

7.2 SOME FEATURES OF COMMON AND PREFERRED STOCK

In discussing common stock features, we focus on shareholder rights and dividend payments. For preferred stock, we explain what "preferred" means, and we also debate whether preferred stock is really debt or equity.

Common Stock Features

The term **common stock** means different things to different people, but it is usually applied to stock that has no special preference either in paying dividends or in bankruptcy.

common stock
Equity without priority for dividends or in bankruptcy.

Shareholder Rights The conceptual structure of the corporation assumes that shareholders elect directors who, in turn, hire management to carry out their directives. Shareholders, therefore, control the corporation through the right to elect the directors. Generally, only shareholders have this right.

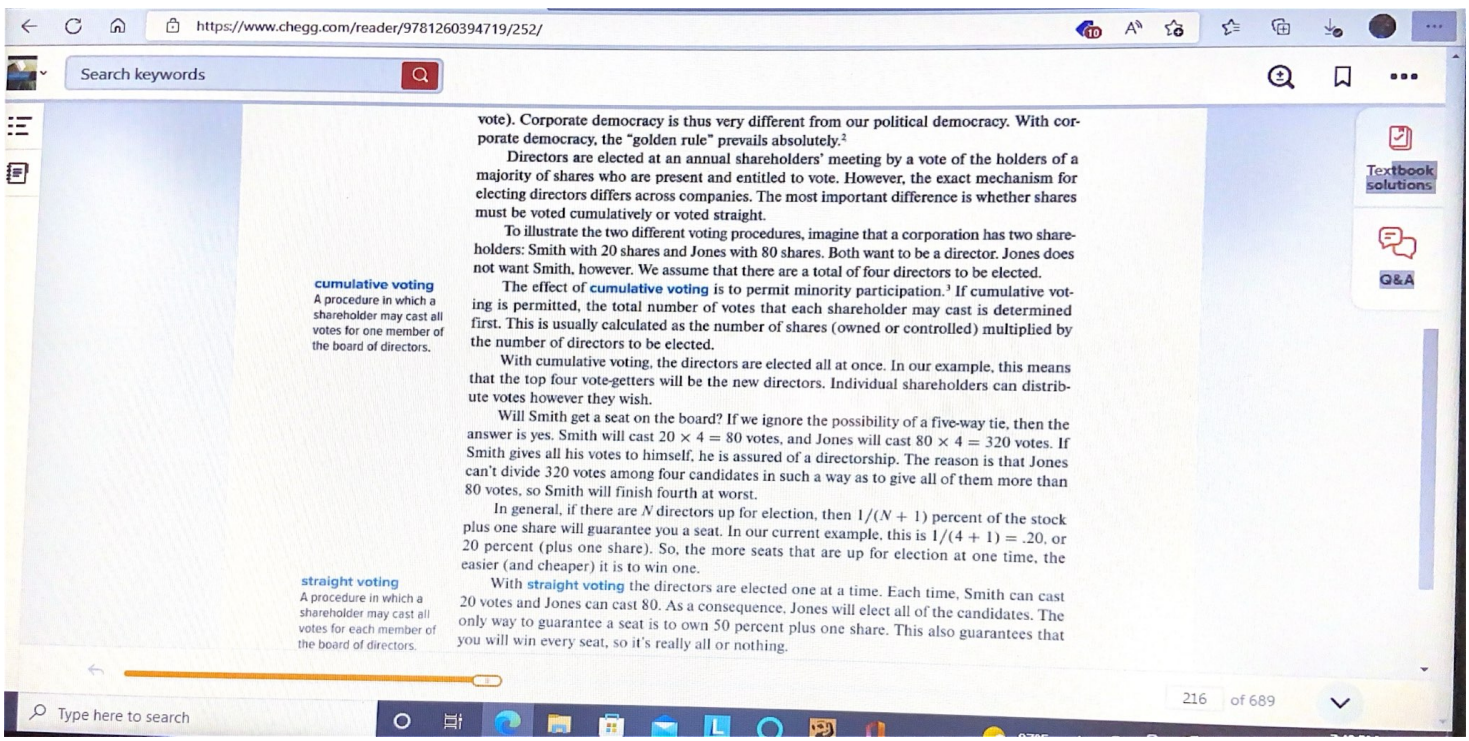
Directors are elected each year at an annual meeting. Although there are exceptions (discussed in a moment), the general idea is "one share, one vote" (*not one shareholder, one vote*). Corporate democracy is thus very different from our political democracy. With corporate democracy, the "golden rule" prevails absolutely.²

Directors are elected at an annual shareholders' meeting by a vote of the holders of a majority of shares who are present and entitled to vote. However, the exact mechanism for electing directors differs across companies. The most important difference is whether shares must be voted cumulatively or voted straight.

To illustrate the two different voting procedures, imagine that a corporation has two shareholders: Smith with 20 shares and Jones with 80 shares. Both want to be a director. Jones does not want Smith, however. We assume that there are a total of four directors to be elected.

The effect of **cumulative voting** is to permit minority participation.³ If cumulative voting is permitted, the total number of votes that each shareholder may cast is determined

cumulative voting
A procedure in which a



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The effect of **cumulative voting** is to permit minority participation.³ If cumulative voting is permitted, the total number of votes that each shareholder may cast is determined first. This is usually calculated as the number of shares (owned or controlled) multiplied by the number of directors to be elected.

With cumulative voting, the directors are elected all at once. In our example, this means that the top four vote-getters will be the new directors. Individual shareholders can distribute votes however they wish.

Will Smith get a seat on the board? If we ignore the possibility of a five-way tie, then the answer is yes. Smith will cast $20 \times 4 = 80$ votes, and Jones will cast $80 \times 4 = 320$ votes. If Smith gives all his votes to himself, he is assured of a directorship. The reason is that Jones can't divide 320 votes among four candidates in such a way as to give all of them more than 80 votes, so Smith will finish fourth at worst.

In general, if there are N directors up for election, then $1/(N + 1)$ percent of the stock plus one share will guarantee you a seat. In our current example, this is $1/(4 + 1) = .20$, or 20 percent (plus one share). So, the more seats that are up for election at one time, the easier (and cheaper) it is to win one.

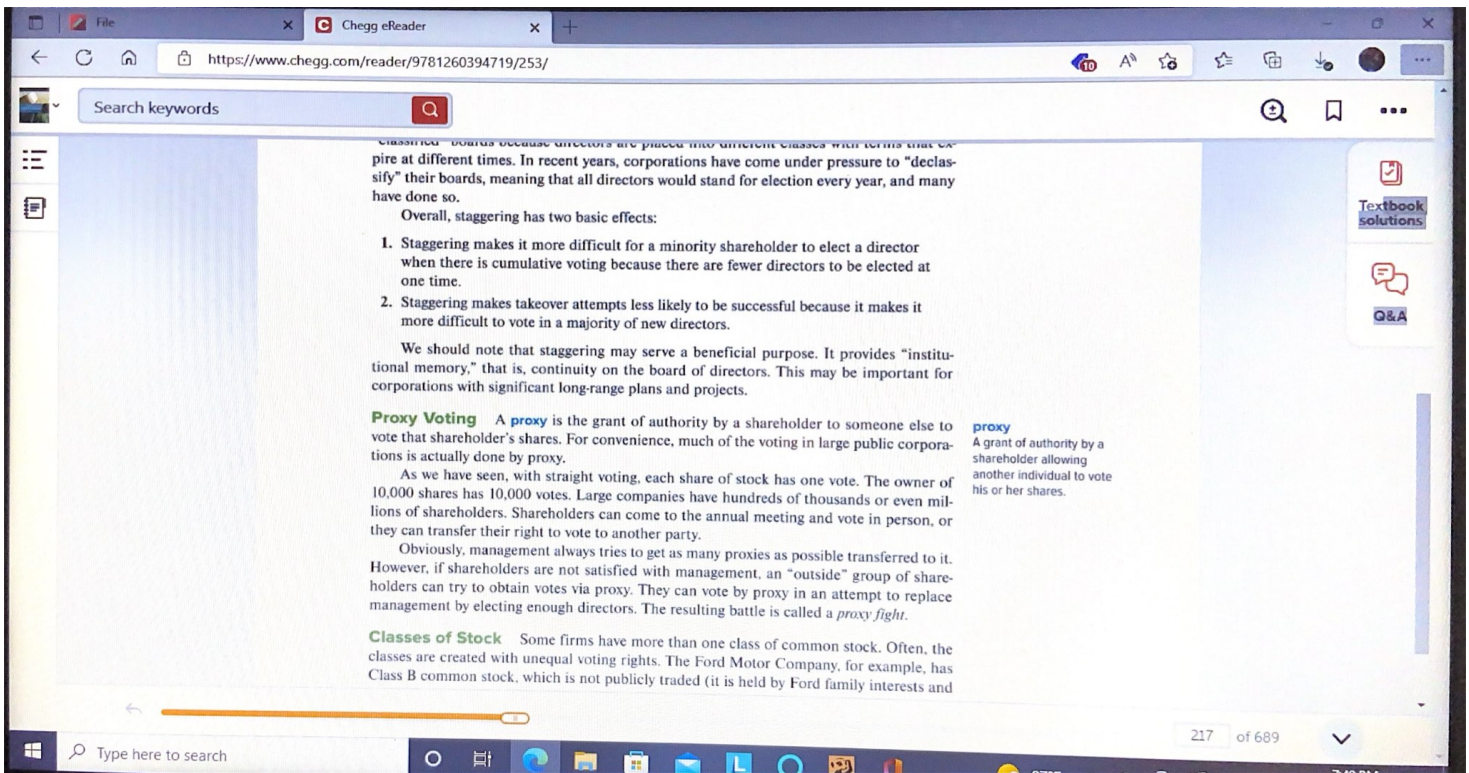
With **straight voting** the directors are elected one at a time. Each time, Smith can cast 20 votes and Jones can cast 80. As a consequence, Jones will elect all of the candidates. The only way to guarantee a seat is to own 50 percent plus one share. This also guarantees that you will win every seat, so it's really all or nothing.

cumulative voting
A procedure in which a shareholder may cast all votes for one member of the board of directors.

straight voting
A procedure in which a shareholder may cast all votes for each member of the board of directors.

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classified boards because directors are placed into different classes with terms that expire at different times. In recent years, corporations have come under pressure to "declassify" their boards, meaning that all directors would stand for election every year, and many have done so.

Overall, staggering has two basic effects:

1. Staggering makes it more difficult for a minority shareholder to elect a director when there is cumulative voting because there are fewer directors to be elected at one time.
2. Staggering makes takeover attempts less likely to be successful because it makes it more difficult to vote in a majority of new directors.

We should note that staggering may serve a beneficial purpose. It provides "institutional memory," that is, continuity on the board of directors. This may be important for corporations with significant long-range plans and projects.

Proxy Voting A proxy is the grant of authority by a shareholder to someone else to vote that shareholder's shares. For convenience, much of the voting in large public corporations is actually done by proxy.

As we have seen, with straight voting, each share of stock has one vote. The owner of 10,000 shares has 10,000 votes. Large companies have hundreds of thousands or even millions of shareholders. Shareholders can come to the annual meeting and vote in person, or they can transfer their right to vote to another party.

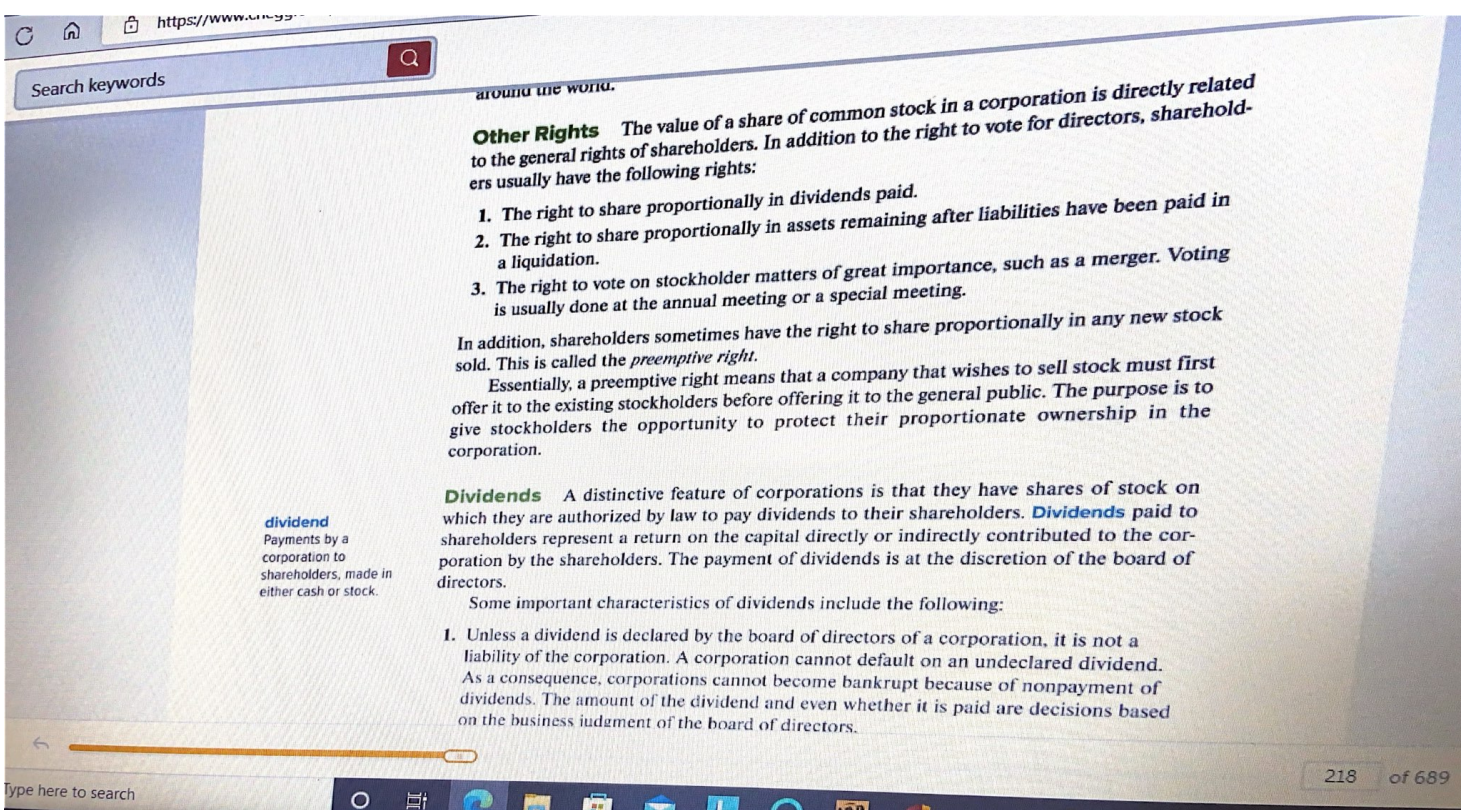
Obviously, management always tries to get as many proxies as possible transferred to it. However, if shareholders are not satisfied with management, an "outside" group of shareholders can try to obtain votes via proxy. They can vote by proxy in an attempt to replace management by electing enough directors. The resulting battle is called a *proxy fight*.

Classes of Stock Some firms have more than one class of common stock. Often, the classes are created with unequal voting rights. The Ford Motor Company, for example, has Class B common stock, which is not publicly traded (it is held by Ford family interests and

proxy
A grant of authority by a shareholder allowing another individual to vote his or her shares.

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dividend
Payments by a corporation to shareholders, made in either cash or stock.

Dividends A distinctive feature of corporations is that they have shares of stock on which they are authorized by law to pay dividends to their shareholders. **Dividends** paid to shareholders represent a return on the capital directly or indirectly contributed to the corporation by the shareholders. The payment of dividends is at the discretion of the board of directors.

Some important characteristics of dividends include the following:

1. Unless a dividend is declared by the board of directors of a corporation, it is not a liability of the corporation. A corporation cannot default on an undeclared dividend. As a consequence, corporations cannot become bankrupt because of nonpayment of dividends. The amount of the dividend and even whether it is paid are decisions based on the business judgment of the board of directors.

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2. The payment of dividends by the corporation is not a business expense. Dividends are not deductible for corporate tax purposes. In short, dividends are paid out of the corporation's aftertax profits.
3. Dividends received by individual shareholders are taxable. In 2018, the tax rate was 15 to 20 percent. However, corporations that own stock in other corporations are permitted to exclude 50 percent of the dividend amounts they receive and are taxed on only the remaining 50 percent (the 50 percent exclusion was reduced from 70 percent by the Tax Cuts and Jobs Act of 2017).⁴

Preferred Stock Features

Preferred stock differs from common stock because it has preference over common stock in the payment of dividends and in the distribution of corporation assets in the event of liquidation. *Preference* means only that the holders of the preferred shares must receive a dividend (in the case of an ongoing firm) before holders of common shares are entitled to anything.

Preferred stock is a form of equity from a legal and tax standpoint. It is important to note, however, that holders of preferred stock sometimes have no voting privileges.

Stated Value Preferred shares have a stated liquidating value, usually \$100 per share. The cash dividend is described in terms of dollars per share. For example, General Motors "\$5 preferred" easily translates into a dividend yield of 5 percent of stated value.

Cumulative and Noncumulative Dividends A preferred dividend is not like interest on a bond. The board of directors may decide not to pay the dividends on preferred shares, and their decision may have nothing to do with the current net income of the corporation.

Dividends payable on preferred stock are either *cumulative* or *noncumulative*; most are cumulative. If preferred dividends are cumulative and are not paid in a particular year, they

preferred stock
Stock with dividend priority over common stock, normally with a fixed dividend rate, sometimes without voting rights.

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Dividends payable on preferred stock are either *cumulative* or *noncumulative*; most are cumulative. If preferred dividends are cumulative and are not paid in a particular year, they will be carried forward as an *arrearage*. Usually, both the accumulated (past) preferred dividends and the current preferred dividends must be paid before the common shareholders can receive anything.

Unpaid preferred dividends are not debts of the firm. Directors elected by the common shareholders can defer preferred dividends indefinitely. However, in such cases, common shareholders also must forgo dividends. In addition, holders of preferred shares are often granted voting and other rights if preferred dividends have not been paid for some time. For example, at one point, US Airways had failed to pay dividends on one of its preferred stock issues for six quarters. As a consequence, the holders of the shares were allowed to nominate two people to represent their interests on the airline's board. Because preferred stockholders receive no interest on the accumulated dividends, some have argued that firms have an incentive to delay paying preferred dividends, but, as we have seen, this may mean sharing control with preferred stockholders.

Is Preferred Stock Really Debt? A good case can be made that preferred stock is really debt in disguise, a kind of equity bond. Preferred shareholders are only entitled to receive a stated dividend, and, if the corporation is liquidated, preferred shareholders are only

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entitled to the stated value of their preferred shares. Often, preferred stocks carry credit ratings much like those of bonds. Furthermore, preferred stock is sometimes convertible into common stock, and preferred stocks are often callable.

In addition, in recent years, many new issues of preferred stock have had obligatory sinking funds. The existence of such a sinking fund effectively creates a final maturity because it means that the entire issue ultimately will be retired. For these reasons, preferred stock seems to be a lot like debt. However, for tax purposes, preferred dividends are treated like common stock dividends.

CONCEPT QUESTIONS

- 7.2a What is a proxy?
- 7.2b What rights do stockholders have?
- 7.2c Why is preferred stock called preferred?

7.3 THE STOCK MARKETS



primary market

The market in which new securities are originally sold to investors.

secondary market

The market in which previously issued securities are traded

Back in Chapter 1, we very briefly mentioned that shares of stock are bought and sold on various stock exchanges, the two most important of which are the New York Stock Exchange and the NASDAQ. From our earlier discussion, recall that the stock market consists of a **primary market** and a **secondary market**. In the primary, or new-issue, market, shares of stock are first brought to the market and sold to investors. In the secondary market, existing shares are traded among investors.

In the primary market, companies sell securities to raise money. We will discuss this process in detail in a later chapter. We therefore focus mainly on secondary market activity in this section. We conclude with a discussion of how stock prices are quoted in the financial press.



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primary market
The market in which new securities are originally sold to investors.

secondary market
The market in which previously issued securities are traded among investors.

dealer
An agent who buys and sells securities from inventory.

broker
An agent who arranges security transactions among investors.

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Dealers and Brokers

Because most securities transactions involve dealers and brokers, it is important to understand exactly what is meant by the terms *dealer* and *broker*. A **dealer** maintains an inventory and stands ready to buy and sell at any time. In contrast, a **broker** brings buyers and sellers together but does not maintain an inventory. Thus, when we speak of used car dealers and real estate brokers, we recognize that the used car dealer maintains an inventory, whereas the real estate broker does not.

In the securities markets, a dealer stands ready to buy securities from investors wishing to sell them and sell securities to investors wishing to buy them. Recall from our previous chapter that the price the dealer is willing to pay is called the bid price. The price at which the dealer will sell is called the ask price (sometimes called the asked, offered, or offering price). The difference between the bid and ask prices is called the spread, and it is the basic source of dealer profits.

Dealers exist in all areas of the economy, not just the stock markets. For example, your local college bookstore is probably both a primary and a secondary market textbook dealer. If you buy a new book, this is a primary market transaction. If you buy a used book, this is a secondary market transaction, and you pay the store's ask price. If you sell the book back, you receive the store's bid price, often half of the ask price. The bookstore's spread is the difference between the two prices.

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In contrast, a securities broker arranges transactions between investors, matching investors wishing to buy securities with investors wishing to sell securities. The distinctive characteristic of security brokers is that they do not buy or sell securities for their own accounts. Facilitating trades by others is their business.

Organization of the NYSE

The New York Stock Exchange, or NYSE, popularly known as the Big Board, was founded in 1792. It has occupied its current location on Wall Street since the turn of the twentieth century. Measured in terms of dollar volume of activity and the total value of shares listed, it is the largest stock market in the world.

Members Historically, the NYSE had 1,366 exchange members. Prior to 2006, the exchange members were said to own "seats" on the exchange, and, collectively, the members of the exchange were also the owners. For this and other reasons, seats were valuable and were bought and sold fairly regularly. Seat prices reached a record \$4 million in 2005.

member
As of 2006, a member is the owner of a trading license on the NYSE.

In 2006, all of this changed when the NYSE became a publicly owned corporation called NYSE Group, Inc. Naturally, its stock is listed on the NYSE. Now, instead of purchasing seats, exchange members must purchase trading licenses, the number of which is limited to 1,366. In 2018, a license would set you back a cool \$50,000—per year. Having a license entitles you to buy and sell securities on the floor of the exchange. Different members play different roles in this regard.

On April 4, 2007, the NYSE grew even larger when it merged with Euronext to form NYSE Euronext. Euronext was a stock exchange in Amsterdam, with subsidiaries in Belgium, France, Portugal, and the United Kingdom. With the merger, NYSE Euronext became the world's "first global exchange." Further expansion occurred in 2008 when NYSE Euronext merged with the American Stock Exchange. Then, in November 2013, the acquisition of NYSE Euronext by Intercontinental Exchange (ICE) was completed.

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As we briefly describe how the NYSE operates, keep in mind that other markets owned by NYSE Euronext and ICE may function differently. What makes the NYSE somewhat unique is that it is a *hybrid market*. In a hybrid market, trading takes place both electronically and face-to-face.

With electronic trading, orders to buy and orders to sell are submitted to the exchange. Orders are compared by a computer and whenever there is a match, the orders are executed with no human intervention. Most trades on the NYSE occur this way. For orders that are not handled electronically, the NYSE relies on its license holders. There are three different types of license holders, **designated market makers (DMMs)**, **floor brokers**, and **supplemental liquidity providers (SLPs)**, and we now discuss the role played by each.

The DMMs, formerly known as "specialists," act as dealers in particular stocks. Typically, each stock on the NYSE is assigned to a single DMM. As a dealer, a DMM maintains a two-sided market, meaning that the DMM continually posts and updates bid and ask prices. By doing so, the DMM ensures that there is always a buyer or seller available, thereby promoting market liquidity.

The job of a floor broker is to execute trades for customers, with an emphasis on getting the best price possible. Floor brokers are generally employees of large brokerage firms such as Merrill Lynch, the wealth management division of Bank of America. The interaction

designated market makers (DMMs)

NYSE members who act as dealers in particular stocks. Formerly known as "specialists."

floor brokers

NYSE members who execute customer buy and sell orders.

supplemental liquidity providers (SLPs)

Investment firms that are active participants in stocks assigned to them. Their job is to make a one-sided market (i.e., offering to either buy or sell). They trade purely for their own accounts.



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between floor brokers and DMMs is the key to nonelectronic trading on the NYSE. We discuss this interaction in detail in just a moment.

The SLPs are essentially investment firms that agree to be active participants in stocks assigned to them. Their job is to regularly make a one-sided market (i.e., offering to either buy or sell). They trade purely for their own accounts (using their own money), so they do not represent customers. They are given a small rebate on their buys and sells, thereby encouraging them to be more aggressive. The NYSE's goal is to generate as much liquidity as possible, which makes it easier for ordinary investors to quickly buy and sell at prevailing prices. Unlike DMMs and floor brokers, SLPs do not operate on the floor of the stock exchange.

In recent years, floor brokers have become less important on the exchange floor because of the efficient Pillar system, which allows orders to be transmitted electronically directly to the DMM. Additionally, the NYSE has an electronic platform called Arca, which accounts for a substantial percentage of all trading on the NYSE, particularly for smaller orders. The average time for a trade on the NYSE Arca is less than 1 second.

Finally, a small number of NYSE members are floor traders who independently trade for their own accounts. Floor traders try to anticipate temporary price fluctuations and profit from them by buying low and selling high. In recent decades, the number of floor traders has declined substantially, suggesting that it has become increasingly difficult to profit from short-term trading on the exchange floor.

Operations Now that we have a basic idea of how the NYSE is organized and who the major players are, we turn to the question of how trading actually takes place. Fundamentally, the business of the NYSE is to attract and process **order flow**. The term *order flow* means the flow of customer orders to buy and sell stocks. The customers of the NYSE are the millions of individual investors and tens of thousands of institutional investors who place their orders to buy and sell shares in NYSE-listed companies. The NYSE has been quite successful in attracting order flow. Currently, it is common for more than one billion

order flow
The flow of customer orders to buy and sell securities.

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Floor Activity It is quite likely that you have seen footage of the NYSE trading floor on television, or you may have visited the NYSE and viewed exchange floor activity from the visitors' gallery (it's worth the trip). Either way, you would have seen a big room, about the size of a basketball gym. This big room is called, technically, "the Big Room." There are a couple of other, smaller rooms that you normally don't see, one of which is called "the Garage" because that is literally what it was before it was taken over for trading.

On the floor of the exchange are a number of stations. These stations have multiple counters with numerous terminal screens above and on the sides. People operate behind and in front of the counters in relatively stationary positions.

Other people move around on the exchange floor. In all, you may be reminded of worker ants moving around an ant colony. It is natural to wonder: What are all those people doing down there (and why are so many wearing funny-looking coats)?

As an overview of exchange floor activity, here is a quick look at what goes on. Each of the counters is a **DMM's post**. DMMs normally operate in front of their posts to monitor and manage trading in the stocks assigned to them. Clerical employees working for the DMMs operate behind the counter. Moving from the many workstations lining the walls of the exchange out to the exchange floor and back again are swarms of floor

DMM's post
A fixed place on the exchange floor where the DMM operates.

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brokers, receiving customer orders, walking out to DMMs' posts where the orders can be executed, and returning to confirm order executions and receive new customer orders.

To better understand activity on the NYSE trading floor, imagine yourself as a floor broker. Your clerk has just handed you an order to sell 2,000 shares of Walmart for a customer of the brokerage company that employs you. The customer wants to sell the stock at the best possible price as soon as possible. You immediately walk (running violates exchange rules) to the DMM's post where Walmart stock is traded.

As you approach the DMM's post where Walmart is traded, you check the terminal screen for information on the current market price. The screen reveals that the last executed trade was at \$25.63 and that the DMM is bidding \$25.50 per share. You could immediately sell to the DMM at \$25.50, but that would be too easy.

Instead, as the customer's representative, you are obligated to get the best possible price. It is your job to "work" the order, and your job depends on providing satisfactory order execution service. So, you look around for another broker who represents a customer who wants to buy Walmart stock. Luckily, you quickly find another broker at the DMM's post with an order to buy 2,000 shares. Noticing that the dealer is asking \$25.76 per share, you both agree to execute your orders with each other at a price of \$25.63. This price is halfway between the DMM's bid and ask prices, and it saves each of your customers $\$13 \times 2,000 = \260 as compared to dealing at the posted prices.

For a very actively traded stock, there may be many buyers and sellers around the DMM's post, and most of the trading will be done directly between brokers. This is called trading in the "crowd." In such cases, the DMM's responsibility is to maintain order and to make sure that all buyers and sellers receive a fair price. In other words, the DMM essentially functions as a referee.

More often, however, there will be no crowd at the DMM's post. Going back to our Walmart example, suppose you are unable to quickly find another broker with an order to buy 2,000 shares. Because you have an order to sell immediately, you may have no choice but to sell to the DMM at the bid price of \$25.50. In this case, the need to execute an order

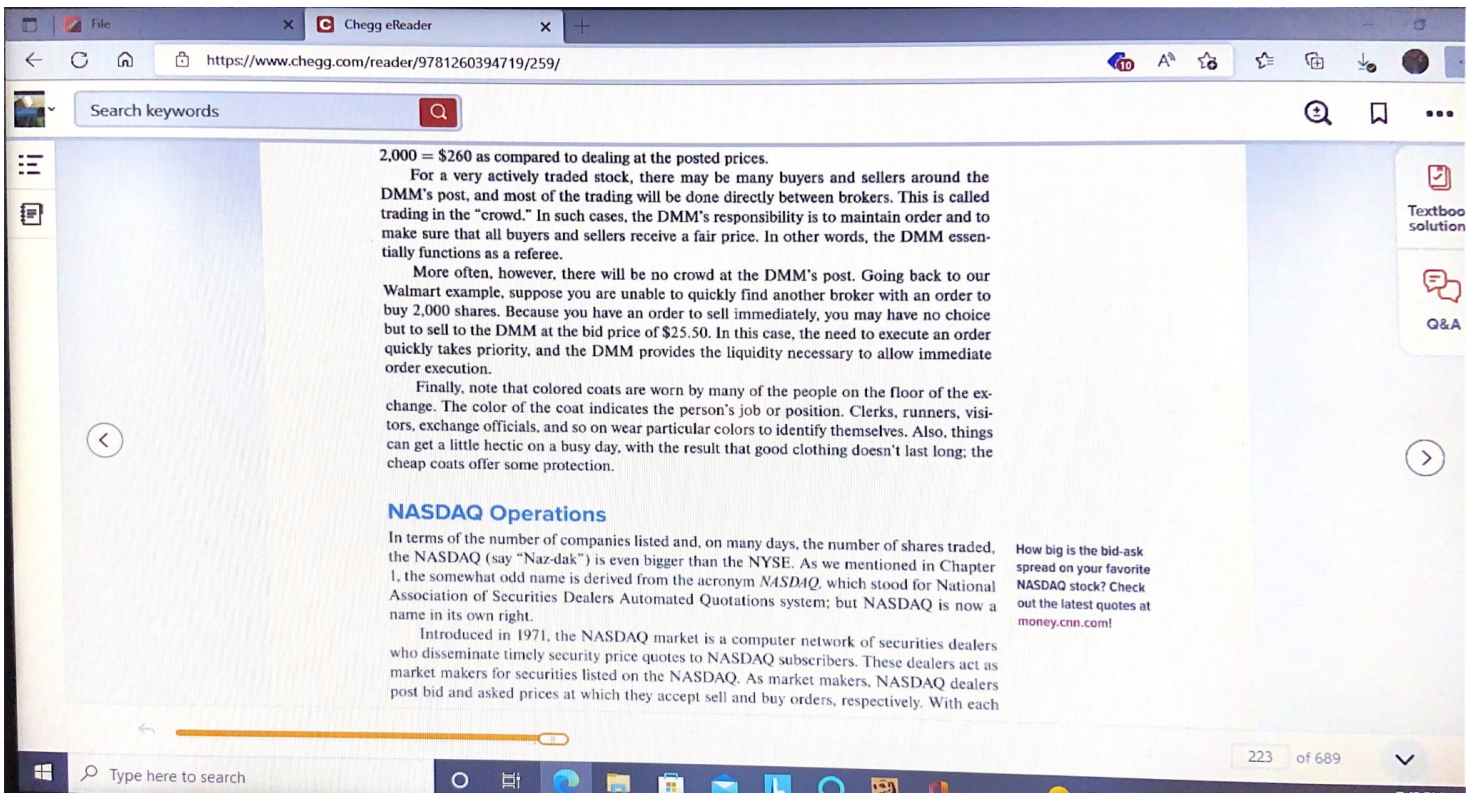
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Finally, note that colored coats are worn by many of the people on the floor of the exchange. The color of the coat indicates the person's job or position. Clerks, runners, visitors, exchange officials, and so on wear particular colors to identify themselves. Also, things can get a little hectic on a busy day, with the result that good clothing doesn't last long; the cheap coats offer some protection.

NASDAQ Operations

In terms of the number of companies listed and, on many days, the number of shares traded, the NASDAQ (say "Naz-dak") is even bigger than the NYSE. As we mentioned in Chapter 1, the somewhat odd name is derived from the acronym *NASDAQ*, which stood for National Association of Securities Dealers Automated Quotations system; but NASDAQ is now a name in its own right.

Introduced in 1971, the NASDAQ market is a computer network of securities dealers who disseminate timely security price quotes to NASDAQ subscribers. These dealers act as market makers for securities listed on the NASDAQ. As market makers, NASDAQ dealers post bid and asked prices at which they accept sell and buy orders, respectively. With each

How big is the bid-ask spread on your favorite NASDAQ stock? Check out the latest quotes at [money.cnn.com!](http://money.cnn.com/)

NASDAQ
(www.nasdaq.com) has a great website; check it out!

inside quotes
The highest bid quotes and the lowest ask quotes for a security.

price quote, they also post the number of stock shares that they obligate themselves to trade at their quoted prices.

Not to be outdone by the NYSE, the NASDAQ completed a merger in May 2007 when it finalized its deal to buy the OMX, which controlled seven Nordic and Baltic stock exchanges. Since the merger, the NASDAQ is officially the NASDAQ OMX Group, although it is still often referred to as NASDAQ.

Unlike the NYSE DMM system, NASDAQ relies on multiple market makers for actively traded stocks. Thus, there are two key differences between the NYSE and NASDAQ: (1) NASDAQ is a computer network and has no physical location where trading takes place and (2) NASDAQ has a multiple market maker system rather than a DMM system. Notice that there is no direct trading in the crowd as there may be on the NYSE.

About 3,400 companies are listed on the NASDAQ system, with an average of about a dozen market makers for each security. Traditionally, shares of stock in smaller companies were listed on the NASDAQ, and there was a tendency for companies to move from the NASDAQ to the NYSE once they became large enough. Today, however, giant companies such as Amazon, Microsoft, and Intel have chosen to remain on the NASDAQ.

The NASDAQ network operates with three levels of information access. Level 1 is designed to provide a timely, accurate source of price quotations. These prices are freely available over the Internet.

Level 2 allows users to view price quotes from all NASDAQ market makers. In particular, this level allows access to **inside quotes**. Inside quotes are the highest bid quotes and the lowest asked quotes for a NASDAQ-listed security. Level 2 is now available on the web, sometimes for a small fee. Level 3 is for the use of market makers only. This access level allows NASDAQ dealers to enter or change their price quote information.

The NASDAQ is actually made up of three separate markets: the NASDAQ Global Select Market, the NASDAQ Global Market, and the NASDAQ Capital Market. As the market for NASDAQ's larger and more actively traded securities, the Global Select Market

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The highest bid quotes and the lowest ask quotes for a security.

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The NASDAQ is actually made up of three separate markets: the NASDAQ Global Select Market, the NASDAQ Global Market, and the NASDAQ Capital Market. As the market for NASDAQ's larger and more actively traded securities, the Global Select Market lists about 1,600 companies (as of 2018), including some of the best-known companies in the world, such as Microsoft and Intel. The Global Market companies are somewhat smaller in size, and NASDAQ lists about 860 of these companies. Finally, the smallest companies listed on NASDAQ are in the NASDAQ Capital Market; about 940 are currently listed. Of course, as Capital Market companies become more established, they may move up to the Global Market or Global Select Market.

electronic communications networks (ECNs)
Websites that allow investors to trade directly with one another.

ECNs In a very important development in the late 1990s, the NASDAQ system was opened to so-called **electronic communications networks (ECNs)**. ECNs are basically websites that allow investors to trade directly with one another. Investor buy and sell orders placed on ECNs are transmitted to the NASDAQ and displayed along with market maker bid and ask prices. Thus, the ECNs open up the NASDAQ by essentially allowing individual investors, not just market makers, to enter orders. As a result, the ECNs act to increase liquidity and competition. Our nearby *Work the Web* box describes one ECN, the CBOE Global Markets (markets.cboe.com/us/equities), and contains important information about ECN "order books." Be sure to read it.

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FINANCE MATTERS

The Wild, Wild West of Stock Trading

Where do companies go when they can't (or don't want to) meet the listing requirements of the larger stock markets? Two options are the Over-the-Counter Bulletin Board (OTCBB) and the OTC Markets, formerly Pink Sheets. These two electronic markets are part of the Wild, Wild West of stock trading. The somewhat odd names have simple explanations. The OTCBB began as an electronic bulletin board that was created to facilitate OTC trading in nonlisted stocks. The name "Pink Sheets" reflects the fact that, at one time, prices for such stocks were quoted on pink sheets of paper.

The well-known markets such as the NASDAQ and the NYSE have relatively strict listing requirements. If a company fails to meet these requirements, it can be delisted. The OTCBB and the Pink Sheets, on the other hand, have no listing requirements. The OTCBB does require that companies file financial statements with the SEC (or other relevant agency), but the Pink Sheets does not.

Stocks traded on these markets often have very low prices and are frequently referred to as "penny stocks," "microcaps," or even "nanocaps." Relatively few brokers do any research on these companies, so information is often spread through word of mouth or the internet, not the most reliable of sources. In fact, for many stocks, these markets often look like big electronic rumor mills and gossip factories. To get a feel for what trading looks like, we captured a typical screen from the OTCBB website (finra-markets.morningstar.com/MarketData/EquityOptions/default.jsp).

First, let's look at the returns. Intelligent Highway Solutions, Inc. (IHSI), had a return on this day of 100 percent! Of course, the gain occurred because the stock price jumped by \$0.0001. The stock price of Sky440, Inc. (SKYF), fell about 43 percent, as its price dropped by \$0.0003. Stocks on the OTCBB tend to have large trading volumes when they do trade, but the dollar amount is quite a bit

Most Actives	% Gainers	% Losers	Exchange by OOTC			
Symbol	Last	Chg	Chg %	Vol (mil)		
SKYF	0.0004	-0.0003	-42.8571	617.1280		

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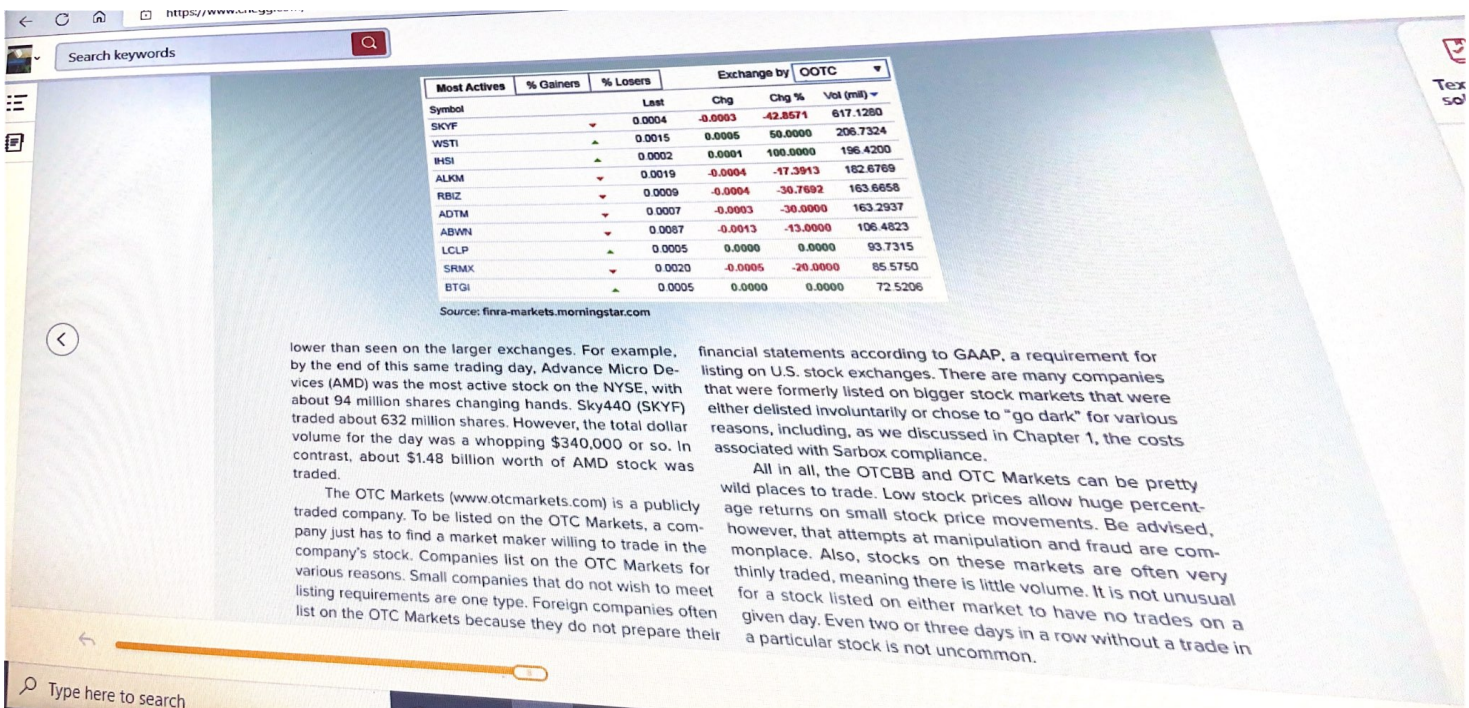
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Symbol	Last	Chg	Chg %	Vol (mil)
SKYF	0.0004	-0.0003	-42.8671	617.1280
WSTI	0.0015	0.0006	50.0000	206.7324
IHSI	0.0002	0.0001	100.0000	196.4200
ALJM	0.0019	-0.0004	-17.3913	162.6769
RBIZ	0.0009	-0.0004	-30.7692	163.6658
ADTM	0.0007	-0.0003	-30.0000	163.2937
ABWN	0.0067	-0.0013	-13.0000	106.4823
LCLP	0.0005	0.0000	0.0000	93.7315
SRMX	0.0020	-0.0005	-20.0000	85.5750
BTGI	0.0005	0.0000	0.0000	72.5206

Source: finra-markets.morningstar.com

lower than seen on the larger exchanges. For example, by the end of this same trading day, Advance Micro Devices (AMD) was the most active stock on the NYSE, with about 94 million shares changing hands. Sky440 (SKYF) traded about 632 million shares. However, the total dollar volume for the day was a whopping \$340,000 or so. In contrast, about \$1.48 billion worth of AMD stock was traded.

The OTC Markets (www.otcmartets.com) is a publicly traded company. To be listed on the OTC Markets, a company just has to find a market maker willing to trade in the company's stock. Companies list on the OTC Markets for various reasons. Small companies that do not wish to meet listing requirements are one type. Foreign companies often list on the OTC Markets because they do not prepare their

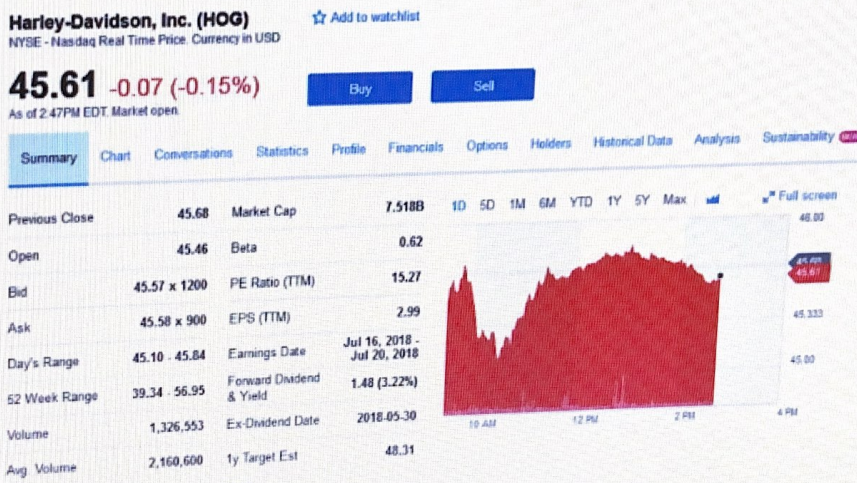
financial statements according to GAAP, a requirement for listing on U.S. stock exchanges. There are many companies that were formerly listed on bigger stock markets that were either delisted involuntarily or chose to "go dark" for various reasons, including, as we discussed in Chapter 1, the costs associated with Sarbox compliance.

All in all, the OTCBB and OTC Markets can be pretty wild places to trade. Low stock prices allow huge percentage returns on small stock price movements. Be advised, however, that attempts at manipulation and fraud are commonplace. Also, stocks on these markets are often very thinly traded, meaning there is little volume. It is not unusual for a stock listed on either market to have no trades on a given day. Even two or three days in a row without a trade in a particular stock is not uncommon.

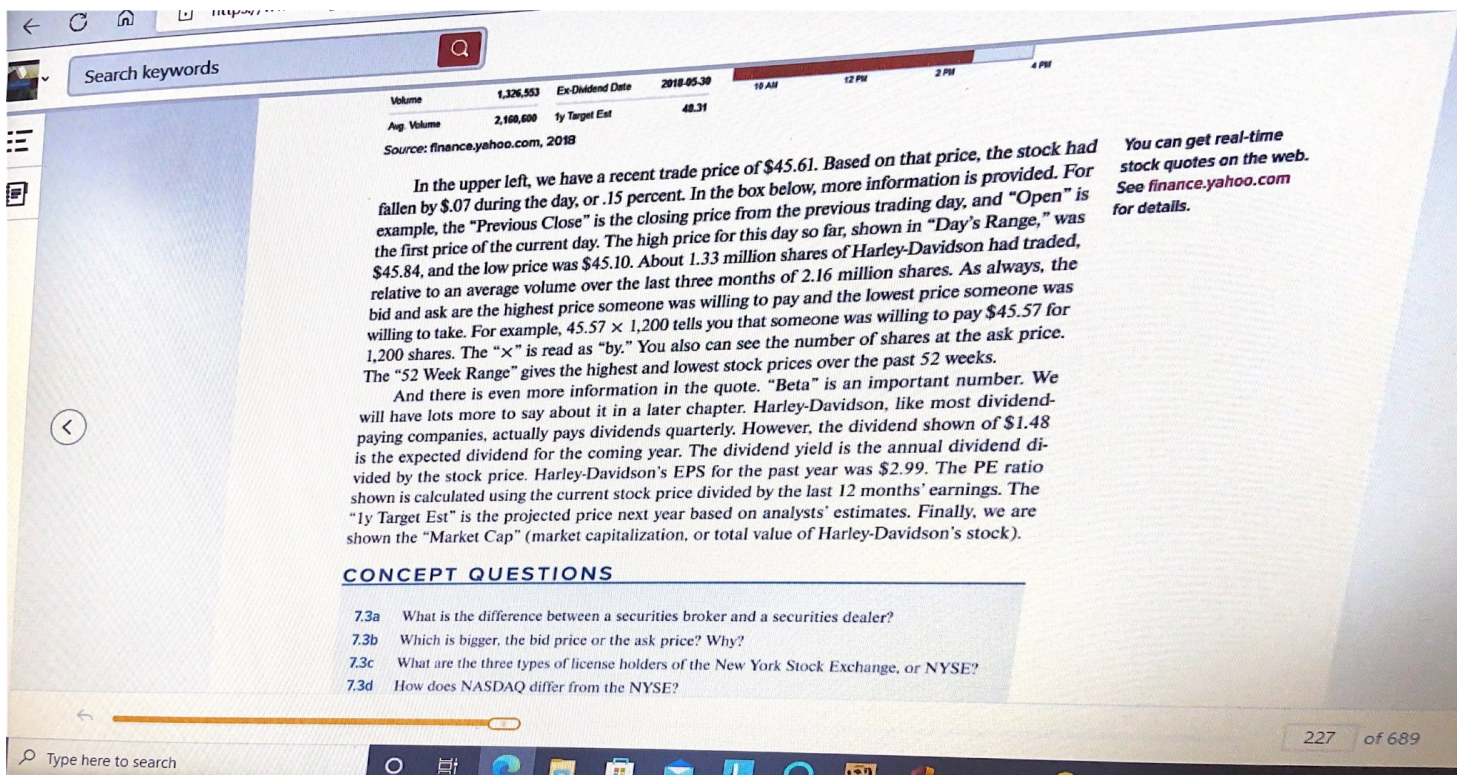
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Stock Market Reporting

Like so many other things, stock price reporting has largely migrated to the web. You can get up-to-the-minute prices on stocks from many online servers, along with plenty of information about a stock. The following is a stock quote from finance.yahoo.com for famed motorcycle manufacturer Harley-Davidson (HOG) from June 21, 2018.



Source: finance.yahoo.com, 2018



Volume 1,326,553 Ex-Dividend Date 2018-05-30
Avg Volume 2,160,600 1y Target Est 48.31
Source: finance.yahoo.com, 2018

In the upper left, we have a recent trade price of \$45.61. Based on that price, the stock had fallen by \$.07 during the day, or .15 percent. In the box below, more information is provided. For example, the "Previous Close" is the closing price from the previous trading day, and "Open" is the first price of the current day. The high price for this day so far, shown in "Day's Range," was \$45.84, and the low price was \$45.10. About 1.33 million shares of Harley-Davidson had traded, relative to an average volume over the last three months of 2.16 million shares. As always, the bid and ask are the highest price someone was willing to pay and the lowest price someone was willing to take. For example, $45.57 \times 1,200$ tells you that someone was willing to pay \$45.57 for 1,200 shares. The "x" is read as "by." You also can see the number of shares at the ask price. The "52 Week Range" gives the highest and lowest stock prices over the past 52 weeks. And there is even more information in the quote. "Beta" is an important number. We will have lots more to say about it in a later chapter. Harley-Davidson, like most dividend-paying companies, actually pays dividends quarterly. However, the dividend shown of \$1.48 is the expected dividend for the coming year. The dividend yield is the annual dividend divided by the stock price. Harley-Davidson's EPS for the past year was \$2.99. The PE ratio shown is calculated using the current stock price divided by the last 12 months' earnings. The "1y Target Est" is the projected price next year based on analysts' estimates. Finally, we are shown the "Market Cap" (market capitalization, or total value of Harley-Davidson's stock).

You can get real-time stock quotes on the web. See finance.yahoo.com for details.

CONCEPT QUESTIONS

- 7.3a What is the difference between a securities broker and a securities dealer?
- 7.3b Which is bigger, the bid price or the ask price? Why?
- 7.3c What are the three types of license holders of the New York Stock Exchange, or NYSE?
- 7.3d How does NASDAQ differ from the NYSE?

SUMMARY AND CONCLUSIONS

This chapter has covered the basics of stocks and stock valuation. The key points include:

1. The cash flows from owning a share of stock come in the form of future dividends. We saw that in certain special cases it is possible to calculate the present value of all the future dividends and thus come up with a value for the stock.
2. As the owner of shares of common stock in a corporation, you have various rights, including the right to vote to elect corporate directors. Voting in corporate elections can be either cumulative or straight. Most voting actually is done by proxy, and a proxy battle breaks out when competing sides try to gain enough votes to have their candidates for the board elected.
3. In addition to common stock, some corporations have issued preferred stock. The name stems from the fact that preferred stockholders must be paid first, before common stockholders can receive anything. Preferred stock has a fixed dividend.
4. The two biggest stock markets in the United States are the NYSE and the NASDAQ. We discussed the organization and operation of these two markets, and we saw how stock price information is reported.

This chapter completes Part Four of our book. By now, you should have a good grasp of what we mean by present value. You also should be familiar with how to calculate present values, loan payments, and so on. In Part Five, we cover capital budgeting decisions. As you will see, the techniques you have learned in Chapters 4–7 form the basis for our approach to evaluating business investment decisions.



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