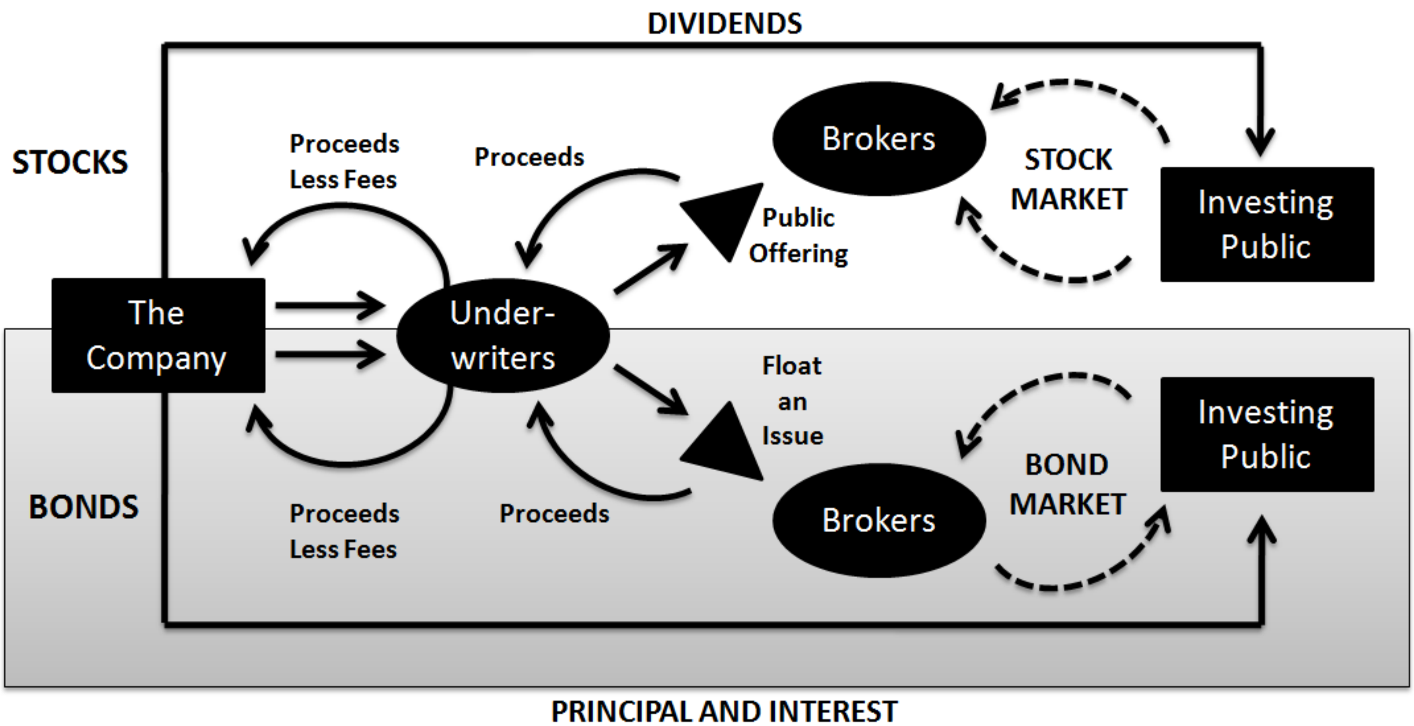
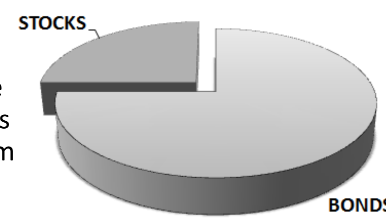
THE MARKET-GO-ROUND

Companies, like people, need money to finance their "lives" – to develop new products, build new plants, expand operations. Some of this money comes from company profits. Businesses also can raise money by selling stocks and bonds.

Stock represents ownership: People who buy shares gain equity, or a piece of the firm selling the shares. Bonds represent debt: People who buy bonds lend the company money (principal) that the company must pay back with interest.





Stocks vs. Bonds
Companies rarely sell stocks and bonds directly to the public. The diagram above illustrates the multistep process companies use to sell their securities. The diagram is divided into halves. The top half represents the procedure for stock sales; the bottom represents bonds.

This doesn't mean that the sizes of the stock and bond markets are equal, however. Companies raise far more money each year from bond sales than they do from initial public offerings of stock, as the pie chart in the bottom right corner of the diagram clearly shows. The pie chart represents the average annual proceeds over a 10-year period from sales of newly issued corporate stocks and bonds.

How Companies Sell Securities
Basically, companies sell stocks and bonds "wholesale" to underwriters, usually a group of investment banks. This sale is indicated by the two straight arrows at the left of the diagram, coming out of the box labeled ''The Company."

Underwriters "retail" securities to investors individuals or institutions such as insurance companies or pension funds. These sales – called a "public offering" in the case of stocks and "floating an issue" for bonds-are represented by the straight arrows coming out of the circle labeled "Underwriters."

The individuals and institutions who make up the investing public then buy and sell the securities among themselves (represented by the outer circles of dotted lines on the right side of the diagram).

These sales are generally handled through stockbrokers, financial consultants, or other investment professionals. The investment professionals and underwriters often work for the same companies, in different departments.

Companies obtain their money from proceeds of sales to underwriters (represented by the curved arrows labeled "Proceeds Less Fees" on the left). Underwriters make their money from fees companies pay to them (indicated by the curved arrows labeled "Proceeds").

Companies don't obtain any money from the resale of their securities in the market. All the money from public trading in the so-called secondary market circulates among investors and brokers and is represented by the inner circles of dotted lines on the right.

Not all investors trade. Many buy securities and hold them, making money from stock dividends (represented by the long arrow at the top of the diagram) or from company repayment of bond principal and interest (represented by the long arrow at the bottom.)

Answer the following questions based on the diagram and the reading *(use space provided; 1 sentence minimum)*

1. What is the difference between equity and debt?

2. What is the difference between a bond and a share of stock?

3. What does the top half of the diagram represent?

4. What does the bottom half of the diagram represent?

5. Which form of capitalization (raising money) is more popular with companies (stock or bonds)? Why?

6. If you purchase stock on the NYSE, AMEX, or NASDAQ, how much of the purchase price goes to the company whose stock you are buying?

7. What is the purpose of stock exchanges?