authors has become a basis to classify specific features of exchange trade (table 1).

Table 1 – Specific features of exchange trade

Criterion group	Details
Common traits of exchange trade	- exchange doesn't involve in trade mediation activities, it only creates the conditions for it;

	<ul style="list-style-type: none"> <li>- trade publicity (exchange trade takes place in the presence of all exchange members or with their full knowledge);</li> <li>- trade transparency (the results of exchange trade are open to public, their details are available through the media);</li> <li>- state and public regulation of trade</li> </ul>
Exchange trade as a form of organized market	<ul style="list-style-type: none"> <li>- existence of approved rules of trade, calculations and delivery of assets (goods, services, securities, etc.);</li> <li>- existence of an organization which manages the market;</li> <li>- concentration of sufficient number of sellers and buyers in time and space;</li> <li>- state regulation and self-regulation</li> </ul>
Specific organizational characteristics of exchange trade	<ul style="list-style-type: none"> <li>- it belongs to certain place and time (exchange trade takes place only in specially designated areas (or on a special website in case of online trading) and only at a specified time);</li> <li>- exchange develops specific rules of trade which apply to this exchange facility, are obligatory for all exchange trade members and involve penalties for non-compliance with them;</li> <li>- trade is carried out typically through exchange intermediaries, both on the part of a seller and a buyer</li> </ul>
Market features of exchange trade	<ul style="list-style-type: none"> <li>- concentration of supply and demand for goods that are sold on the exchange;</li> <li>- exchange transactions can have production and consumption orientation or they may possess a speculative nature based on traders' desire to achieve maximum commercial success</li> </ul>
Specific characteristics of a commodities exchange	<ul style="list-style-type: none"> <li>- trade is carried out through quality description and in absence of commodity itself;</li> <li>- the consignment of goods which are being sold, are standardized, homogeneous and interchangeable.</li> </ul>
Specific characteristics of online trading	<ul style="list-style-type: none"> <li>- both client and broker have permanent access to the necessary exchange information with the account of trading schedule;</li> <li>- risk for the traders is minimized with the help of special computer technologies and financial calculation schemes;</li> <li>- the usage of a special software which was either specifically designed with the account of a certain exchange platform or borrowed and adapted to the specific problems of the domestic market</li> </ul>
Specific characteristics of futures exchange trade	<ul style="list-style-type: none"> <li>- fictitious nature of agreements (exchange of goods is virtually non-existent, and obligations of the parties under the agreement are terminated through concluding a retroactive agreement);</li> <li>- strict unification of the use value of an exchange commodity, a certain amount of which represents an exchange-traded contract that is used as a price carrier;</li> <li>- strict regulation of the quantity of goods that are allowed for delivery, and of the time and place of their delivery; indirect connection with the real goods market mainly through the exchange-traded insurance (hedging) and not through the delivery of goods;</li> <li>- impersonality of agreements and substitutability of their counterparties (since these agreements are concluded between a seller, a buyer and a clearing house, and not between a specific seller and buyer; the clearing house here acts as a guarantor of fulfillment of obligations).</li> </ul>

Source: Developed by the authors on the basis of [1-4, 9-11, 13]

There is a great variety of goods offered on the market, but not all of them can become an object of exchange trade. The goods which can't be an object of exchange trade are unique items, if they are not sold as a consignment of goods, and any capital assets or used goods with the exclusion of vehicles. Likewise, the indicated restriction does not apply to the property that has been sold as a tax lien or confiscated.

According to the Law of Ukraine "On the Commodities Exchange", the traded commodities include real goods, securities, currency, financial engineering instruments which meet the required conditions of the exchange trade.

It should be noted that an exchange commodity must meet the following requirements [3; 4; 9; 10]:

- large-scale production and consumption, a lot of producers and a wide range of consumers;

- standardization, meaning that a commodity has to conform to the requirements established by the current legislation regarding quality and other characteristics. The commodity has to be easily standardized in order to be sold without the necessity to review its sample or technical description. In practice, exchange standardization is one of the main attributes of an exchange commodity;

- interchangeability within the certain groups and types of commodities;

- transportability;

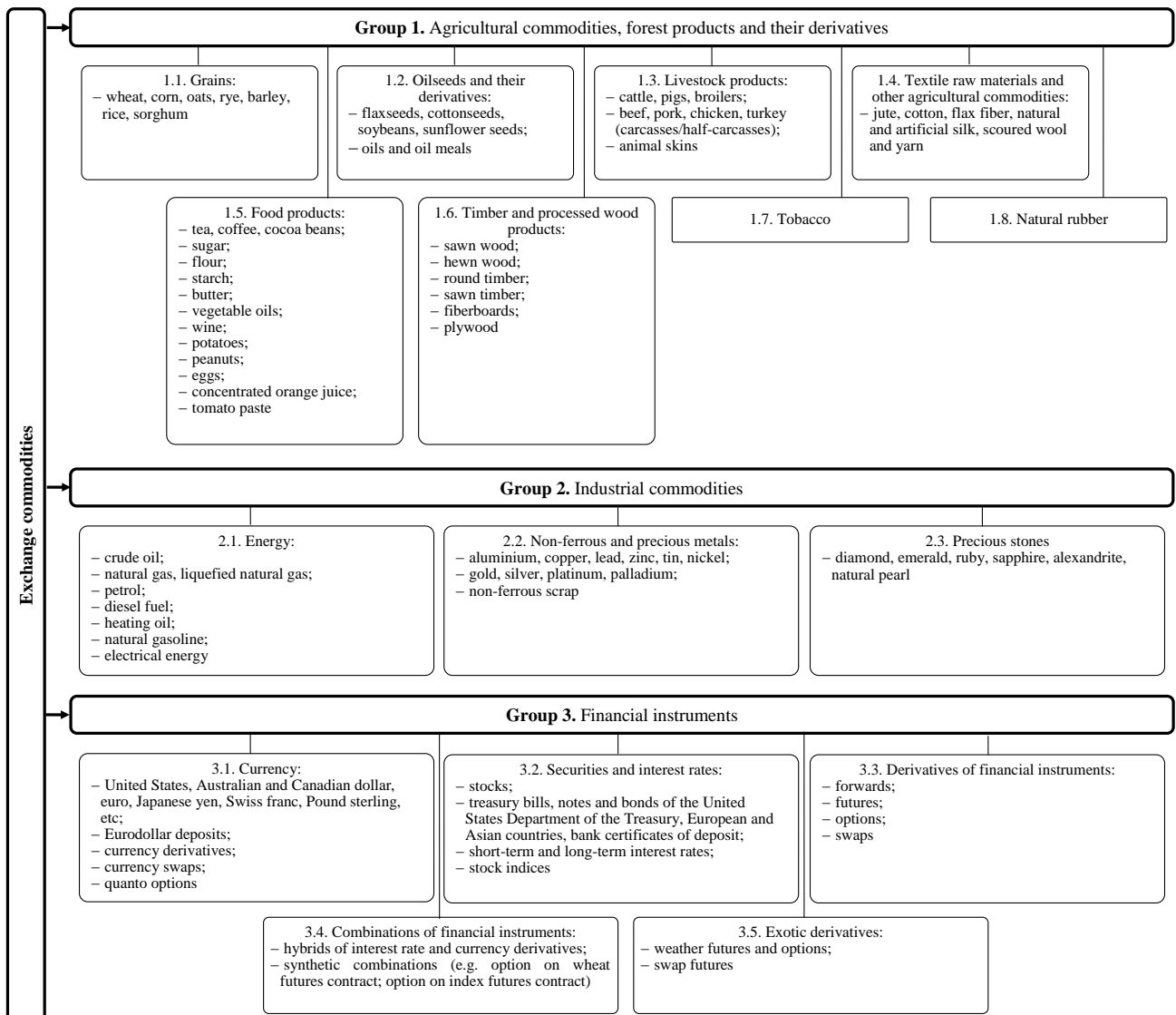
- good preservation;

- independence of the qualitative characteristics of the commodity from a specific consumer;

- price variability under the influence of natural, seasonal and other factors.

In the past few decades the share of trade of the exchange-traded contracts with real goods has drastically decreased, and, respectively, the share of contracts with financial instruments has considerably grown.

Studying the experience of the world's exchange trade, we can single out three classes of exchange commodities (material commodities; financial instruments; foreign currency) that can be divided into 3 groups (figure 1):



**Figure 1 – Classification of the exchange commodities**  
Source: Developed by the authors on the basis of [1-4, 9, 10]

The continued development of the exchange market promotes the amplification and sophistication of the list of exchange commodities. It involves mainly the third group of the exchange commodities, financial instruments.

If the Ukrainian exchange market is viewed more generally, then, according to Yasenetskyi V. S. [15], its operational problems arise from a short period of development, unregulated legal framework, vague organizational and legal status of the exchange, a considerable degree of administrative price regulation, low level of exchange transactions technification.

A lot of Ukrainian scientists dedicate their researches today to a comprehensive assessment of the existing development problems of the Ukrainian exchange market and finding ways of overcoming them. Using the results of our own observations and summing up the ideas of the Ukrainian scientists, we can single out top 10 problems of the Ukrainian exchange market [7, 14, 15]:

- imperfect legal framework. The main legislative acts which regulate the exchange activity in Ukraine are the Laws of Ukraine “On the Commodities Exchange” and “On the Securities and Stock Market”. Unfortunately, their fragmentation and inconsistency with the other legislative documents, that regulate business activities of the national economic agents, hinder the Ukrainian exchanges to get near the international exchange community;

- low level of market organization. In spite of a record number of officially created business organizations entitled “exchange” (in the fig.2 we can see the trend of exchanges number growing from 77 in 1995 to 555 in 2015 [6]), the Ukrainian exchange market is an artificial creation and doesn’t perform its inherent functions. The exchanges operate mainly in their own isolated business environment, or they are created for the business benefit of a certain group of people. The majority of the exchange transactions are carried out on the over-the-counter market, and agreements that are concluded on the exchange, aren’t actually exchange-traded contracts for the most part. It should also be noted that the market lacks transparency of pricing mechanisms and openness of information. As confirmation of this, you can see the unstable indicator of average sales per 1 exchange (fig. 2).

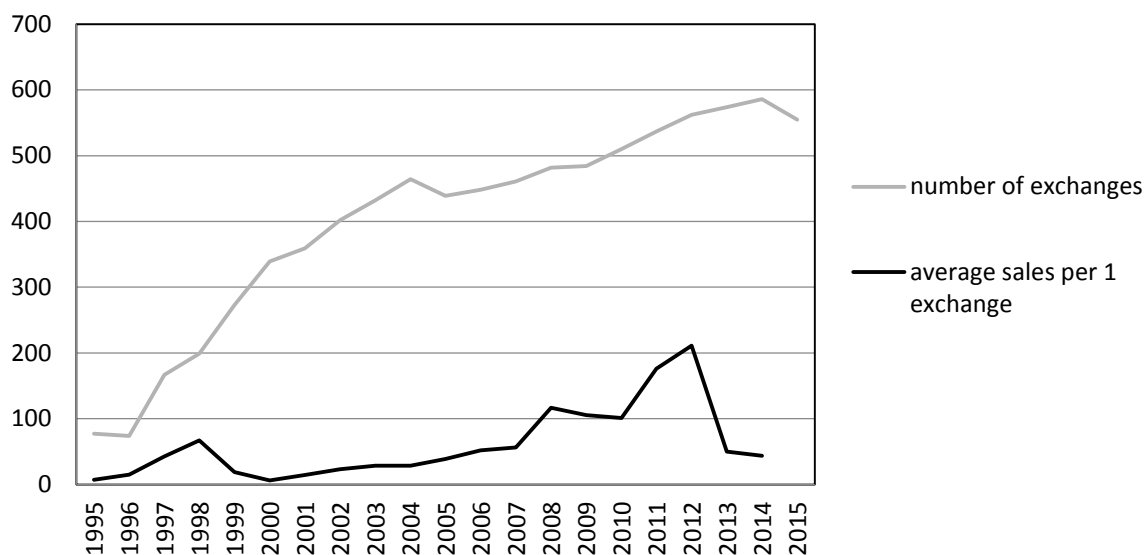


Figure 2 – Indicators of Ukrainian exchanges in 1995-2015  
(Developed by the authors based on [6])

- low level of market liquidity. A limited number of exchange transactions cause low liquidity of an organized market, which in turn hinders its development considering that investors aren’t able to properly perform the investment portfolio management. This means a lack of possibilities to perform asset transactions at market prices due to absence or insufficient level of their supply and demand. One of the consequences is high market volatility;

- limited number of exchange instruments. In spite of the existing variety of financial instruments and derivatives, there is only a narrow range of them in Ukraine with a limited number of characteristics (i.e. profitability, riskiness, protectability, etc);

- low level of trust. Operating commodities exchanges cannot ensure traders that the commitments under the exchange-traded contracts will be fulfilled. This weakens market players' interest in exchange trade and, consequently, leads to small amount of exchange trade. On the other hand, companies don't regard stock market as an available source of low-cost financial resources. Company stock prices don't indicate their success and developments prospects. As a result, there is a significant underestimation of the majority of exchange assets and a low level of capitalization of the stock market. The market is also characterized by the scarcity of financial resources accompanied by an unfavorable investment climate in the country due to low international image of the national business structures;

- imperfect fiscal stimulus. Lack of benefits for investors, double taxation of dividends, taxation of investment income, registration fee for securities, license fees, etc;

- lack of qualified specialists and impossibility until recently to get field-specific education in Ukrainian schools. Only in the recent years Ukrainian higher education establishments have started to open training programs for those who major in exchange activities and trade. It should be noted that previously all interested could get expensive education abroad or attend the training courses that gave only a cursory view of the specifics of exchange processes. The establishments that provide such services often operate as a pyramid scheme.

- low level of protection of stockholders' and investors' rights. The protection of stockholders' rights in Ukraine is more a formality than an effectively functioning mechanism. It is typical that it is impossible to have any real impact on joint-stock company's activity, there are no guarantees on behalf of the state regarding the protection of rights, the companies don't want to pay dividends, natural persons have limited access to the stock market.

- low level of exchange ethics and business-culture. The world exchange trade is characterized by the high level of regulation of its activities, has certain rules of subordination and even its own specific language. International exchanges conduct their activities according to the principles of transparency and openness, present their results at free access to the general public. In the meantime Ukrainian enterprises in general and exchange entities in particular are characterized by low level of compliance with rules and business ethics, are quite closed and prefer to conduct business behind the scenes.

- technological backwardness. The national exchanges use outdated technologies and primitive electronic trading instruments. Today's pressing matter is integration of electronic trading platforms into the state procurement system ProZorro hidden difficulties (for example, exchange accreditation, coherence of the platforms that are written in different programming languages, etc.)

It should be noted that, in spite of quite a large number of problems of the Ukrainian exchange market, they can be overcome. Solution of the underlying causes will lead to the disappearance or minimization of the secondary problems. The chaos and inconsistency of the exchange activities have mainly to do with the fact that domestic exchanges try to travel a long way of the foreign exchanges in a much shorter time. The accelerated pace and certain specifics of the development of the

Ukrainian economics lead to problems in a process of adaptation of the international experience to the Ukrainian realities.

The subsequent studies will be dedicated to the in-depth studies of scientific and methodological framework for exchange management taking into account national conditions of development of the exchange trade.

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