

THE FUNCTION OF SECURITIES MARKETS

Financial marketplaces for stocks and bonds serve two major functions:

1. Assist businesses in finding long-term funding for capital needs. Ex. Expanding operation, developing new products, buying major goods or services
2. Provide private investors a place to buy securities (investments) such as stocks and bonds that can help them build their financial future.

Divided into two different markets:

1. **Primary Markets** handle the sale of new securities (stocks). The firm makes money when the selling securities on the primary market.
Initial public offering—First public offering of corporation’s stock.
2. **Secondary Markets** handles the trading of the securities between investors, with the proceeds of the sale going to the investor selling the stock, not to the corporations whose stock is sold. Ex. Buying a stock for \$10 and it grows to \$15 and deciding to sell the stock to another investor.

ROLES OF INVESTMENT BANKERS

Investment Bankers: Specialists who assist in the issue and sale of new securities.

Institutional Investors: Large organizations—such as pension funds, and insurance companies—that invest their own funds or funds of others. These types of investors are a powerful force in securities markets because of their vast buying power.

STOCK EXCHANGES

An organization whose members can buy and sell (exchange) securities for companies and individual investors.

Over-the-Counter Market (OTC)

Exchange that provides a means to trade stocks not listed on the national exchanges

Securities and Exchange Commission (SEC)

The Federal agency that has responsibility for regulating the various stock exchanges. Started in 1933 to help protect investors by requiring full disclosure of financial information by firms selling bonds or stock.

NASDAQ

A telecommunications network that links dealers across the nation so that they can buy and sell securities electronically rather than in person. It is the largest U.S. electronic stock trading market.

Prospectus: A condensed version of economic and financial information that a company must file with the SEC before issuing stock; the prospectus must be sent to prospective investors.



HOW BUSINESS RAISE CAPITAL BY SELLING STOCK

Stock: Shares of ownership in a company

Stock Certificate: Evidence of stock ownership that specifies the name of the company, the number of shares it represents, and the type of stock being issued.

Dividends: Part of a firm’s profits that the firm may distribute to stockholders as either cash payments or additional shares of stock.

ADVANTAGES OF SELLING STOCK

1. Stockholders never have to be repaid for their investment
2. No legal obligation to pay dividends to stockholders thus allowing a firm to reinvest their profits back in the firm
3. Improves the firm’s balance sheet since issuing stock creates no debt.

DISADVANTAGES OF SELLING STOCK

1. Alters the control of the firm as far as ownership and who has a say.
2. If or when a firm issues dividends, they are going to be not-tax deductible.
3. The need to make stockholders happy can affect management decisions.

Common Stock

The most basic form of ownership in a firm; it confers voting right and the right to share in the firm’s profits through dividends, if approved by the firm’s board of directors.

Preferred Stock

Stock that gives its owners preference in the payment of dividends and an earlier claim on assets than common stockholders if the company is forced out of business and its assets sold.

HOW BUSINESS RASIE CAPITAL BY ISSUING BONDS

Bond: A corporate certificate indicating that a person has lent money to a firm (or a government)

Maturity Date: The exact date the issuer of a bond must pay the principal to the bondholder.

Interest: The payment the issuer of the bond makes to the bondholders for use of the borrowed money.

Advantages of Issuing Bonds

1. Bondholders seldom vote on corporate matters; thus, management maintains control over the firms operations.
2. Bond interest is tax-deductible to a firm
3. They are only a temporary source of funding. They’re eventually repaid and the debt obligation is eliminated.
4. Bonds could be repaid before the maturity date and also could be converted into common stock.

Disadvantages of Issuing Bonds

1. Bonds increase debt (long-term liabilities) and may adversely affect the market’s perception of the firm.
2. Paying interest on bonds is a legal obligation. If interest is not paid, bondholders can take legal action to force payment.
3. Face value must be repaid on the maturity date. Without careful planning, this obligation can cause flow problems when repayment comes due.

Debenture Bonds: Bonds that are unsecured (I.E. not backed by any collateral such as equipment).

Sinking Fund: A reserve account in which the issuer of a bond periodically retires some part of the bond principal prior to maturity so that enough capital will be accumulated by the maturity date to pay off the bond.