Stocks and Shares

Stocks, shares and equities

Stocks and shares are certificates representing part ownership of a company. The people who own them are called **stockholders** and **shareholders**. In Britain, stock is also used to refer to all kinds of securities, including government bonds. (See Unit 33) The word **equity** or **equities** is also used to describe stocks and shares. The places where the stocks and shares of **listed** or **quoted** companies are bought and sold are called **stock markets** or **stock exchanges**.

Going public

A successful existing company wants to expand, and decides to **go public**.

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The company gets advice from an investment bank about how many shares to offer and at what price.

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The company gets independent accountants to produce a **due diligence** report.

go public: change from a private company to a public limited company (PLC) by selling shares to outside investors for the first time (with a flotation)

due diligence: a detailed examination of a company and its financial situation

The company produces a **prospectus** which explains its financial position, and gives details about the senior managers and the **financial results** from previous years.

The company makes a **flotation** or **IPO** (initial public offering).

An investment bank **underwrites** the stock issue.

prospectus: a document inviting the public to buy shares, stating the terms of sale and giving information about the company

financial results: details about sales, costs, debts, profits, losses, etc. (See Units 11–14)

flotation: an offer of a company's shares to investors (financial institutions and the general public)

underwrites a stock issue: guarantees to buy the shares if there are not enough other buyers

BrE: ordinary shares; AmE: common stock

Ordinary and preference shares

If a company has only one type of share these are **ordinary shares**. Some companies also have **preference shares** whose holders receive a **fixed dividend** (e.g. 5% of the shares' nominal value) that must be paid before holders of ordinary shares receive a dividend. Holders of preference shares have more chance of getting some of their capital back if a company **goes bankrupt** – stops trading because it is unable to pay its debts. If the company **goes into liquidation** – has to sell all its assets to repay part of its debts – holders of preference shares are repaid before other shareholders, but after owners of bonds and other debts. If shareholders expect a company to grow, however, they generally prefer ordinary shares to preference shares, because the dividend is likely to increase over time.

Match the words in the box with the definitions below. Look at A, B and C opposite to help you.

bankrupt	prospectus
going public	ordinary shares
flotation	preference shares
investors	stock exchange
liquidation	to underwrite

1. a document describing a company and offering stocks for sale
2. a market on which companies' stocks are traded
3. buyers of stocks
4. changing from a private company to a public one, quoted on a stock exchange
5. the first sale of a company's stocks to the public
6. to guarantee to buy newly issued shares if no one else does
7. shares that pay a guaranteed dividend
8. the most common form of shares
9. insolvent, unable to pay debts
10. the sale of the assets of a failed company

Are the following statements true or false? Find reasons for your answers in A, B and C opposite.

1 New companies can apply to join a stock exchange.
2 Investment banks sometimes have to buy some of the stocks in an IPO.
3 The due diligence report is produced by the company's own accountants.
4 The dividend paid on preference shares is variable.
5 If a company goes bankrupt, the first investors to get any money back are the holders of preference shares.

Make word combinations using a word or phrase from each box. Then use the correct forms of the word combinations to complete the sentences below. Look at A, B and C opposite to help you.

offer go produce underwrite	an issue a prospectus shares public

After three very profitable years, the company is planning to (1) .... (2) .... and we're (3) .... 100,000 (4) .... for sale. We've (5) .... a very attractive (6) .... , and although a leading investment bank is (7) .... the (8) .... , we don't think they'll have to buy any of the shares.

Buying and selling shares

After newly issued shares have been sold (usually by investment banks) for the first time – this is called the **primary market** – they can be repeatedly traded at the stock exchange on which the company is listed, on what is called the **secondary market**.

Major stock exchanges, such as New York and London, have a lot of requirements about publishing financial information for shareholders. Most companies use **over-the-counter** (OTC) markets, such as NASDAQ in New York and the Alternative Investment Market (AIM) in London, which have fewer regulations.

The **nominal value** of a share – the price written on it – is rarely the same as its **market price** – the price it is currently being traded at on the stock exchange. This can change every minute during trading hours, because it depends on **supply** and **demand** – how many sellers and buyers there are. Some stock exchanges have computerized **automatic trading systems** that match up buyers and sellers. Other markets have **market makers**: traders in stocks who quote **bid** (buying) and **offer** (selling) prices. The **spread** or difference between these prices is their profit or **mark-up**. Most customers **place** their buying and selling orders with a **stockbroker**: someone who trades with the market makers.

New share issues

Companies that require further capital can issue new shares. If these are offered to existing shareholders first this is known as a **rights issue** – because the current shareholders have the first right to buy them. Companies can also choose **to capitalize** part of their profit or retained earnings. This means turning their profits into capital by issuing new shares to existing shareholders instead of paying them a dividend. There are various names for this process, including **scrip issue, capitalization issue** and **bonus issue.** Companies with surplus cash can also choose to buy back some of their shares on the secondary market. These are then called **own shares.**

BrE: own shares;
AmE: treasury stock

Categories of stocks and shares

Investors tend to classify the stocks and shares available in the **equity markets** in different categories.

- **Blue chips**: Stocks in large companies with a reputation for quality, reliability and profitability. More than two-thirds of all blue chips in industrialized countries are owned by institutional investors such as insurance companies and pension funds.
- **Growth stocks**: Stocks that are expected to regularly rise in value. Most technology companies are growth stocks, and don't pay dividends, so the shareholders' equity or owners' equity increases. This causes the stock price to rise. (See Unit 11)
- **Income stocks**: Stocks that have a history of paying consistently high dividends.
- **Defensive stocks**: Stocks that provide a regular dividend and stable earnings, but whose value is not expected to rise or fall very much.
- **Value stocks**: Stocks that investors believe are currently trading for less than they are worth – when compared with the companies' assets.

Match the words in the box with the definitions below. Look at A and B opposite to help you.

to capitalize	market price	primary market	own shares
rights issue	secondary market	nominal value	

1 new shares offered to existing shareholders
2 the price written on a share, which never changes
3 to turn profits into stocks or shares
4 the market on which shares can be re-sold
5 the price at which a share is currently being traded
6 shares that companies have bought back from their owners
7 the market on which new shares are sold

Are the following statements true or false? Find reasons for your answers in A and B opposite.

1 Stocks that have already been bought at least once are traded on the primary market.
2 NASDAQ and the AIM have more regulations than the New York Stock Exchange and the London Stock Exchange.
3 The market price of stocks depends on how many buyers and sellers there are.
4 Automatic trading systems do not require market makers.
5 Market makers make a profit from the difference between their bid and offer prices.

Complete the sentences. Look at B and C opposite to help you.

1. A stock whose price has suddenly fallen a lot after a company had bad news could be a .... , as it will probably rise again.

2. The stocks of food, tobacco and oil companies are usually .... , as demand doesn't rise or fall very much in periods of economic expansion or contraction.

3. Pension funds and insurance companies, which can't take risks, usually only invest in ....

4. The best way to make a profit in the long term is to invest in ....

5. This stock used to be considered an .... , but two years ago the company started to cut its dividend and reinvest its cash in the business.

6. The financial director announced a forthcoming .... of new shares to existing shareholders.

7. The company is planning a .... of one additional share for every three existing shares.

8. We have bought back 200,000 ordinary shares, which increases the value of our .... to €723,000.

Over to you

If you had a lot of money to invest in stocks, what kind of stocks would you buy, and why?