



**ALFRED NOBEL UNIVERSITY,  
DNIPROPETROVSK**

**DEPARTMENT OF INTERNATIONAL ECONOMY  
AND ECONOMIC THEORY**

**A. ZADOIA**

# **INTERNATIONAL INVESTMENT ACTIVITY**

**TEXTBOOK**

Dnipropetrovsk  
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У цьому навчальному посібнику наводяться базові знання у галузі міжнародної інвестиційної діяльності, закономірності міжнародного інвестиційного процесу, форми його реалізації та регулювання на державному і міждержавному рівнях. Курс включає в себе два змістових модулі: «Засади та управління міжнародною інвестиційною діяльністю» та «Міжнародна діяльність на ринку фінансових інвестицій». Вивчення курсу сприяє формуванню знань та набуттю аналітичних і практичних навичок у сфері реалізації зарубіжних та іноземних інвестицій, у тому числі в конкретних умовах України.

Призначено для студентів економічних спеціальностей та усіх, хто цікавиться питаннями міжнародної інвестиційної діяльності.

**Zadoia A.**

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This textbook discloses the basic knowledge in the field of international investment activity, tendencies of international investment process, forms of its realization and regulation on the state and interstate levels. The course includes two content modules: “Principles and management of international investment activities” and “International activity in financial investment market”. Studying of this course will help forming knowledge and acquiring skills in sphere of the foreign investment realization, including specificity of the Ukrainian conditions.

The material of this book is intended to students of economic specialities and also to all the people who are interested questions of international investment activity.

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## Introduction

Today international investment activity in its scope and degree of impact on national economies and global economic processes belongs to the group deciding factors. Therefore, the training of specialists in international economics studying the subject of "International investment activity" is an important component of the formation of professional competence.

The purpose of teaching "International investment activity" is to develop students' understanding of the principles of international investment, knowledge creation and acquisition of analytical and practical skills in the implementation of foreign investments, including in particular the case of Ukraine.

The task of discipline is the study of the principles of investment by the state, international and domestic corporations, as well as the most common instruments of international investment.

As required by educational and professional program students must:

***know:***

- the essence of international investments, their place and role in today international business;
- methodological principles of international investment activity;
- the essence of the investment activity of transnational corporations;
- the essence of international investment activity at the market of financial investments;
- tools of analysis of international investment market;
- the regulation mechanism of international investment activity;
- the main principle of Ukraine and Ukrainian producers in the international investment market.
- the essence of the investment activity of transnational corporations;

***be able to:***

- Explore features and problems that arise in the international investment market;
- Independently analyze the state of international investment activity;
- Use portfolio management techniques of international investment.

The course "International investment activity" includes two content modules "Principles of international investment and management activity" and "International activity at the market of financial investments." The first semantic module is considered the essence of international investment and the principles of its implementation, specifically examines foreign direct and portfolio investments, it is studied international infrastructure investment, methods of evaluating the

effectiveness of international investment projects, forms and methods of state regulation of international investment process and its characteristics in Ukraine. The second module is devoted studying the contents of international activity in the field of financial investments. Especially the global market shares, bonds and derivatives, the practice of using different indices to assess the state of the stock market are researched, with the main principles formation of investment portfolio management.

The proposed lecture notes include instructional materials for each topic of the course. They consist of list of basic questions that reveal the content of the topic, a brief statement of each issue and problematic situations whose analysis will verify their knowledge and level of learning.

However, learners should be understood that the material outline is just a framework for better understanding of the discipline. It could not answer all questions. Therefore it is necessary to study additional literature, a list of which is given at the end of this outline.

# Chapter 1

## Features and principles of international investment activities

### Chapter Outline

- 1.1. The essence of investments. The concept of investment activities.  
Classification of investments. Sources of investments
- 1.2. Description and purposes of international investment. Forms of international investment. The subjects and objects of international investment
- 1.3. Investment resources. Motivation of subjects of international investment activities
- 1.4. The impact of international investment activities on developing home base countries and host countries

1.1. The essence of investments. The concept of investment activities. Classification of investments. Sources of investments

**Investments** (Latin - *investio*, Ger. - *Investition*, Eng. - *Invest*) means "to invest".

*Investments shall be any and all kinds of material and intellectual values, which are made to objects of business activity and other kinds of activity, and result of which is connected with creation of profits , or any other social effect is achieved.*

**Law of Ukraine "On investment activity"**

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**Form of investments:**

- Funds, target bank deposits, shares, stocks and other securities
- Real estate and movable estate
- Property rights arising from copyright, experience and other intellectual values
- Know-how
- The rights use of resources
- Other values

*In the context of **microeconomics**:*

- Investments are any economic tool in which could invest money for profit (income)

*In the context of **macroeconomics**:*

- Investments are financing the operation, growth and development of the national economy

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**Factors of net investment:**

- Distribution of profits obtained on consumption and savings
- The expected rate of net profit
- The amount of interest rate
- Expected inflation rate

*Any of these factors are considered as not fully defined or risk-related*

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*The investment activities are consistent, purposeful activities which are be entitled to the capitalization of property, in the formation and use of investment resources, the regulation of the investment process and the international movement of investments and investment goods, creating an appropriate investment climate and aims to make a profit or a specific social effect*

**Subjects of the investment activity (originally):**

- *authorized bodies to manage state and municipal property or proprietary rights;*
- *citizens, including foreigners;*
- *companies, business associations and other legal entities, states and local organizations*

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**Subjects of the investment activity (by role):**

- *Investors*
- *Customers*
- *Contractors*
- *Suppliers*
- *Banks*
- *Intermediary companies*
- *Exchanges*

**Objects of the investment activity:**

- *any property, including basic and working capital in all sectors and areas of commercial complex;*
- *securities;*
- *special-purpose contributions;*
- *research and development products;*
- *intellectual valuables;*
- *other objects of property;*
- *property rights.*



**Classification of  
investments for facilities  
investment**

**Real investment** is investing in tangible (buildings, facilities and equipment) and intangible assets or innovation patents, licenses, "know-how", documentation of scientific and technical, and design works, software, etc.

**Financial investment** is contribution of assets in various financial instruments - securities, deposits, special bank deposits, government bonds to cover budget deficits.

**Classification of investments in various features**

<b>Features of classification</b>	<b>Types of investments</b>				
<i>by objects of investment</i>	<i>Real</i>				<i>financial</i>
	<i>tangible</i>	<i>intangible</i>			
		<i>intangible assets</i>	<i>intellectual</i>		
<i>by the participation in investment</i>	<i>direct</i>			<i>indirect</i>	
				<i>indifferent</i>	<i>portfolio</i>
<i>by the investment period</i>	<i>short-term (1 year)</i>			<i>long-term (over 1 year)</i>	
<i>by the form of ownership</i>	<i>public</i>	<i>polled</i>	<i>private</i>	<i>social</i>	<i>non-government</i>
<i>by the territorial basis</i>	<i>domestic(national)</i>			<i>outward (Foreign)</i>	
<i>by the extent of risk</i>	<i>zero risk</i>	<i>with acceptable level of risk</i>	<i>with level of critical risk</i>	<i>with unacceptable (catastrophic) level of risk</i>	
<i>by reproduction of capital pattern</i>	<i>gross</i>			<i>net</i>	

## Sources of investment

### **at the macro level:**

- gross domestic product, which is distributed through the state budget
- proceeds from the securities issue
- share of profits from the export of capital
- funds from the public in banks
- foreign capital

### **at the micro level:**

- own financial resources of enterprises
- involved financial resources
- borrowed financial assets

## 1.2. Description and purpose of international investment. Forms of international investment. The subjects and objects of international investment

**International investment activity** is an activity related to exports and imports of capital, technologies, services, implementation with other countries projects, creating joint ventures, to the integration processes in various areas

**Subjects of international investing activities**

- investor investing abroad is a donor who is a resident of a country (based country) and invests in facilities abroad;

- foreign investment recipient is a subject who is not a resident of a based country and receiving money from an investor who is a resident of the based country;

- foreign investor is a subject who is not a resident of the host country and who invests in recipients who are residents of the host country;

- recipient of foreign investment is a subject who is resident in the host country and who attracts foreign investors.

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**Direct investments** are an investment fund in order to help finding the business profit (income) and attachments that are caused by long-term economic interests and provide control over the investment object.

- Primary inputs
- Reinvestment
- Intranet reallocation of capital

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**Portfolio investment** is investment in securities to generate income (dividends). Such investments do not provide real investor control over the investment object.

### 1.3. Investment resources. Motivation of subjects of international investment activity

**Motivation of international investment activity:**

- *making a profit*
- *Gaining control*
- *Humanitarian objectives*

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**Sources of entities involved in investment activities**

<b>Investors</b>	<b>Sources</b>	
	<b>own</b>	<b>involved and borrowed</b>
<i>Individuals</i>	<i>Savings unconsumed part of the individual income</i>	—
<i>Corporation</i>	<i>Company reserves, retained earnings, depreciation and other funds, other own resources (know-how, non-operating income, etc.)</i>	<i>Funds raised through the sale of stocks, bonds, other securities, long-term loans and borrowings</i>
<i>The state (government)</i>	<i>Profits of state-owned enterprises, tax revenues, contributions to the state social security funds, public reserves, monetary affairs issue, the proceeds of privatization</i>	<i>Internal and external bonds (government bonds, treasury bills, etc.)</i>

**Motivation for investment by individuals:**

- *the increase in consumption in the future*
- *creating an insurance fund*

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**Motivation for investment by mononational corporations:**

- Increase the value of assets (maximizing capitalization of equity securities)
- Increase the profitability in the current year (investment is made as long as the return on invested capital cannot be compared with the cost of debt)
- Maximization of consolidated net present value (combining the first and second goal)

**Possible mobility of corporate capital:**

- 1) **absence of capital mobility**, suggesting a large influence legislative or other barriers, resulting in international corporate capital flows do not respond to fluctuations in domestic profitability of investment projects;
- 2) **low capital mobility**, which suggests a fairly large impact of legislative and other barriers, leading to a weak dependence of the import volume of capital investment from changes in profitability;
- 3) **high capital mobility**, in which international flows are sensitive to even small fluctuations profitability of investment projects in the country, but there is a difference between profitability of investment projects in the country and abroad;
- 4) **absolute capital mobility**, in which international flows can move freely into and out of the country in response to even the slightest fluctuations in profitability of investment projects.

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**Motivation for investment by multinationals:**

- Penetration of new markets
- Avoidance of trade restrictions
- Access to the resources
- Diversification of risks
- The tax structuring

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**Motivation for investment by financial institutions:**

- *Making a profit*
- *Diversification*
- *Long-term strategic objectives*

**Motivation for investment by governments**

**Strategic promotion of national companies**  
*There is a significant difference in the cost of credit granted in the form of commercial loans (commercial value of resources are much higher), and loans and loans granted by governments. The national benefit in such cases is obtained through other mechanisms that are put into effect in the host country as a condition of the loan.*

**The aim of the international technical assistance is not generate income directly but indirectly**  
*It is mainly aimed at the development of conditions for the export of capital through the development of market economy, the creation of the investment climate, training people and organizations which kindly will relate to the activities of foreign companies in their country.*

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**1.4. The impact of international investment activity in developing based countries and host countries**

**Priority involvement of different types of foreign capital:**

- 1. Foreign direct investment*
- 2. Irretrievably provided resources (aid, etc.).*
- 3. Portfolio investment*
- 4. International credit*

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**Gains from foreign investment to the host country:**

- Allow to enhance economic growth
- Stimulate the inflow other forms of foreign capital
- Could contribute to technological and organizational improvements

**The impact of foreign investment on the economies of resident and recipient countries**

<i>Resident exporter country</i>		<i>Recipient importing country</i>	
<i>Benefits</i>	<i>Disadvantages</i>	<i>Benefits</i>	<i>Disadvantages</i>
<i>Revenue growth from investments by reallocating capital in the country in more profitable overseas.</i> <i>Increasing exports of goods, equipment, technologies, stimulating the production process.</i> <i>Simulating innovation process</i>	<i>The high degree of risk.</i> <i>Slowdown in domestic production.</i> <i>The migration of labour.</i> <i>The slowdown in economic growth and country development through the transfer of capital abroad</i>	<i>Stimulating the growth rate of the national economy.</i> <i>Proceeds of modern technology, machinery and equipment</i> <i>The creation of additional jobs.</i> <i>Increased competition in the country</i>	<i>Lower income from investments as investor income is coming into the country resident.</i> <i>Ability revenues techniques and technologies are not new.</i> <i>The danger of dumping.</i> <i>The high cost of credit.</i> <i>Wages below the world level</i> <i>Bankruptcy domestic producers due to a lack of competitiveness</i>

## Chapter 2

### Direct and portfolio investments

#### Chapter Outline

- 2.1. The place and role of foreign direct investment (FDI). Motivation implementation of FDI. Forms of FDI.
- 2.2. Investment risks associated with the placement countries.
- 2.3. International portfolio investment: nature, types and values. Classification of securities in the international investment market.

- 2.1. The place and role of foreign direct investment (FDI). Motivation implementation of FDI. Forms of FDI

#### **The value of direct investment to the host country:**

- *Increasing exports of goods (\$ 1 of investment increases exports by \$ 2., according to the OECD);*
- *Increasing imports (\$ 3 investment increases imports by \$ 1);*
- *Work creation (\$ 3,000 – 25,000 investment create 1 work position, according to Canadian researchers)*

#### **New conditions for the movement of capital in the global economic system:**

1. *Further concentration flows and accumulated foreign direct investment in countries with market economies.*
2. *Market introduction the capital of new agents as an exporter of developing countries.*
3. *Tightening competition to attract foreign investment.*
4. *Reassessment of the factors that allow countries to attract foreign capital.*
5. *The advantage of cross-border acquisitions and takeovers instead of creating new enterprises or companies*
6. *Controlling the flow of foreign, investment behavior of investors and states that are taking on a bilateral and multilateral basis.*



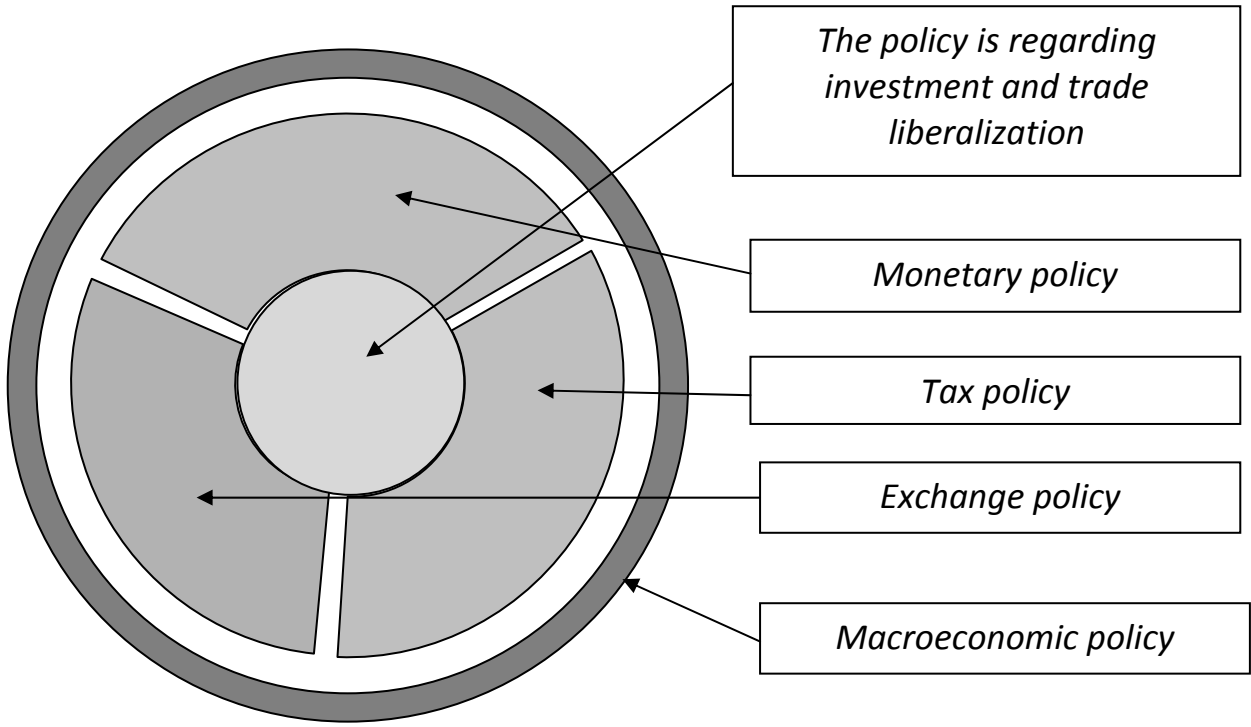
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**Policy of attraction the foreign investments**



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**Regulating measures the movement of FDI:**

- *trade policy;*
- *competition policy;*
- *antimonopoly policy;*
- *industrial policy;*
- *property relations regulating policy;*
- *tax and customs policy;*
- *incentives for lending;*

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**Regulating measures the movement of FDI:**

- *provision of guarantees by the state;*
- *monetary policy (the convertibility of the national currency, restrictions on transfer of dividends, royalties, etc.);*
- *price controls (fixing and differentiation prices, setting transfer prices);*
- *requirement to provide a certain percentage of exports of local components, etc.;*
- *specific sectoral measures*

**Motives for FDI:**

- *Productive-economic (immediate goal is making profit more than at outside the country);*
- *Marketing (capture new product markets);*
- *Propaganda (used by large transnational corporations to spread brand);*
- *Personal (related to family ties or national);*
- *Environmental (for the purpose of going beyond the country of environmentally hazardous activities)*

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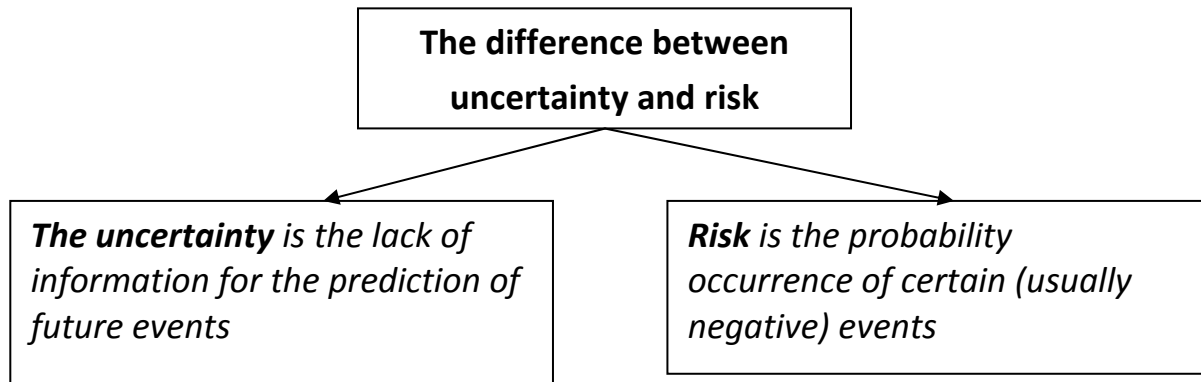
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**National priorities in attracting FDI:**

- *- employment growth and social stability (France, UK),*
- *- export development and transfer of professional experience (China),*
- *- agriculture and extractive industries development (Argentina, Australia),*
- *- resource development and the restructuring of the industry (Brazil, Chile, Venezuela)*
- *- IMF pressure (India, Philippines), the need for immediate capital injection (Mexico, Thailand, Indonesia).*



## 2.2. Investment risks associated with the placement



### Areas of risk and possible investment loss

<b>Extent of risk</b>	<b>The fluctuation range of risk factor, %</b>	<b>Possible loss</b>
<i>Risk-free investment</i>	<i>0</i>	<i>There is no loss</i>
<i>Allowable risk</i>		
<i>minimal risk</i>	<i>Above 0 - 25</i>	<i>Partial loss of net income</i>
<i>increased risk</i>	<i>25 - 50</i>	<i>Total loss of net income</i>
<i>Critical risk</i>	<i>50 - 75</i>	<i>Complete or partial loss balance profit</i>
<i>Catastrophic (unacceptable) risk</i>	<i>75 - 100</i>	<i>Loss of own funds Investor, Bankruptcy</i>

### Methods of risk assessment

**Statistical method** is determined by comparing number of adverse events *X* to the total number of same events:

$$E = (\text{Number of events } X / \text{Total number of events}) \times 100\%$$

■ **The method of expert estimates is determined by a survey of experts on the certain problem**

*As a rule, the method further includes methods of processing - rejecting the extreme and medium output estimates*

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■ **Comparative method is determined by comparing the risk for a given item with similar risk for other similar item**

*Risks associated with the host country*

- *Political*
- *Economical*
- *Legal*
- *Social*
- *Transport*
- *Environmental*
- *Criminal situation*

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**The risk of real investment** (investment in capital contributions) is associated with unsuccessful choice of the construction project location, with interruptions in the supply of capital goods, a significant increase in prices for investment goods, choice of unskilled (unfair) contractor and other factors that delay the commissioning invested or reduction of income (profit) in its operation.

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*The risk of financial investment (shares acquisition of privatized or other enterprises) is associated primarily with volunteer selection of financial instruments for investment; financial difficulties, unforeseen changes in investment conditions, direct deception of investors and others.*

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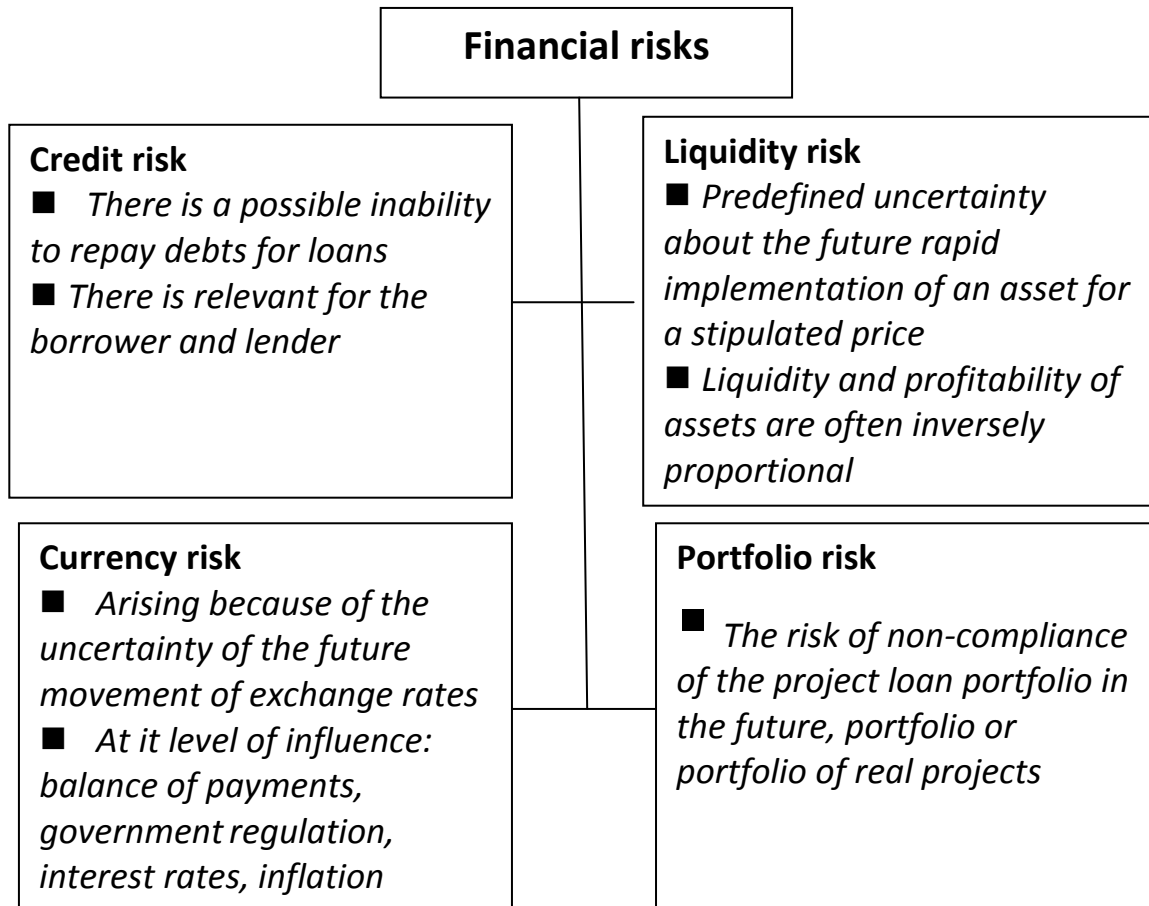
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**Possible measures against the risks:**

- *Mortgage operations and ensuring*
- *Diversification*
- *Insurance*
- *Limitation*
- *Distribution*

## 2.3. International portfolio investment: nature, types and values. Classification of securities in the international investment market

**Securities could be classified in many ways:**

- **economic nature** (property - the shares; credit relations - a bond, note, promissory note);
- **type of law that is realized** (cash requirements – bond, bill, property rights - stocks, mortgage, bill of lading);
- **economic status** (stock and commercial);
- **material form** (impersonal documents, records accounts);
- **ownership** (public and private);
- **nationality** (national, foreign, international);
- **features of the production and circulation** (target orientation, turnover, profitability, transfer of property rights, the sequence satisfying the claims, procedure compliance maturity)

**In a narrow sense**, the direct investment securities are securities that give the holder the right to the assets of the issuer, i.e. all classes of shares all types of issuers.

**In a broad sense (indirectly)**, the investments are **certain types of debt securities, certificates and derivatives**.

The basis of portfolio investments comprise equity and debt securities, but might also be derivative securities (derivatives)

*The share is equity security that entitles the holder to hold the share of profits and to participate in the management of a joint stock*

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*The bond is debt security that entitles the holder to receive from issuer the bond in a predetermined amount of money a pre-specified time*

<b>Investment characteristics</b>	<b>Share</b>	<b>Bond</b>
<i>Relations between the owner and the issuer</i>	<i>Property relations</i>	<i>Debenture stock</i>
<i>Participation in management</i>	<i>Yes</i>	<i>No</i>
<i>Form of income</i>	<i>Dividends</i>	<i>Interest</i>
<i>Source of payment</i>	<i>Net profit</i>	<i>The costs of the issuer</i>
<i>Procedure for payments</i>	<i>After tax</i>	<i>Before tax</i>
<i>Nature of payment</i>	<i>Unfixed without pre-defined terms</i>	<i>Fixed a pre-determined time</i>
<i>Displays the balance</i>	<i>Equity</i>	<i>Liabilities</i>

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**Derivatives:**

- *Forwards*
- *Futures*
- *Options*



***The value of international portfolio investment:***

- *Increase liquidity in the global financial market*
- *Attracted to invest small investors*
- *Contribute to risk sharing*

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## Chapter 3

### International investment infrastructure

#### Chapter Outline

- 3.1. International securities investors and especially their activities
- 3.2. Investment funds in the international investment market
- 3.3. Investment activities of multinational corporations

3.1. International securities investors and especially their activities

*International Financial Institutions (IFI) are created by combining the financial resources of member countries to solve the identified problems in the global economy*

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#### **Functions of IFI:**

- *foreign exchange and stock markets operations to stabilize and regulate the global economy, support and promotion of international trade;*
- *intergovernmental loans are loans for the implementation of public projects and finance the budget deficit;*
- *investment activity / crediting in the field of international projects (projects that concern the interests of several countries involved in the project, directly and through businesses);*
- *investment activity / crediting in the field of "internal" projects (projects that directly affect the interests of one country or commercial entity resident), the implementation of which could affect international business (for example, infrastructure projects, projects in the field of information technologies, the transport development and communication networks, etc.);*
- *charity (funded international aid programs) and the funding of basic research.*



**The goals the IMF:**

- *promoting international cooperation in the field of monetary policy;*
- *promote balanced growth of international trade to maintain high levels of employment and real income for the development of the productive potential of all members;*
- *maintaining the stability of currencies and ordering currency relations between Member States and curb depreciation currencies for reasons of competition;*
- *participation in multilateral payments system, the removal of restrictions on currency transfers;*
- *providing funds to eliminate the imbalance external accounts of member countries.*

**Special arrangements of IMF:**

- *Foundation systemic transformation*
- *Foundation compensatory financing and financing in case of an emergency*
- *The system of financing of buffer stocks*
- *Emergency assistance*
- *Fund structural adjustment*

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**European Bank for Reconstruction and Development**

- *Established in 1990*
- *The main objective is promotion the EBRD transition European post socialist countries to an open, market-oriented economy and the development of private and entrepreneurial initiative*

**Bank for International Settlements**

- *Established in 1930, then part of its functions took the IMF.*
- *- helps central banks in placing foreign exchange reserves, provides a forum for international monetary cooperation, acts as agent or trustee in international loan agreements, and maintains extensive research*

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## Regional development banks (EU)

**European Monetary Institute** (EMI, Frankfurt am Main, 1994) replaced the European monetary fund of cooperation, established in 1973. There is a supranational body composed of twelve Governors of the central banks coordinating monetary and credit policy of the banks, promotes creation of a system of European central Banks and the transition to the single currency. The EMI has got EURO emission function and loans to cover the deficit of the Member States.

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**European Development Fund** (EDF, 1958) provides a collective EU policy towards developing countries, coordinated bilateral official development assistance programs in these countries.

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**European Foundation for guidance and assurance of Agriculture** (1969) helps create a common agricultural market ("Green Europe").

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**European Regional Development Fund** (ERDF, 1975) provides loans at the expense of the common budget of the EU to even out regional disparities in Member States, as it numbers 25 poorest districts, the standard of living which is 2.5 times lower than in the 25 most prosperous countries.

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**European Monetary Institute** (EMI, Frankfurt am Main, 1994) replaced the European monetary fund of cooperation, established in 1973. There is a supranational body composed of twelve Governors of the central banks coordinating monetary and credit policy of the banks, promotes creation of a system of European central Banks and the transition to the single currency. The EMI has got EURO emission function and loans to cover the deficit of the Member States.

### 3.2. Investment funds in the international investment market

**The investment fund** is a type of investment company that receives money from the investors and their name invests the money in various securities.

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Investment fund could be considered as a financial product which investment company is exhibiting at public sale; in other words, an investment company provides investment portfolio, manages and sells ownership of the share of the portfolio with a tool, called the investment fund.

#### **The benefits of investing through funds**

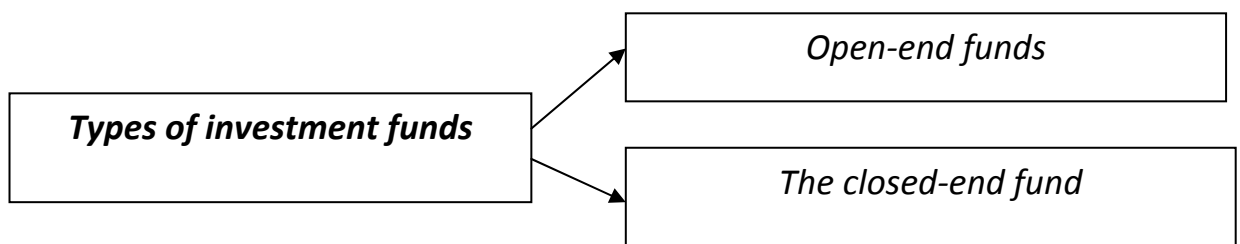
- Diversification
- Professional management
- The initial value of the required investment could be very small

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**The open-end funds:**

- Do not have a certain lifetime
- The amount and timing of the issue of shares are not restricted
- Shares could not be sold to third parties
- Shares in the investor buys investment fund at a price equal to the net asset value attributable to one share

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**The closed-end funds:**

- Have a certain period of existence
- The volume of share issue is strictly limited, in process of the fund operation has no additional emissions
- Shares resold free in the secondary market
- Annually per share accrued dividends
- At the end of the life of the fund securities that are in its possession, sale and the received funds are distributed among the shareholders

<b>The closed-end fund</b>	<b>The open-end funds</b>
<i>Created in the form of legal entity - public corporation</i>	<i>Could be formed in various ways</i>
<i>Number of shares recorded in the prospectus</i>	<i>The number of shares are not fixed</i>
<i>Number of shares does not change throughout the time range</i>	<i>The Fund may continually buy and sell shares or units</i>
<i>The Fund does not have the right to repurchase shares from shareholders</i>	<i>Buying and selling shares are carried out by the management company</i>

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<b><i>The closed-end fund</i></b>	<b><i>The open-end funds</i></b>
<i>Shares may be bought and sold through direct contracts between individuals or through financial intermediaries. These operations are not effect on the fund's assets</i>	<i>Price of sale and purchase shares based on the net asset value</i>
<i>Share price does not necessarily reflect with the net asset value of the fund</i>	<i>The net asset value is based on market value of the portfolio for every day</i>
<i>Management of investment portfolio provides the management company which is separate legal entity</i>	<i>The Fund is managed by a management company, which is in the form of legal entity</i>
<i>Shareholders are entitled to vote in the management of the fund</i>	<i>Depositors do not participate in the management of the fund</i>

3.3. Investment activities of multinational corporations

***International corporation is a corporation that provides direct international investments from the country of deployment in other countries***

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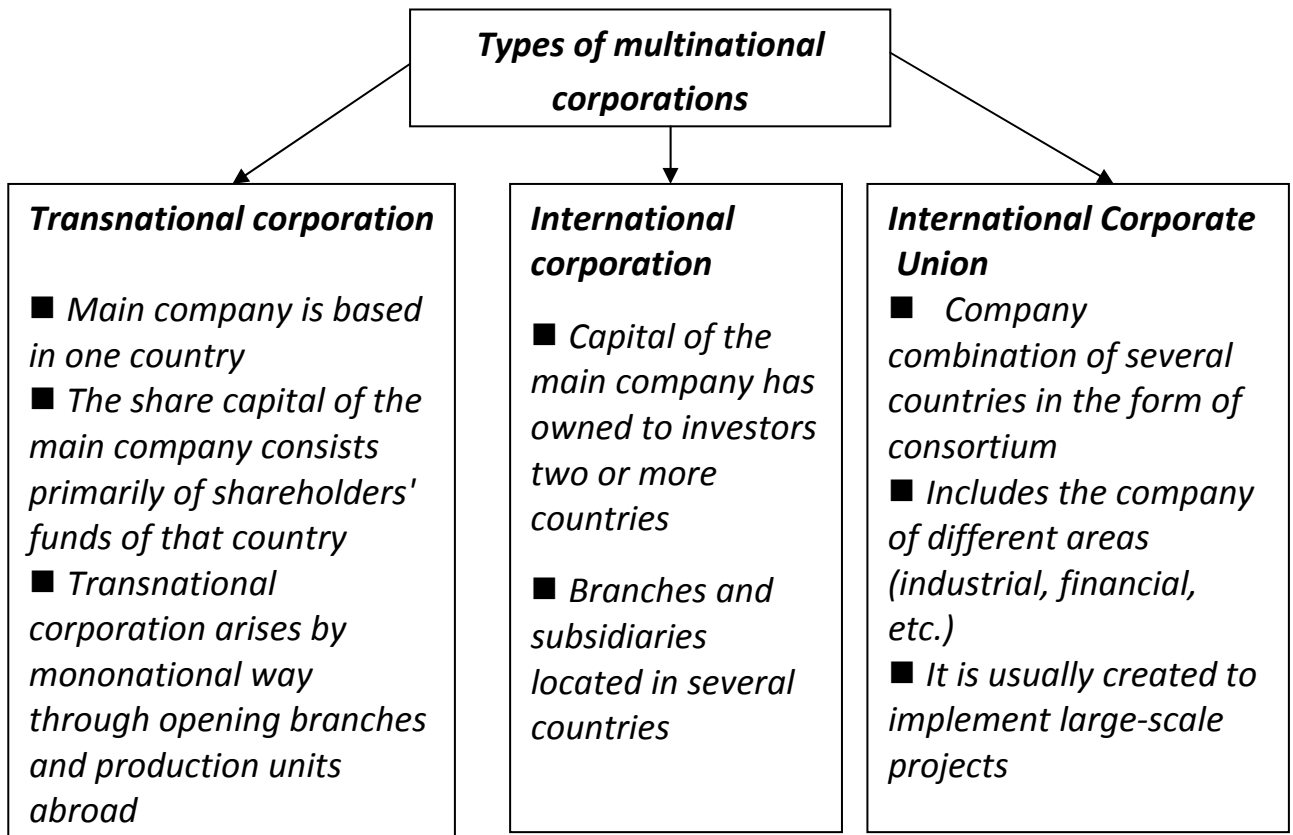
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**Advantages of multinational corporations over national**

- *penetrate to the markets of other countries "inside", bypassing customs barriers in foreign countries*
- *overcome the limitations of the domestic market of the residence country, increasing the size of enterprises and scope of production to the most profitable level*

- *have the natural and human resources, as well as scientific and technical potential in other countries*
- *have the ability to transponder manoeuvre of resources in case of fluctuations change*
- *have possibility to optimize the tax burden using the intracompany supplies*





**The most characteristic features of TNC are:**

- - creation of international production system, separated between many countries, but controlled from one center;
  - - high intensity intracorporation trade between departments, which are located in different countries;
  - - relative autonomy of decision-making from the home and host countries ;
  - - global structure of employment and interstate mobility management; development, transfer and use of advanced technologies in a closed corporate structure.
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**Benefits of TNC:**

- - They have the natural and human resources, and scientific and technical potential in other countries;
- - penetrate to the markets of other countries "inside", bypassing customs barriers in foreign countries for their capital;
- - having branches in different countries, overcoming the limitations of the domestic market of the residence country, increasing the size enterprises and scope of production to the most profitable level

**The reasons that induce a corporation to start investing abroad:**

- - high transport costs;
- - high customs tariff;
- - import restrictions (quotas);
- - preferences for local producers.

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**Factors** contributing to the adoption of the decision:

- - size and market attractiveness;
- - favorable level of production costs;
- - closeness to customers;
- - benefits provided by the authority.

**Variants of investments**

- Assembly factory
- Production contracts with a local manufacturer
- License agreement
- Joint Venture
- Full-scale investment in the construction or acquisition of enterprises

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**Assembly plant** is a trade-off between direct exporting and foreign production. This route avoids the high transport costs and takes advantage of lower customs tariffs on unfinished products

**Production contracts** with local manufacturers provide an opportunity the firm to do without investment in production and without the cost of transport and customs. However, there is a problem of quality control, risk transfer the production know-how to foreign firms, which could become a competitor later. This risk is reduced if the main factors of competitiveness are brand image and marketing know-how.

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**License agreements.** This method is more formal and long term. Firm (licensor) transfers to local firm's patents, brands, names, "know-how" and provides technical assistance. Firm-customer (licensee) pays an initial sum and royalties. Advantages of the agreement for both partners are the same for the franchise agreement. The problem is the difficulty of control and the lack of direct involvement of the company that sold the license

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**Joint Ventures.** Multinational firm invests part of the capital and has voting rights to manage the created company. This position provides better control over operations. Cooperation with local organization is a factor that facilitates integration into an unfamiliar environment

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**Direct investment.** The firm invests in the production in a foreign country by purchasing an existing or creates a new enterprise. This is the maximum participation of firms in manufacturing abroad.

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# Chapter 4

## International business investment activity and economic efficiency

### Chapter Outline

- 4.1. The effectiveness of international investment projects and its criteria
- 4.2. The choice of discount rate to substantiate the international investment project
- 4.3. Methods for evaluating the effectiveness of international investments
- 4.4. Estimated cost of building and the aggregate costs of international investment project

### 4.1. The effectiveness of international investment projects and its criteria

#### Classification of efficiency:

*Cost-effectiveness takes into account costs and benefits associated with the implementation of international projects, going beyond the direct interests of its members and admitting estimated money (cost) value. Could be calculated for a particular company, industry, country in which territory the international project is implemented;*

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*Commercial (financial) efficiency reflects the financial implications of an international project for its direct participants (countries);*

**Budget efficiency** determines the financial impact of the implementation of international projects for budgets of all levels (state, region, area).

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**Justification of the effectiveness of international investment project carried out after determining:**

- The goal of the international project (what, which circumstances is it caused, why does it need, where will be done and why);
- The impact of the international project on current and future activities of member companies;
- The changes or immutability organizational structure, product quality, production volumes, ecology, etc.;
- Terms (periods) of achievement the results of implementation of the international project;
- Investors and investment volumes.

**Performance measures of international investments:**

- **Group I - financial and economic:**
- Maximum profit or return;
- Minimum costs;
- Minimum time to achieve the goal;
- Maximum covered share of the international market;
- Profitability;
- High quality of products, etc.

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- **Group II - legal:**
- The norms of national and international law;
- Requirements for standards and conventions;
- Patentability and other terms of intellectual property rights.

- **Group III - resource:**
- *Availability of necessary scientific and technological heritage;*
- *Providing building specialists corresponding profile and specialization;*
- *Availability of financial resources;*
- *Availability of competing technology options for international projects.*

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#### 4.2. The choice of discount rate to substantiate the international investment project

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- *Discount rate reflects the minimum acceptable return on invested capital, where the investor will prefer the prescribed international project in comparison with an alternative way of allocating capital*

#### **Ways of determine discounting rates:**

- *Based on the deposit rate on deposits;*
- *According to bank lending rates;*
- *As the average cost of capital based on its structure, tax rates and other conditions;*
- *As compensation for the risk of loss, which is approximately equal to the already achieved level of return on equity (ROE) or the average rate of return on assets (ROA)*

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- *Accepted at the level of interest rates on bonds of internal or external loan;*
- *Conforms the interest rate on long-term bonds of joint-stock company;*
- *Based on the cost of attracting capital, reflecting the stock market assessment of the possible future risk levels for operations of the company;*
- *Establishment of a differentiated set of barrier factors (discount rate) are mitigated by less risky project decisions and increase at high risk investors;*

■ *The discount rate (or discount rate) is considered as the criterion of annual percent return on invested capital and it is located in the depending on the bank interest rate:*

$$d(t) = r(t) / (1 + r(t))$$

- *where  $d(t)$  – discount rate, the share of units.;*
- *$r(t)$  – interest rate (rate of return), the share of units.*
- *Rate  $d(t)$  is chosen as a basis of comparison is amount that is returned, and  $r(t)$  - is investigated the initial amount of investment funds;*

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■ *The individual rate of return, which is formed on the basis of aggregate impact of several factors;*

■ *Alternative rate of return which is formed on other possible international investment.*

*If payments are made at constant prices (in UAH terms), the discount rate in Ukraine are better taken as a **deposit rates for legal entities.***

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*If the calculation efficiency of international investment made **in comparable prices in UAH**, should use a formula for calculating the discount rate:*

**$i = (1 + H_n) \times (1 + \pi) \times (1 + r_k) - 1$** , where

- *$i$  – the discount rate:*
- *$H_n$  - minimum guaranteed real rate of return in constant prices (deposit rate for legal entities);*
- *$\pi$  – inflation;*
- *$r_k$  – risk-adjusted.*

**The discount rate allows us to estimate income of future periods based on today's value of money**

### 4.3. Methods for evaluating the effectiveness of international investments

**Methods for assessing the international investment** is a way of determining the appropriateness of long-term capital investment in various objects (projects, events) in order to assess the prospects of return and payback

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Computer programs for evaluating investment projects:

- COMFAR (Computer model for feasibilities analysis and reporting)
- PROSPIN (Project Screening and Preappraisal Information System)
- «PROJECT EXPERT»

### **Methods for assessing the international investment**

#### **1. Net present value– NPV.**

If the international project involves a single investment:

$$NPV = \sum_{k=1}^n \frac{P_k}{(1+i)^k} - I$$

Where:  $n$  - number of years of sale (term) international project;

$k$  – years of sale international project(1, 2. 3... ,  $n$ );

$P_k$  - income (cash receipts) in  $k$ -the year of sale the international project;

$i$  – discount rate, share unit.;

$I$  - amount of one-time investment (cash outflow).



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If it planned consistent international investment:

$$NPV = \sum_{k=1}^n \frac{P_k}{(1+i)^k} - \sum_{j=1}^m \frac{I_j}{(1+i)^j}$$

or

$$NPV = \sum_{k=1}^n \frac{P_k}{(1+i)^k} - \sum_{j=1}^m \frac{I_j}{(1+\pi)^j}$$

where  $m$  – number of years of international investment;

$j$  – years of international investment(1, 2, 3, .....,  $m$ );

$I_j$  – investments volume  $j$ - in year of the international investment;

- estimated average annual rate (rate) of inflation.

- If  $NPV > 0$ , the international project should be adopted because the cost (value) of the company will increase, the stock price will increase.
- If  $NPV < 0$ , the international project should be rejected.
- If  $NPV = 0$ , the international project is not profitable or unprofitable.

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## 2. Index of return (yield) International Investment– PI (profitability index):

With a single investment:

$$PI = \left[ \sum_{k=1}^n \frac{P_k}{(1+i)^k} \right] / I.$$

With consistent international investment:

$$PI = \left[ \sum_{k=1}^n \frac{P_k}{(1+i)^k} \right] / \left[ \sum_{j=1}^m \frac{I_j}{(1+i)^j} \right],$$

or

$$PI = \left[ \sum_{k=1}^n \frac{P_k}{(1+i)^k} \right] / \left[ \sum_{j=1}^m \frac{I_j}{(1+\pi)^j} \right].$$

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- If  $PI > 1$ , the international project should be accepted.
- If  $PI < 1$ , the international project should be rejected.
- If  $PI = 1$ , the international project is not profitable or unprofitable.

**3. Internal rate of return (yield) – IRR.**

With a single investment IRR is the solution of the equation:

$$\sum_{k=1}^n \frac{P_k}{(1 + IRR)^k} = I$$

With consistent international investment IRR is the equation:

$$\sum_{k=1}^n \frac{P_k}{(1 + IRR)^k} = \sum_{j=1}^m \frac{I_j}{(1 + IRR)^j}$$

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The value of IRR reflects the upper limit of the allowable level of bank interest rate or rates to attract financial resources (cost of capital - CC), the excess of which leads to loss of international project.

- If  $IRR > CC$ , the international project should be adopted.
- If  $IRR < CC$ , the international project should be rejected.
- If  $IRR = CC$ , the international project is not profitable or unprofitable.

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■ **4. Period (term) international investment payback– PP (payback period method)**, i.e. the period of time during which the expected return on investment from the revenues derived from the sale of international investment project.

■ *Outcomes and costs associated with the implementation of the international project, could count with and without discounting.*

**A) static (simplified) payback period:**

$$PP = \frac{I}{P_k}$$

where *I* – value of single investment funds;

*P<sub>k</sub>* – annual (average) net income from the international investment.

**B) dynamic (discounted) payback period.**

*Discounted payback period (DPP) for income that could be represented as ordered sequences (annuities), i.e. annually discrete revenue, it is on the equity investment amount to the present value of annuity:*

$$I = P_k \times \frac{1 - (1 + i)^{-DPP}}{i}$$

Here:

$$DPP = \frac{-\ln \left(1 - \frac{I}{P_k} \times i\right)}{\ln(1 + i)}$$

*If the payback period of the international project is bigger than the accepted limits, it is removed from the list of possible international investment projects.*





**The estimated construction cost** is the amount of all costs associated with the construction (reconstruction) of the object of international investment, or cost of construction products. It is defined by the formula:

$$ECC = CCW + CEC + CIC + CUF ,$$

where *ECC* – estimated cost of construction;

- *CCW* – cost of construction works;
- *CEC* – costs for equipment, instruments, tools, equipment required for facility construction and operation of its installation;
- *CIC* – other costs associated with the construction (design, content management of the company, which is under construction);
- *CUF* - costs allowance for unforeseen work.

**Estimated value of construction works is divided into:**

- - **Direct costs**, which is directly related to the implementation of BIS.
- - **Overhead**, which are designed for the organization, management and maintenance of building work.
- - **Planned savings (NPL)** or the estimated profit designers and contractors, set as a percentage of the amount of direct and overhead costs. Their value must take into account the tax rates.

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**To determine the estimated project costs of international investments comprise the following types of estimates:**

- - Summary estimates or the estimated combined calculation that determines the overall cost of the work in accordance with the technical project;
- - Estimates for individual objects and types of work, purchase of equipment and its installation;
- - Estimates for certain types of costs;
- - Calculation of the materials cost, transportation and other costs;
- - Estimates for search of work;
- - Local and objective estimates.

## Chapter 5

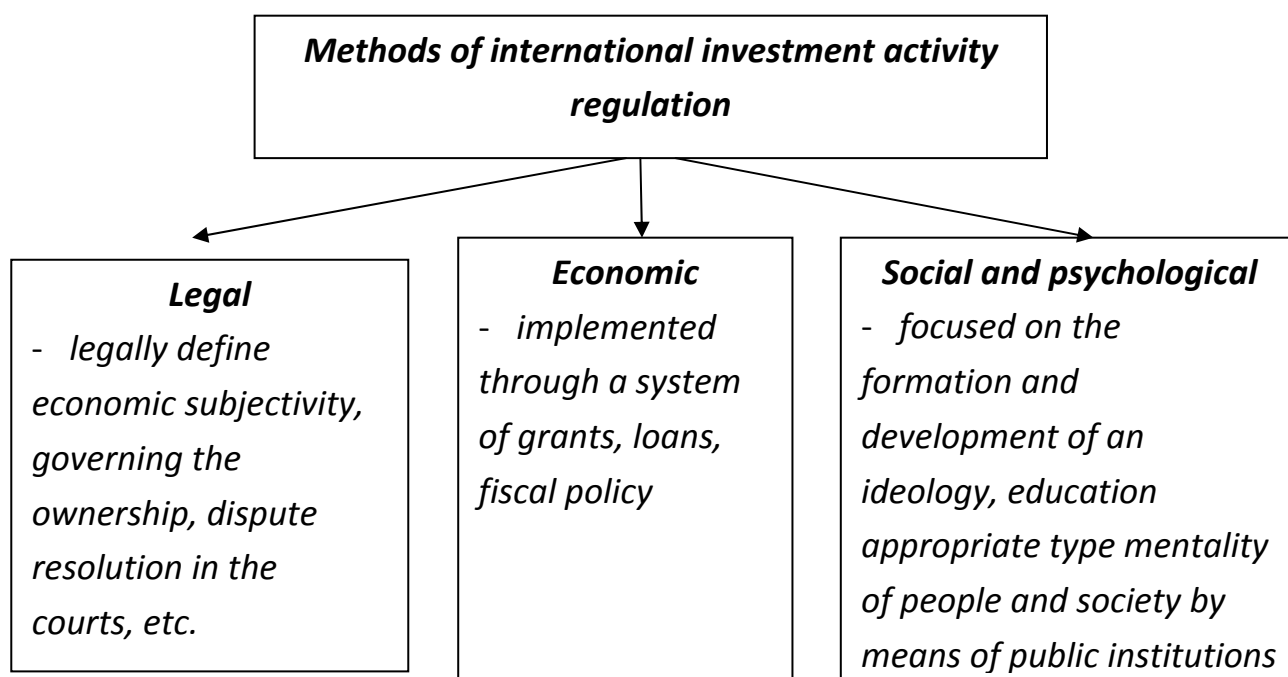
### Forms and methods of government international investment activity

#### Chapter Outline

5.1. The system of regulation of international investment activity. Benefits and guarantees

5.2. International legal regulation of investment activity

5.1. The system of regulation of international investment activity. Benefits and guarantees



**Options for regulation IIA**

***Liberal** is realized in the development of specific regulations that regulate different aspects of foreign investment and business activity*

***Typical for the economically developed, powerful countries***

***Total** is realized through adoption of a single act, which governs the admission of foreign capital in the economy*

***Typical for less economically developed countries that import the capital***

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**Elements of legal regulation**

**The foreign investor identification**

Foreign investors are:

- foreign individuals and entities;
- persons who reside abroad;
- foreign governments and international organizations.

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**Types and forms of foreign investments**

The types of foreign investments are the values that are directly invested by foreign investors in business activities for profit (income) and achieved other goals.

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**Qualified amount (percentage) of foreign investment**

*Foreign investor classified by the amount of capital invested. Thus, in the global practice, the average investment is 50-100 thousand dollars. U.S. and qualifying ownership interest in the investee - share of 20%.*

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**The participation of foreign investors in property**

- preservation state control over strategic sectors of the national economy;*
- preservation of certain industries or types of production under the state ownership;*
- partial lifting of restrictions privileged investors;*
- 100% ownership of foreign investors.*

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**The list of objects that are prohibited for foreign investment**

- to protect national interests from the list of companies to invest are not allowed foreign investors (strategic economic targets, companies, defense industry etc.)*

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**Requirements for the performance of the foreign investor** are defined goals of host country and differentiated according to certain indicators (share of national participant, the level of technology transfer, scale of activity, focus market opportunity training and jobs, etc.).

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**The system of investment benefits and restrictions include:**

- factor benefits (subsidies, guaranteed and soft loans, tax exemptions, partial refunds, accelerating depreciation);
- trade benefits (tariff and non-tariff import barriers);
- Special measures to limit and control the foreign investor's activity.

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**The system of investment guarantees**

- Guarantees inclusion of the rights of foreign investors in the national legal system
- Guarantees of sustainability legislation
- Guarantees of protection against confiscation

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**Industrialized countries prefer financial incentives** to fiscal as the first is more effective: they provide targeted exposure and concentrate on achieving specific national and national-oriented results.

**Developing countries and countries with transition economies use tax incentives and administrative measures** (this is due to lack of financial resources in these countries).

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**Institutions supporting investment abroad**

Created in developed countries to support private investment in developing countries

Represent the institution, providing information, investment brokerage, insurance and other financial organization services

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**Investment agreements**

- *concluded to obtain legal protection by based countries their investment in the host country from possible non-commercial risks, and support the stability and reliability of the relationship between countries*

*Standard content of the investment agreement between countries:*

- *investment and investors identification*
- *conditions for the importation of foreign direct investment*
- *investment promotion*
- *general standards of regime*
- *transfer of payments*
- *requirements for business results*
- *deprivation property rights of investor*
- *dispute resolution*
- *codes of conduct of corporations*

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**The main controversy about TNC between developed countries and developing countries**

***Contradictions about compulsory of legal acts***

Developing countries insist on the use of mandatory acts

Developed countries prefer acts of "voluntary character"

***Contradictions about jurisdiction over investment disputes***

Developing countries, seek to resolve disputes within the national legal system

Developed countries seek to apply international law or require freedom of law choice

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**Behavior principles of multinational companies:**

- 1) compliance with international law;
- 2) being subject to the right of the host countries;
- 3) taking into account the policy of the host country in the field of development and law;
- 4) cooperation with the host country, the exclusion of the practice of bribery and subsidies;
- 5) non-interference in the internal affairs.

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**International institutions that promote IIA:**

- Multilateral Investment Guarantee Agency
- Service for Foreign Investment
- Multilateral investment agreements under international economic groups

**Benefits to foreign investors**

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**Financial:**

Funding of joint projects with private businesses, preferential loans, and state investment guarantees, accelerated depreciation, investment guarantees

**Fiscal:**

- providing benefits for a certain period (tax holiday);
- provision in respect of certain taxes, fields of industry, regions and forms of economic activity (innovation, export);
- investment tax rebate;
- abolition of tax on reinvestment;
- tax treaties with other countries

**Other:**

- Customs privileges
- Benefits for using the infrastructure: lands, communications, transportations

**Economic evaluation of benefits for investors:**

- + Allow to attract more foreign investment
- + Contribute to the modernization of equipment and technologies
- + Create new jobs
- + Compensates for the unfavorable economic climate
- Could contribute to irrational allocation of financial resources
- Discriminate against investors (domestic and foreign investors from different countries)
- Reduce the profitability of foreign investments
- Efficiency benefits are reduced with an increase in their number

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**Types of guarantees:**

- *guarantees from changes in legislation;*
- *guarantees from confiscation and illegal actions of state bodies and their officials;*
- *compensation and restitution to investors;*
- *guarantee in the event of termination of investment activity;*
- *guarantee the transfer of revenues, profits and other sums due to foreign investment.*

**Advantages the guarantees of benefits:**

- *Guarantees are cheaper for the country because it does not necessarily lead to cost*
- *Guarantees provide benefits to weakest investors aligning competitive situation*

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## 5.2. International legal regulation of investment activity

**Two main systems of regulatory agreements** with foreign investment are used for regulating investment activities. These rules operate **within national legal** systems and regulations operating **within the limits of international law system**. Latest contained in bilateral and multilateral agreements and treaties.

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State, individuals and entities that conclude the investment agreements (contracts) **decide themselves** on the election of the regulatory regime their relationship, and then **not allowed waiver of the parties of their obligations under this contract**, including the nomination of claims based on state immunity.

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### **International agreements on investment protection:**

- concluded on the initiative of the countries - exporters of capital and to ensure their investors certain minimum legal and economic guarantees of security and stability

### **The conditions specified in international agreements on investment protection:**

- conditions that define the concept of foreign investment and foreign investors circle
- conditions of rights protection of foreign investors from certain political risks
- stabilizing warnings that are intended to provide investors with investment immutability legal conditions for a specified period of time from the date of his investment
- Procedure for making pre-arbitral disputes
- The authority which granted the right to consider disputes concerning international investments (Referee)

**Agreement on Avoidance of Double Taxation**

- *The Agreement on preventing the imposition of one object individual taxpayers with the same (or similar) tax for the same period of time (usually - tax period)*

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**Benefits for investor:**

- *defined types of income that could be taxed only in one country;*
- *installed the maximum allowable rate of taxation in one of the countries with some income that could be taxed in two countries;*
- *procedure provides for deduction of tax paid abroad, with a total tax liability on income subject that are both objects of taxation in the two countries.*

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**Groups of international tax treaties:**

- *Conditionally tax agreement in which tax issues are regulated along with other issues that are not the subject of tax law.*
- *General tax is the agreement that govern general, the main problems of taxation between the contracting parties (agreements on avoidance of double taxation).*
- *Limited-tax is the agreement that lead to the application of the taxation mechanism concerning a particular type of tax, the taxpayer or the tax object*

**Agreement on free trade and industrial cooperation**

- *non-use of import duty in respect of goods of domestic production of the exporting country*
- *VAT application and excise duty on imports of goods at rates that do not exceed established for similar goods of national production of the importing country;*
- *quantitative restrictions on imports of certain goods in the event of necessity apply for a specified period, subject to a study by conducting bilateral consultations*

**Cooperative delivery of goods:**

- *supply raw and other materials, components, spare parts, workpieces, components and other products industry and cross-industry destination, technologically interconnected and essential to the manufacture of final products*

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**Method of providing services in cooperation:**

- *Project work*
- *Repair work*
- *Technical maintenance*
- *Technical operations*



# Chapter 6

## Features of Foreign Investments in Ukraine

### Chapter Outline

- 6.1. Formulation and estimation parameters of the national investment climate
- 6.2. Potential free (special) economic zones
- 6.3. Problems of investment from Ukraine

#### 6.1. Formulation and estimation parameters of the national investment climate

**Investment climate is:**

- combination of political, legal, economic, institutional and social conditions that determine the attractiveness and desirability of investing a particular economic system (national economy, region, company)

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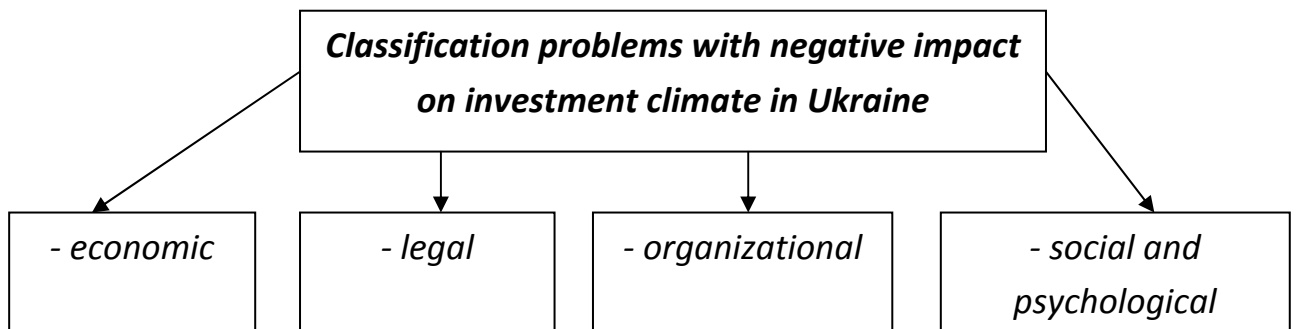
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**Social and psychological:**

- - Indiscipline and un reliability business partners from the Ukrainian side;
- - Corruption and bureaucracy in matters of business;
- - Inertia and low entrepreneurial activity of the population;
- - Reluctance of most Ukrainian businessmen to cooperate with foreign partners, which is found primarily in the non-fulfillment of contractual obligations relating to the timeliness of settlements.

**Investment attractiveness is:**

- assessment of the Investment Climate in relation to a particular investment object

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**Elements of investment attractiveness (according to the magazine "Euromoney")**

- economic efficiency
- level of political risk
- state of the debt
- ability to repay debt
- solvency
- availability of bank credit
- availability of short-term financing
- availability of long-term debt capital
- probability of force majeure

**6.2. Potential free (special) economic zones**

**1. Free Economic Zone** is a limited part of the country, which is characterized by a specific mode of operation of economic entities, the enclave as a guarantee of the stability and a certain freedom

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*According to the decision of the Kyoto Conference (1973), under a free economic zone understands the territory of the country where the products are considered as objects that are outside the customs territory and are not subject to the usual customs and taxation*

### **Types of FEZ**

**Duty-free trade zones** (ports, warehouses, transit zones, customs zones for companies)

- *Essence - Mitigation (reversal) of customs duties and export-import controls movement of goods*
- *Purpose - Accelerate the movement of goods, handling, processing, storage*

**Export production zones** (industrial, recreational)

- *Essence - Preferential trade, customs and tax modes operation*
- *Purpose - Promote the production of exports, development of tourism*

**Imported production zones, zones of import substitution**

- *Essence - preferential trade and tax operation mode*
- *Purpose - Provide customers with imported products, stimulating the production of import substitution*

**Banking and insurance duty-free zone**

- *Essence - Preferential treatment perform banking and insurance operations*
- *Purpose - Effective implementation of banking and insurance operations, the development of appropriate infrastructure*

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**Technology Development Zone** (parks, technopolis)

- *Essence - System privileges providing design, development and implementation of technology*
- *Purpose - Promote the development and exploration of modern technologies, the implementation of the current scientific and technological capabilities*

**Comprehensive zones**

- *Essence - Use of different types of free zones*
- *Purpose - deal with complex internal and external challenges, regional development*

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**2. Offshore zone** is a country or territory of some countries where at the state level for certain types of companies owned by foreigners, substantial tax benefits, partially or completely removed customs and trade barriers, reduced or no requirements for accounting and auditing

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An offshore company (a company incorporated in a jurisdiction with low tax or tax-free based on small fixed fee) could receive benefits only **if company owners are foreigners**, and profits should be removed outside the jurisdiction where it is registered.

Offshore companies **are prohibited to conduct business in the home country**, because otherwise the government would put in unequal conditions local firms comparison with offshore, which have tax advantages.

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*Countries and territories are deliberately creating favorable conditions for international economic activity ("clean" offshore zones) there are about 80. Majority of them are concentrated in Europe and the Caribbean.*

**Offshore zones could be classified according to the degree of reliability:**

- **The first group:** Hong Kong, Singapore, Luxembourg, Switzerland, Dublin, Guernsey, Isle of Man and Jersey
- **Second group:** Andorra, Bahrain, Barbados, Bermuda, Gibraltar, Labuan (Malaysia), Macau, Malta, Monaco,
- **Third group:** Antigua and Barbuda, Aruba, Belize, British Virgin Islands, Cayman Islands, Cook Islands, Costa Rica, Cyprus, Lebanon, Liechtenstein, Marshall Islands, Mauritius, Nauru, Netherlands Antilles (Netherlands), Panama, St. Kitts Island and Nevis, Saint Lucia, Samoa, Seychelles, Bahamas, Vanuatu.

**The attractiveness of offshore zones for Ukrainian businessmen explained by the following circumstances:**

- - Volatility of financial and credit system of Ukraine;
- - A high degree of risk in capital investment;
- - A large tax burden.

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**Basic principles of FEZ:**

- **1. Clearly define objectives of the FEZ.**  
*Foreign experts claim that the zone does not need to solve a large number of tasks, and implement a specific purpose.*
- **2. The objectives determine the choice of the zone type .** *Due to the fact that only an organization of any zone makes certain tasks.*
- **3. The success of the zone depends on its competitiveness in relation to other zones rather than on national treatment of business activities**

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- **4. Create FEZ associated with significant financial costs of the state.** It should be noted that the provision of benefits cause to a reduction in government revenue.
- **5. The validity of providing certain benefits to subjects FEZ**
- **6. The stability of the legal framework.** Amendments to the regulations should be imposed only in extreme cases.

According to Art 1 of the Law of Ukraine "On general principles of creation and functioning of special (free) economic zones" it is defined as the territory of Ukraine, which are set special legal regime of economic activity and the application and operation of the legislation of Ukraine

**3. Priority Development Area (PDA)** is a territory within the city (district), with unfavorable socio-economic conditions and which introduced a special regime of investment to create new jobs.

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*Differences between FEZ and PDA*

- The FEZ introduced special (other than Ukraine-wide) customs, monetary and financial, tax and other conditions of economic activity
- PDA is special mode of investment activity to create workplaces

**To create an FEZ is necessary to present the following documents:**

- decision of the local council or the local state administration with a request for the creation of FEZ in their territory or written consent if the initiative comes from the President of Ukraine or the Cabinet;
- draft regulation on charter, management and the official name of the FEZ;
- precise description of the boundaries and map FEZ territory;
- technical and economic rationale for the establishment and functioning of FEZ;
- The law establishing the specific FEZ.

### 6.3. Problems of investment from Ukraine

**Prohibited goods to invest from Ukraine:**

- *raw material*
- *component parts*
- *spare parts*
- *the consumer goods*
- *highly liquid products, which are provided the export licensing, quotas and special treatment*

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**It is not investment:**

- *Operation residents of converting the funds to support their own offices (branches) abroad*
- *Payment of membership (entrance) contributions in foreign (international) organizations*
- *Payment of insurance and health care*
- *Current accounts in foreign banks*

**Required documents to obtain a license for foreign investment:**

- *letter of appeal with the rationale for the implementation of investment property outside Ukraine;*
- *a notarized copy of the certificate of registration of a business entity if the legal entity or individual is such;*
- *a notarized copy of the constituent documents of legal entities (the statute, founding treaty, provisions);*
- *consent of the relevant state of executive power or other executive body when outside Ukraine invested property that is owned by the State;*
- *the bank certificate where the account of resident;*
- *document proving the value of assets in foreign convertible currency for international markets prices;*
- *calculation of needed terms to implement property investment outside Ukraine;*
- *document which confirms payment for an individual license;*
- *documents that show the registration (creation), company, affiliates, representatives, or other separate unit in the country of location (extract from the trade, bank, court registry, etc.) and their constituent documents*



*Overseas investment, including the purchase of securities (exclusive of securities or other rights derived by individuals resident in the gift or legacy), realizes with an individual license from the NBU. It issues to hold a one-time monetary transaction for the period required for such operations*

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# Chapter 7

## International stock market

### Chapter Outline

- 7.1. General features of investing in stocks
- 7.2. Classification shares as investment object
- 7.3. The main indicators for assessing shares
- 7.4. Strategies of investing in common stocks

### 7.1. General features of investing in stocks

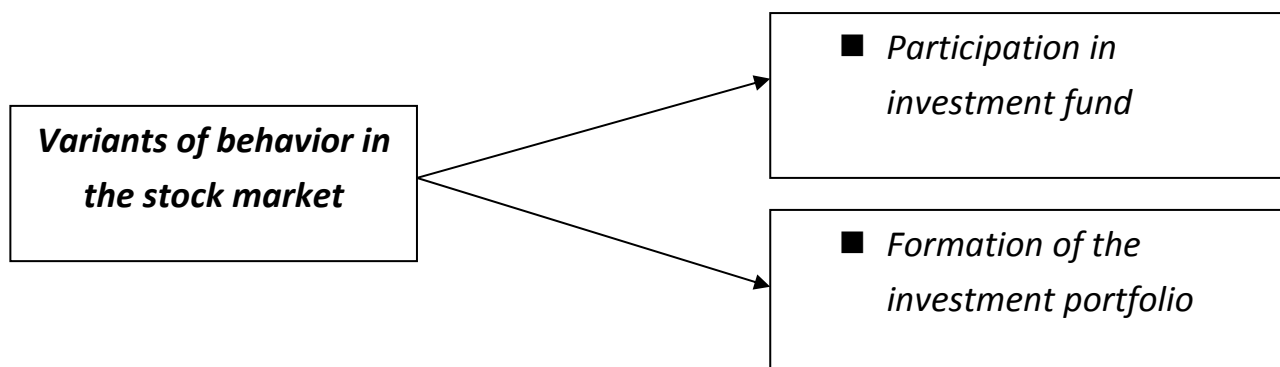
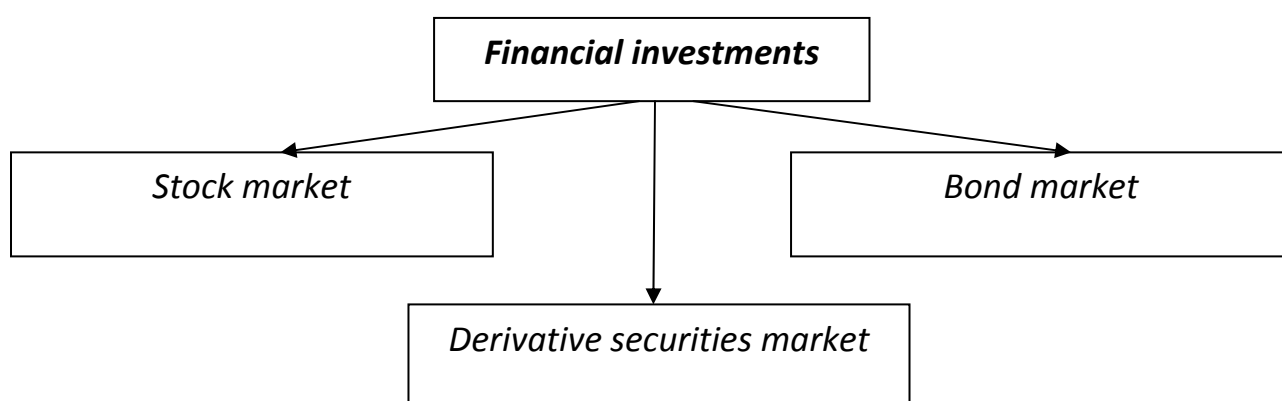
*The financial investment is business transaction that involves the purchase of corporate rights, primary securities, derivatives and other financial instruments*

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**The objectives of equity investments:**

- Participation in the management of the investee
- Preservation of capital
- The accumulation of capital
- Obtaining current income

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**Types of shares**

**Ordinary**

- - give the right to participate in management;
- - profitability is not secured

**Preferable**

- - do not give the right to vote at meetings of shareholders;
- - profitability is secured

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**Types of preferable shares**

<p>■ <b>Accumulating :</b></p> <p>- Unpaid dividends for previous periods paid after recovery payments</p>	<p>■ <b>Noncumulative:</b></p> <p>- Unpaid dividends in previous years are lost</p>
<p>■ <b>Participating :</b></p> <p>- If the dividends on ordinary shares are greater than guaranteed by the preferable shares, then it also paid for higher dividends</p>	<p>■ <b>Non participating:</b></p> <p>- Dividends are paid at the level guaranteed, regardless of the level of profitability of ordinary shares</p>
<p>■ <b>Converted:</b></p> <p>- Give the right owners swap preferable shares for a number of ordinary</p>	<p>■ <b>Non-converted:</b></p> <p>■ - Do not give this right</p>

<ul style="list-style-type: none"> <li>■ <b>Shares with warrant:</b></li> <li>- Giving the right to purchase a certain number of ordinary shares at par</li> </ul>	<ul style="list-style-type: none"> <li>■ <b>Actions without a warrant:</b></li> <li>- Do not have such preference</li> </ul>
<ul style="list-style-type: none"> <li>■ <b>Reverse Shares:</b></li> <li>- May be revoked by the issuer</li> </ul>	<ul style="list-style-type: none"> <li>■ <b>Irreversible Shares :</b></li> <li>- Can not be revoked by the issuer</li> </ul>
<ul style="list-style-type: none"> <li>■ <b>Shares with a fixed dividend rate:</b></li> <li>- Dividend rate set for the entire period</li> </ul>	<ul style="list-style-type: none"> <li>■ <b>Shares with floating dividend rate:</b></li> <li>- Dividend rate is tied to the Bank Rate</li> </ul>
<ul style="list-style-type: none"> <li>■ <b>Shares that are implemented at par</b></li> </ul>	<ul style="list-style-type: none"> <li>■ <b>Shares that are implemented at a premium (extra charge)</b></li> </ul>
<p><b>About type of shares can be judged on the basis of the terms of their issue or under the provisions of the shares, acting on each company</b></p>	

**Sources of income from ordinary shares:**

- Dividends
- Revenue from growth rate
- Other income

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**Factors that determine amount of dividends:**

- The net profits earned by company
- Type of shares (ordinary or preferable with a fixed dividend, accumulating or noncumulative)
- Structure of the profits
- Taxation of dividend income

**Factors that determine income opportunity on the growth:**

- The dynamics of share price
- Liquidity of shares
- Taxation of securities transactions
- Interest rate

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**The calculation of the indicative share prices**

$$\text{Stock price} = \frac{\text{Dividends}}{\text{Interest rate}}$$

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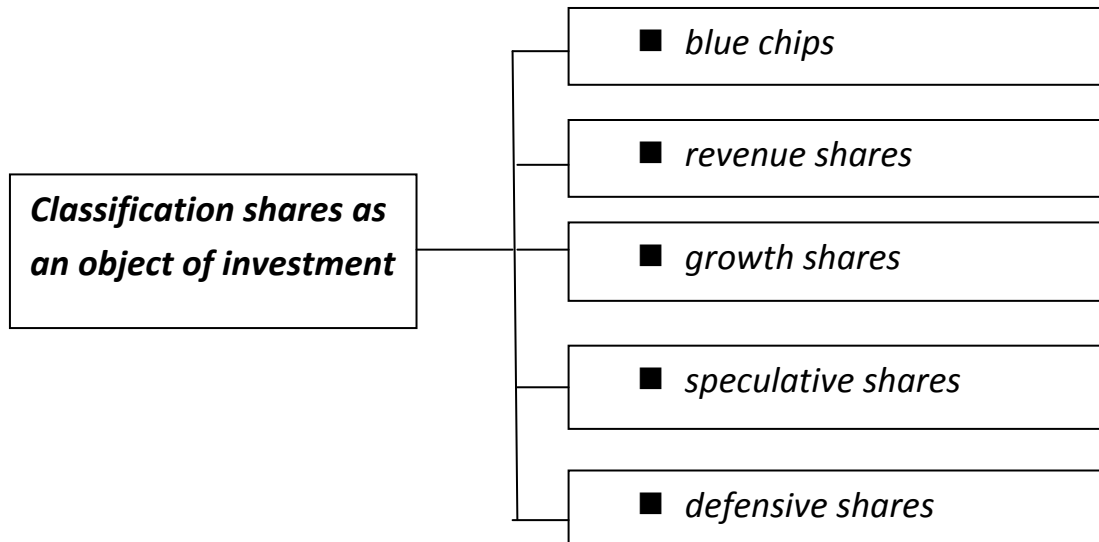
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7.2. Classification shares as investment object



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**Blue chips**

- There are shares the largest, most well-known and sufficiently stable companies
- Have little growth potential (due to the high initial price)
- Provide a stable dividend income (2.3%)
- There are attractive in terms of long-term investment with low risk (5-10 years or more)

**Revenue shares**

- Have little potential for growth through a steady volume of business company activity
- Provide a high enough dividend income (more than the blue chips, 3-8%)
- Attractive for moderately aggressive investors
- The degree of risk is higher than in share of the first group

**Growth shares**

- *There are company shares with a very favorable growth prospects*
- *The dividends are not paid, or have a symbolic amount*
- *The potential problem may occur when trying to fix the course of profit for a large block of shares*
- *Attractive to investors seeking substantial capital gains with limited risk*

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**Speculative shares:**

- *The shares of small and young companies*
- *Their current price, according to an investor is low*
- *Prospects for the payment of dividends and the price dynamics are uncertain*
- *In case of a successful investment could bring profits which several times higher than initial investment*

**Defensive shares:**

- *Issuers are companies with less elastic demand*
- *Fluctuations in stock prices are insignificant regardless of the macroeconomic situation*
- *Shares used to preserve the value of financial capital in times of crisis*

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7.3. The main indicators for assessing shares

**Potential investors in evaluating shares could:**

- *- Rely on estimates of the experts (in the case of stock shares);*
- *- Take own assessment of the stocks attractiveness.*

**Options of evaluation shares by experts:**

- Strong Buy
- Buy
- Hold
- Sell

**Analytical indicators in assessing the attractiveness of shares:**

- price /earnings (P/E)
- growth of price / earnings ratio (P/E ratio growth, PEG)
- price / sales ratio (PSR)
- price /book value ratio (PBR)
- Current Ratio ( CR)
- Performance Indicators of management
- «Beta» ratio

**Price / earnings ratio:**

- calculated by dividing the current share price by the amount of profit in the company per share;
- the expression "Shares of Procter & Gamble Co. traded with a multiplier 38" means that currently for every dollar of profit the company investors pay \$ 38;
- could be evaluated by comparing with corresponding indicators of other companies and the industry as a whole

**Growth of price / earnings ratio:**

- Considered that the value of REG is higher than 1, indicating that investors overpay for the shares of the company because its true ratio P / E is not justified by the expected growth rate of earnings. Therefore, investors preferred shares with a REG value below 1.
- REG particular stock as well as the ratios P / E should be considered with the average value REG for the industry to which is the analyzed company.

**Price / sales ratio:**

- RSR is considered as the ratio of the current price-to-sales of the company per share for the year. This parameter is especially useful in the case where the analyzed company is still young and it is not reached the level of profitability.
- Ideally, the PSR should be less than 1.
- The value of PSR at 2 and below is quite acceptable when looking for undervalued stocks.

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**Price/book value ratio:**

- This ratio represents the ratio of the current market value of shares to net assets value according to the latest quarterly report
- The lower the ratio is better
- It is necessary to compare PBR this share with PBR, the industry average.

**Current ratio:**

- The concept of current ratio means the ability of the company to cover their daily expenses and to fulfil short-term liabilities to the extent of their payment due date.

**CR= (current assets)/ (current liabilities)**

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**Performance Indicators of management:**

- Return on Equity ratio (ROE).
- Return on Investment ratio (ROI)
- Return on Assets ratio (ROA)



**Return on Equity ratio (ROE):**

- Index of ROE is calculated as the percentage ratio of net profit to the company's cost of equity; indicator of ROE reflects management's ability to manage its assets and shows that the profit of the company brings its share capital.

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**Return on Investment ratio (ROI):**

- Index of ROI is different from the previous ones, which defines management's ability to profit from the management is not only with the own costs but also the funds invested in the company by investors to significant time.

**Return on Assets ratio (ROA):**

- ROA index describes the ability of a company to make a profit from the total assets held by the company, and is calculated as follows:

**ROA = Net profit (after tax) / total assets**

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**The general rule for investors is to find a company with high levels of ROE, ROI and ROA, and do not invest in companies in which these values tend to decrease**

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**«Beta» ratio:**

- It is used in relation to the shares in the U.S. market
- Calculated using the formula:  

$$\frac{\text{The percentage change in the stock price}}{\text{The percentage change Standard \& Poors 500}}$$
- Used to evaluate shares in terms of "defense" and "speculation"

- *Aggressive investors are able to take risks for the sake of high returns, they will select shares with high values of  $\beta$ . Investors whose strategy is to preserve capital and ensure its moderate growth, they will pick up shares with a value of  $\beta$ , less than or equal to 1.*
- *In addition there is a general rule, according to which **the expected market growth investors buy shares with high value  $\beta$ , and the expected decrease in market shares of low value  $\beta$ .***

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#### 7.4. Strategies of investing in common stocks

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##### **Strategies of investing in common stocks:**

- *The strategy of long-term ownership*
- *The strategy of high returns on invested capital*
- *The strategy for long-term investment growth*
- *Aggressive management of portfolio*
- *The strategy of speculation*

##### **The strategy of long-term ownership:**

- *- use the investors whose primary goal is to preserve the invested capital.*
- *- the funds are placed only in high-quality stocks that are circulating in the market at least 15-20 years and have an excellent reputation.*
- *- much of the income received in the form of dividend payments, it is used to supplement the investment portfolio of the same reliability or the same shares.*

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**The strategy of high returns on invested capital:**

- - used investors who use shares as a source of current income
- - buy a reliable and high-yield shares
- - not necessarily that shares had significant percentages of growth. The main thing is safety shares and high dividend income.

**The strategy for long-term investment growth:**

- - this strategy involves a high degree of risk compared to the previous two, and sufficiently high trading activity, which consists in a fairly large number of transactions.
- - shares used large, reliable company that is constantly growing. Stock portfolio is reviewed periodically and changes its composition - bought new promising shares and sold shares which potential, according to investors, largely exhausted.
- - dividends in this strategy are considered as an additional source of income, as in many growth stocks are not paid generally.

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**Aggressive management of portfolio:**

- Aggressive management of portfolio is very similar to the strategy of long-term investment growth. If the investment horizon the previous strategy is 2-3 years, with this strategy the investor plans to get the same profit for 8-10 months
- Set of investment instruments used at work as in this strategy, and the strategy for long-term investment growth, similar - profitable growth stocks, defense stocks, but trading activity on higher order.

***The strategy of speculation:***

- *The most risky strategy that could bring as a fantastic income, and catastrophic losses, until the complete ruin.*
- *It is more a game rather than investment because the process of analyzing companies and market fades into the background, and the process sometimes is absent.*
- *At the foreground of market knowledge of psychology, personal psychological stability and composure, as well as the ability to apply some methods of technical analysis.*

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# Chapter 8

## International bond market

### Chapter Outline

8.1. Essence and types of bonds

8.2. Key indicators in assessing bonds

#### 8.1. Essence and types of bonds

*Bonds are securities with pre-defined period of existence, which reflects the loan relationship between the lender (bond holder) and the borrower (issuer of bonds)*

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<b>Differences between investment instruments</b>		
<b>Index</b>	<b>Ordinary share</b>	<b>Bond</b>
<i>Circulation period</i>	<i>Is not defined</i>	<i>Defined</i>
<i>The fee amount</i>	<i>Floating</i>	<i>Fixed</i>
<i>Terms do not receive remuneration</i>	<i>Lack of income</i>	<i>Lack of property company</i>

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#### **The segments of the bond market:**

- *Government bonds*
- *Government departments bonds*
- *Municipal Bonds*
- *Corporate Bonds*



**Government departments bonds:**

- **1. Federal National Mortgage Association, FNMA (Fannie Mae)** — is largest investors in residential mortgage loans in the United States; the main objective of the company is to ensure the liquidity of the mortgage market. Profits from these securities are taxed.
- **2. Federal Home Loan Mortgage Corporation, FHLMC (Freddie Mac)** — the goal of the company is to provide access to residential mortgage loans and stabilization of the secondary mortgage market. Profits from these securities are also taxed.
- **3. Federal Home Loan Bank System, FHLB (Home Loan)** — purpose of the bank is to provide financial support to their own residential space. FHLB papers are tax deductible from state and municipal authorities.
- **4. Federal Farm Credit Bank, FFCB (Farm Credit)** — purpose of the bank is extend credits to the agricultural industry in terms of competitive interest rates. Profits from these securities are not subject to taxation by the states and municipalities.
- **5. Government National Mortgage Association, GNMA, (Ginnie Mae)** purpose of the association is mortgage lending. Profits from these securities are taxed.
- **6. Student Loan Marketing association, SLMA (Sallie Mae)** – federal agency, which is wholly owned by the state, which purpose is to provide loans for education. Its obligation is not subject to tax in most states, except Pennsylvania, Massachusetts, Tennessee, and Mississippi.

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**Municipal Bonds:**

- *Municipal obligations (municipal bonds or muni's) are issued by state, county, cities and are usually issued in denominations of 5000 dollars. Proceeds from sale of municipal obligations are used for the construction and operation of multiple global facilities such as schools, hospitals, roads, stadiums, etc.*

**Corporate Bonds:**

- *Corporate liabilities, known as «corporates», available as open shareholders and private companies.*
- *There are 5 main types of corporate liabilities of issuers representing various sectors of the economy:*
  - *- Public utility.*
  - *- Transport companies.*
  - *- Industrial companies.*
  - *- Financial companies.*
  - *- Multiple Corporation*

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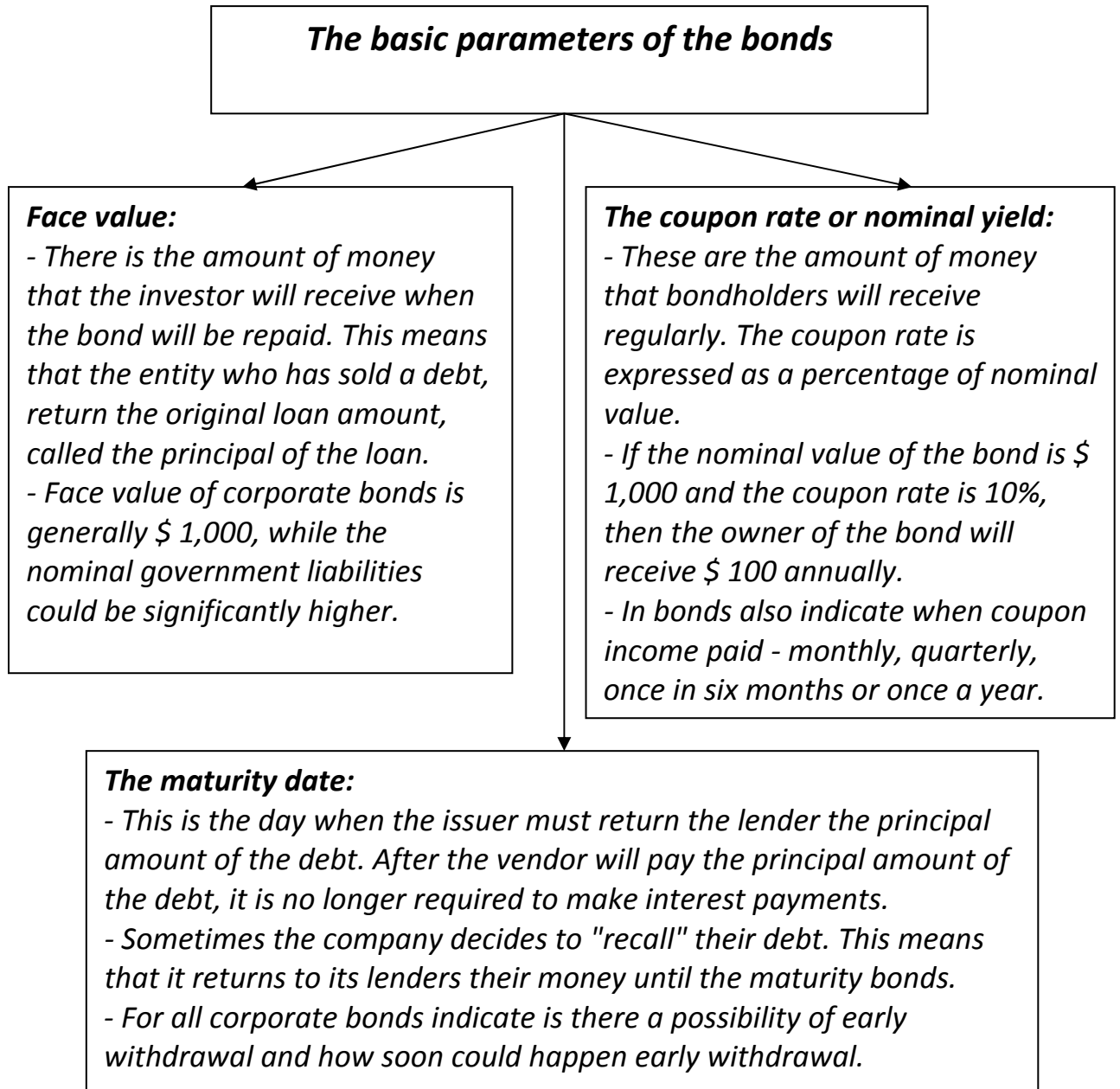
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<b>Types of Corporate Bonds</b>		
<b>1. Depending on the duration:</b>	1.1. Bonds with certain maturities: 1.1.1. Short 1.1.2. Medium 1.1.3. Long	1.2. Bonds without a specific remaining term: 1.2.1. Callable bonds 1.2.2. Puttable bonds 1.2.3. Bonds with the right postpone repayment 1.2.4. Extend bonds
<b>2. Depending on the order of the ownership:</b>	2.1. Registered	2.2. In bearer form
<b>3. Depending on the purpose of the loan:</b>	3.1. Ordinary	3.2. Target
<b>4. According to the character of circulation:</b>	4.1. Convertible	4.2. Non-convertible
<b>5. According to timing of dividend payment</b>	5.1. Coupon	5.2. Zero coupon
<b>6. Depending on the software:</b>	6.1. Collateral bonds	6.2. Bonds without collateral
<b>7. Depending on the source of income:</b>	7.1. Discount bonds	7.2. Interest bonds



## 8.2. Key indicators in assessing bonds



Bond profitability is calculated by dividing the annual interest income at the current market bond price.

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*Bond prices fluctuate in response to changes in interest rate on long-term loans because bond could be sold at a price that exceeds or it is below its face value, depending on what is the interest rate.*

- *If an investor plans to hold the bond until its maturity date, he will not be interested in a change in the market price of the bond over time, because it guaranteed the payment of its face value at maturity date of the bond.*
- *If the investor plans to sell the bond before its maturity date, he will be forced to sell it at the current estimated price, which may differ significantly from the nominal value of the paper as the larger and the smaller side.*

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**Profitability to maturity:**

- *When buying bonds at par value of its profitability to maturity are equal to their current profitability and coupon interest rate,*
- *If the bond is purchased at a premium or discount, its profitability to maturity will be more or less of its current profitability.*
- *In calculating the profitability to maturity takes into account the sum of all interest payments received by the investor after buying the paper to maturity date, as well as possible damage or capital gains, the investor receives at maturity bonds, if the price of purchase and nominal value are not the same.*

**The credit quality of the bonds**

- Determined through appropriation bonds credit rating.
- **Credit rating** is a rating of the issuer reliability and the chances performance of its obligations
- Ratings are assigned **the rating agencies**.

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**Prestigious U.S. rating agencies:**

- A.M. Best Company, Inc.
- DBRS Ltd.
- Egan-Jones Rating Company
- Fitch, Inc.
- Japan Credit Rating Agency, Ltd.
- LACE Financial Corp.
- Moody's Investors Service, Inc.
- Rating and Investment Information, Inc.
- Standard & Poor's Ratings Services.

**Self-assessment bonds:**

- 1. Is the company's revenue sufficient to fulfill contractual obligations to bondholders?  
■ - **Preferably about three times the excess of revenue over liabilities.**
- 2. Is sufficient cash flow to repay the debt? Did turndown fund formed?  
■ - **Situation is considered stable if the fund is 20-30% of the debt**
- 3. The ratio of debt to equity capital  
■ - **Western boundary ratio is 0.5:1**

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# Chapter 9

## Derivative securities in the international market

### Chapter Outline

- 9.1. Derivatives securities: the nature and types
- 9.2. Forward and futures contracts
- 9.3. Option contracts

#### 9.1. Derivatives securities: the nature and types

- *Securities that capture partners` interim law during the transaction are called **derivatives**.*
- *They do not give their holders any ownership or rights to receive income, but certifying the right to buy or sell securities in the future of a species (usually shares).*

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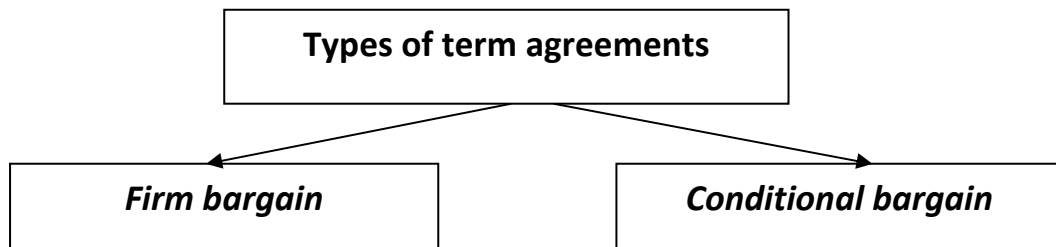
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- *Firm bargains are mandatory for execution (forwards and futures)*
- *Conditional bargains are providing one of the parties of the agreement the right to perform or not to perform it (option agreement).*

**Specific terms:**

- **Opening a long position** - purchase contract
- **Opening a short position** - sale contract
- **Closing position** is an operation opposite to the previous
- **Offset operation** is an agreement which covers the previous operation

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9.2. Forward and futures contracts

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- Agreement which provide the immediate delivery of the asset is called **cash or spot** ("spot" means "available"), and the market for such transactions is called **cash or spot**. Price that arises as a result of making cash (spot) transactions is called **cash or spot**.

**Forward contract:**

- - there is an agreement between the contracting parties on **the future delivery** of the contract subject (asset).
- - it is placed outside the stock exchange.
- - contract terms are stipulated at the time of conclusion of the contract and its performance shall be subject to such conditions within the specified period.

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- Forward contract is concluded usually for making **the real sale or purchase** of the related asset and it is aimed at **insurance** vendor or purchaser against possible adverse changes to it in the market.

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■ *Forward contract cannot be negotiated only for insurance (hedging) against possible losses, but also **to play on the difference in market (foreign exchange) asset price.** In this case, the person who opens a long position (buy contract), looking forward to future growth the asset price and the person who takes a short position (sell contract), relies on decline asset prices.*

**Forward contract:**

- *- It is not standard, i.e. the composition of its terms could be arbitrary, but the same conditions could be uncontrollable.*
- *- It reduces the secondary market of forward contracts.*

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■ *Liquidate their position in a forward contract one party usually has the right **only with the consent of the other party.***

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**Futures contract:**

- *It is concluded only on **Stock Exchange** and it is a standard composition of conditions and procedures for implementation, which develop exchange for each asset.*
- *Futures contracts are liquid and they have a wide aftermarket.*

**Stock Exchange:**

- *The first stock exchange was established in Amsterdam in 1602. Only bonds were in circulation*
- *There are 13 stock exchanges in the United States today*
- *New York Stock Exchange is the biggest exchange. 70% of turnover is selling shares (founded in 1792)*

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- *The United Kingdom has 22 stock exchanges. The biggest one is London Stock Exchange (the second in the world)*
- *France has 8 stock exchanges. The biggest one is the Paris stock exchange*
- *Germany has 7 stock exchanges. The biggest one is in Frankfurt am Main*
- *Japan has 9 exchanges. The biggest one is Tokyo Stock Exchange (third in the world).*

**Stock exchanges are organized as:**

- *- Private Joint Stock Company (USA);*
- *- Public and legal institutions (Germany);*
- *- Securities traders (at least 20) (Ukraine).*

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- *The most common model Stock Exchange - Closed Joint Stock Company - combines equal members who bought a place to do transactions on the exchange. Only members of a joint stock company are allowed to carry out transactions on the stock exchange.*

- *The stock exchange is not a commercial organization and it does not aim to get benefit. Its income is the sale of shares of regular membership fees, exchange fees and penalties. Incomes are used to completely cover the costs for maintenance and development activities of the exchange.*

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**As at 2015 Ukraine has the following stock exchanges:**

- *PJSC "Ukrainian Exchange" (Kyiv)*
- *PJSC "East-European stock exchange" (Kyiv)*
- *PJSC "Stock Exchange" Perspective "(Dnepropetrovsk)*
- *Private JSC "Ukrainian Interbank Currency Exchange" (Kyiv)*
- *Private JSC "Ukrainian International Stock Exchange" (Kyiv)*
- *PJSC "Kyiv International Stock Exchange" (Kyiv)*
- *PJSC "PFTS Stock Exchange" (Kyiv)*
- *Private JSC "Dnieper stock exchange" (Dnepropetrovsk)*
- *Private JSC "Stock Exchange "Inneks" (2006 - JSC" Donetsk Stock Exchange ") (Kyiv)*
- *Private JSC "Ukrainian Stock Exchange" (Kyiv)*

- *Classic Exchange is the auction where trade is conducted through the exchange of verbal instructions between **traders**.*
- *Quickly apply **electronic exchanges**.*
- *Saved some of the traditional ones.*

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**The key concept of stock trading – liquidity**

*A liquid market is characterized by:*

- - *Frequent transaction;*
- - *Narrow the gap between the asking price and the price the buyer;*
- - *Minor fluctuations prices from agreement to agreement.*

**Principles of the Stock Exchange:**

- - *Personal trust (often agreements on the Exchange concluded orally and issued later);*
- - *Transparency (publication of information about all agreements and their contents);*
- - *Strict control over compliance with financial, administrative, sales and accounting rules.*

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*To be able have on exchange their traders, **institutional dealer** has to become a member:*

- - *Apply;*
- - *To prove that management has adequate training;*
- - *Confirm that has sufficient capital for operations;*
- - *Post a message about applying.*

- *After the positive decision of the exchange committee dealer buys a "place."*
- *Buy a place can be in the same exchange (if available) or in existing firms.*
- *Place price determined by supply and demand*

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- *Different committees are created in stock exchange. Two committees are required:*
- **Committee listing** *(considering an application for inclusion of securities to listing)*
- **Committee on the shop floor procedures** *(including administration defining the trade mode).*

■ **Listing** *is a procedure for inclusion of securities in the list of those who publicly traded*

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- Benefits of entering in the listing:**
- *- Investors prestige;*
  - *- Better credit conditions;*
  - *- Excellent visibility of the market;*
  - *- Provides an objective assessment of the value of shares for tax purposes;*
  - *- More attention from potential investors*

- Disadvantages of listing:**
- *- Additional control over the company;*
  - *- Additional costs (exchange listing fee, annual listing fee for support, etc.);*
  - *- Openness of information, which is known not only to potential investors, but also competitors.*

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- Companies requirements for including in the listing:**
- *- profitability (profit margins over the last year profitability during the period);*
  - *- Minimum working capital;*
  - *- Minimum net intangible assets*



## Technology futures trading

- *Futures contracts are by nature speculative. Therefore, the decision sell or buy is not determined by the need for shares of the company, and the forecast change in prices.*
- *If a stock gambler believes that the company's stock price will be greater than the contract price, he buys stocks. If the opposite - he sells them. In this absolutely does not matter if he has these shares or he does not have.*

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- *The agreement of purchase and sale is not concluded between traders and between each of them and Clearing House exchange*
- *"I pledge to buy 100 shares of the N company 25 August 2014 at the price of \$12 per share"*
- *At the conclusion of the contract the buyer pays commissions and **margin**.*
- ***Margin** is a percentage of the transaction value, which is a guarantee of compliance by the buyer / seller contractual terms and conditions*

- *If the shares price is reduced (buyer loses) and the difference between the market price and the contract price exceeds the margin, the buyer within one day should initiate a difference in the clearing house.*
- *In case of violation of the conditions clearinghouse may unilaterally terminate the contract and remove the trader to participate in the exchange.*

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■ *Buyer at any moment could close his position by selling the contract and completing with the Clearing House payments, depending on winning or losing.*

■ *If at the time of the contract the shares price appeared 13 USD, Clearinghouse purchases the buyer's right to purchase the shares for 12 USD, paying him the difference (in this case 100 USD).*

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### 9.3. Option contracts

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■ *The word "option" means a possibility. The choice is given to the buyer of the option.*

■ *The option owner has the right to conduct transactions with securities but he is not required to perform this operation.*

■ *An option is a standard agreement. It indicates the amount of assets, the price of the contract and the date of the transaction*

**Types of options:**

- *call option, i.e. the option to buy (option buyer);*
- *put option, i.e. the option to sell (option seller)*
- *double option, that the buyer chooses the right to sell, or the right to purchase.*

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- Option price is called the premium.
- The buyer of the option has the right; seller of the option has the obligation + bonus.

**Option price (premium) depends on:**

- - supply and demand options;
- - The dynamic of the market price;
- - The time left before the option exercise;
- - The amount of short-term bank percent.

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**Premium includes two price components:**

- - independent value;
- - time value

Option has **independent value** when it makes sense to implement the right of option that is to profit from the right to the option. This option is called "**in the money**"

Option, which currently has no independent value, i.e. the implementation of which will not be earned income, is called "**out of the money**"

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- **Time value** is the amount of money that the option buyer wants to pay more than independent value in the hope that the value of the option will increase due to the price variance of goods.

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# Chapter 10

## Stock market indexes and investment ratings

### Chapter Outline

10.1. Stock market indexes: general concepts and calculation method

10.2. Investment rating agencies and investment ratings

### 10.1. Stock market indexes: general concepts and calculation method

*Stock market index is called a number that characterizes its quality and condition with a rough estimate of the dynamics of the stock market. By itself significance of this number does not have valuable information. It was not exactly the value of that number, and its position to the values that it took before.*

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#### **Sphere of stock indexes using:**

- They are included in system of national economy statement indicators
- They are effective tool for forecasting of the stock marker statement
- They are orienting point for estimation of stock portfolio management efficiency
- They may be base for using different tools of stock market hedging.

#### **Stock indexes may be:**

- international;
- national;
- sectoral;
- subsectoral.

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**International indexes** characterize statement of the world market or its geographical parts (Europe, Asia, etc)  
**National indexes** show national stock market activity  
**Sectoral indexes** reflect statement some parts of national market, for example, marker of the selected shares on the selected stock exchange  
**Subsectoral indexes** characterize activity in selected sphere of economy

**The main specifications of stock indexes:**

- Based level;
- Base;
- Weighting;
- Method of averaging out

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**Based level** is the level of this indicator in the beginning of period  
**Base** is a list of enterprises, which securities are used for calculation of stock indexes  
**Weighting** may use both market prices of stocks and market capitalization  
**Method of averaging out** may be both simple average and geometric average

**The most popular types of stock indexes:**

- Price average indexes;
- Market capitalization weighted indexes

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■ From 1928 till the present time this indicator covers the 30 largest high quality industrial companies of US, stocks behavior which is considered representative for the overall dynamics of the security market. Shares of these companies are called "blue chips».

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**The companies included in the DJIA and ticker symbol**

<b>Ticker symbol</b>	<b>Company name</b>	<b>Ticker symbol</b>	<b>Company name</b>
AA	Alcoa Inc.	IBM	Int'l Business Machines Corp.
AXP	American Express Company	INTC	Intel Corporation
T	AT & T Company	IP	International Paper Co
BA	Boeing Company	JPM	J.P. Morgan Chase & Co
CAT	Caterpillar Inc.	JNJ	Johnson & Johnson
C	Citigroup Inc.	MCD	McDonald's Corporation
KO	Coca-cola Company	MRK	Merck & Co. Inc.
DD	E.I. DuPont de Nemours & Co	MSFT	Microsoft Corporation
EK	Eastman Kodak Company	MMM	3M Co
XOM	Exxon Mobil Corporation	MO	Altria Group Inc.
GE	General Electric Company	PG	Procter & Gamble Co
GM	General Motors Corporation	SBC	SBC Communications Inc.
HPQ	Hewlett-Packard Company	UTX	United Technologies Corp.
HD	Home Depot Inc.	WMT	Wal-Mart Stores Inc.
HON	Honeywell International Inc.	DIS	Walt Disney Company

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**Other Dow Jones Average:**

- 1. *Dow Jones Transportation Average (Dow Jones Transportation Average), the estimated base composed of 20 transport companies.*
- 2. *Dow Jones Utilities Average (Dow Jones Utilities Average), which includes 15 electricity utility companies.*
- 3. *Dow Jones Composite Average (Dow Jones Composite Average), including 65 listed above companies (DJIA-30, DJTA-20, DJUA-15).*

**Stock index S &P 500**

***(Standard and Poor's 500 Composite Stock Price Index)***

- *This index was designed by the famous publisher of financial news corporation Standard and Poor's in the 20's of the last century and initially it consisted of only 90 companies (among the 500 in the name of the index did not yet exist).*
- *In its present form it was formed in 1957.*
- *Unlike Dow Jones Average in calculating the S & P 500 are counted as equity prices included in the assessment base and the number of shares of each company that are traded on the market, and the resulting value is correlated with the base index value (equal to 10) calculated for the period of 1941-1943 years.*

***Composite index of the market shares of NASDAQ  
( National Association of Securities Dealers  
Automated Quotation Index)***

- *It is the youngest of the listened above indexes. It was developed in February 1971. The method of calculation is identical to calculating the S & P 500. According base equal to 100, the value of shares taken on February 5, 1971.*

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**Composite index of New York Stock Exchange NYSE**

- *Published from July 14, 1966. Includes all companies which defined in this exchange. Unlike the previously discussed indexes measured in dollars. Calculated on the basis of cost and the number of shares issued. The baseline value is equal to 50 adopted value of shares defined on the New York Stock Exchange, the 31.12.65*

**Russell 3000 (Russell 3,000 index):**

- *includes 3,000 companies with the highest value of shares (share price multiplied by number). This index, developed in 1984 by Frank Russell, reflects 98% of the total capital invested in the U.S. equity market.*
- *Index Russell 3000 is divided into two major indices: Russell 1000 and Russell 2000.*
- *Russell 1000 includes 1,000 companies with the highest value of shares, which account for about 92% of the total capitalization of the companies included in the Russell 3000.*
- *Russell 2000 covers the last 2,000 companies. Russell 2000 is a very important index for investors. It is used to analyze the behavior of stocks compared small companies.*

**Wilshire-5000**

- *The index has appeared in 1974 and since has become quite famous because it regularly published in many reputable media outlets, including «The Forbes», «The Barren's», «The Wall Street Journal» and others. It represents the total cost of 5000 share issues (in billions of dollars.) With the highest sales volume in the stock markets, including all shares that are traded on the New York and American stock exchanges, and the most active stocks over-the-counter trading.*

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# Chapter 11

## International portfolio management

### Chapter Outline

- 11.1. A portfolio of international investments: passive and active approaches
- 11.2. Typification of investment portfolios
- 11.3. Formation of financial investment portfolio based on modern portfolio theory
- 11.4. Operational management restructuring portfolio of financial investments

### 11.1. A portfolio of international investments: passive and active approaches

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#### ***Sequences structure formation of international investment portfolio:***

- ***Country (currency) - types of investments and their subtypes (e.g., types of securities) - specific investment (e.g., specific securities);***
- ***Types (subspecies) of investments - country (currency) - specific securities (investment);***
- ***Types (subspecies) of investment securities - specific investments (securities) - country (currency);***
- ***Specific securities - country (currency).***

#### ***Options for purpose entity of IIA:***

- ***- Getting quality (yield and risk), which is close to the quality of the portfolio the structure of which corresponds to the structure of the relevant market capitalization;***
- ***- Getting yield higher than yield of the market portfolio;***
- ***- Providing risk which is lower than risk of the market portfolio.***

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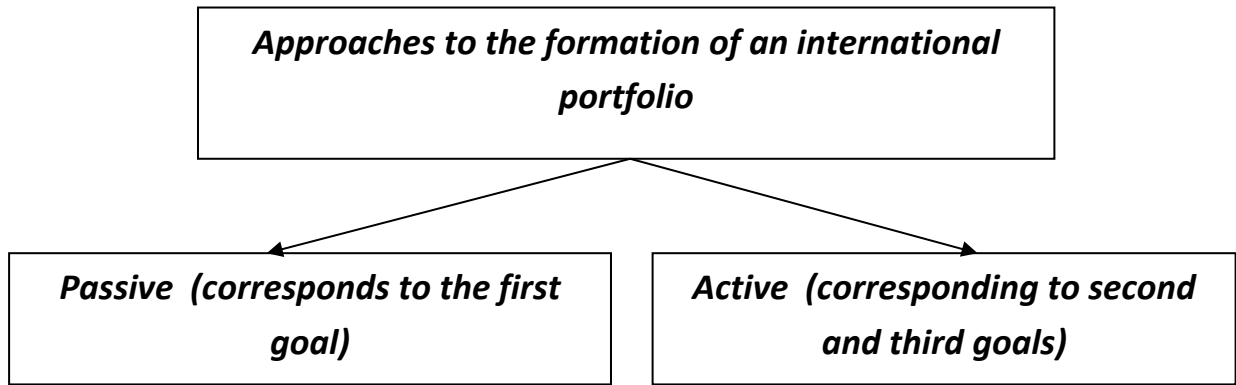
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- Principles of risk management approach**
- Do not perform any action counting on favorable situation;
  - Diversify investments by country, by assets, by economic sectors and by securities;
  - Increase the proportion of investments in non-risky assets (e.g. government securities);
  - Choose less risky assets and currency investments based on forecast quality;
  - Implementation of special measures to protect against adverse changes in assets and / or exchange rate.

### 11.2. Typification of investment portfolios

<b>1. For the purposes of forming investment income</b>	■ portfolio income
	■ portfolio growth

■ *Portfolio income is investment portfolio formed by the criterion of maximizing the investment income in the current period, regardless of the rate of growth of invested capital in the long run.*

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■ *Portfolio growth is investment portfolio formed by the criterion of maximizing the rate of growth of invested capital in the long term future regardless of the formation of investment income in the current period.*

<b>2. By level of the taken risks</b>	■ aggressive (speculative) portfolio;
	■ moderate (compromise) portfolio
	■ conservative portfolio

■ **Aggressive (speculative) portfolio** is investment portfolio formed by the criterion of maximizing current income and growth of capital invested, regardless of concomitant level of investment risk.

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■ **Moderate (compromise) portfolio** is formed aggregate investment of financial instruments for which the overall portfolio risks close to the average.

■ **Conservative portfolio** is an investment portfolio, formed by the criterion of minimizing investment risk level.

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<b>3. By level of liquidity</b>	■ highly liquid portfolio;
	■ medium liquid portfolio;
	■ low liquid portfolio.

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<b>4. By the investment period</b>	■ - short run portfolio;
	■ - long run portfolio.

<b>5. Under the taxation terms of investment income</b>	■ taxable portfolio;
	■ portfolio, free from taxation.

<b>6. By the stable structure of the main types of financial investment tools</b>	■ portfolio structure fixed assets;
	■ portfolio of flexible structure assets.

<b>7. By specializing main types of financial investment tools</b>	■ stocks portfolio;
	■ bonds portfolio;
	■ bills portfolio;
	■ international investments portfolio;
	■ deposit fee portfolio;
	■ portfolio of other forms of specialization.



■ **The traditional approach to portfolio** is forming primarily uses instruments of technical and fundamental analysis and suggests the inclusion of a variety of types of financial investment tools, providing its broad sectoral diversification

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■ **Modern Portfolio Theory** (D. Tobin, W. Sharp) is based on statistical methods optimization mechanism formed investment portfolio, given the criteria value of its expected return and risk.

**The profitability rate of the portfolio is calculated as follows:**

$$PLp = \sum_i^n = 1(Pli \times Li)$$

- where  $Plp$  - profitability level of the investment portfolio;
- $PLi$ — profitability level of certain financial instruments in the portfolio;
- $Li$  - the proportion of certain financial instruments in an aggregate value of the investment portfolio, expressed in decimal fraction.

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**The level of risk of the portfolio is calculated as follows:**

$$RLp = \sum_i^n = 1(LSRi \times Li) + LURp$$

- where  $RLp$  — risk level of investment portfolio;
- $LSRi$  — level of systematic risk of certain financial instruments (measured by beta coefficient);
- $Li$  - the proportion of certain financial instruments in an aggregate value of the investment portfolio, expressed in decimal fraction;
- $LURp$  — unsystematic risk portfolio level achieved in the process of diversification.

- *The investment portfolio that is consistent with the objectives of its establishment as the type and composition included in the financial instruments it represents a "balanced starting investment portfolio."*

#### 11.4. Operational management restructuring portfolio of financial investments

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*Under **the operational management restructuring** of a portfolio of financial investments is understood justification and implementation of management decisions, providing support to target investment portfolio orientation formed the parameters of its profitability, risk and liquidity by rotation of some of its tools.*

#### **Stages of the operational management process**

##### **1. Organization of continuous monitoring conditions of economic development and investment market conditions in terms of its individual segments**

- *In order to monitor the focus should be given to identify the **dynamics of the factors influencing the decline in profitability, risk and liquidity of financial instruments that are part of a portfolio of businesses.***

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- *The evaluation results are the basis for management decisions and directions about the need to restructure the portfolio of financial investments*

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**3. Choosing fundamental approaches to operational restructuring portfolio of financial investments of the company**

- *A **passive approach** to portfolio management based on the principle of "passage in the fairway of the market."*
- *In most passive approach reflects the mentality of the conservative type of portfolio formation.*

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- *An **active approach** to portfolio management based on the principle of "proactive market."*
- *In most proactive approach to portfolio management reflects the aggressive mentality of its formation.*

**4. The restructuring of the portfolio by major types of financial investment tools:**

- *A permanent (fixed) or variable (flexible) ratio speculative and conservative parts of a portfolio of financial investments*

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**5. Restructuring for specific kinds of financial investment tools**

- *Methods such a fundamental restructuring of the portfolio determined approach to its management.*

**6. Timing of restructuring transactions portfolio of financial investments**

- *The principle of determining the time of such agreements (known as the "golden rule of investment") embedded in the formula - "buy cheap, sell expensive."*

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**7. Justification alternative orders to broker transactions, providing portfolio restructuring**

- *There are two basic types of orders to broker transactions that provide Restructuring - "market" and "limit".*

Навчальне видання

**Задоя Анатолій Олександрович**

## **МІЖНАРОДНА ІНВЕСТИЦІЙНА ДІЯЛЬНІСТЬ**

Навчальний посібник

(англійською мовою)

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