

Stocks, Futures & Forwards and Swaps

We have Risk free securities as well as risky securities.

Risky Securities.

Stock is a security that gives its owner the right to a proportion of any profit that might be distributed (rather than reinvested) by the firm that issues the stock.

- What does this mean by distribution of profit.
- what does it mean by the distribution of profit rather than reinvestment?

△ In general a company usually raise money and there are two typical ways of ~~issuing~~ raising money is ~~by~~ issuing bonds and by issuing stocks.

△ Essentially the stock certificates are going to be issued to individuals upon receipt of payment and this money is invested in the business of the firm and once the firm sees profit they can do one of the following two things with the profit.

(i) Either they take the profit and distribute the share of the profit to all people who had purchase the stocks, in this case we say basically a dividend has been paid.

(ii) The other case is that the company might not actually give the share of the profit but rather invest the entire amount of money / or a part of the profit in furthering their business in which case the gain of the owners of the stock would be through the increase in the price of the stock.

Terminologies Associated With Stock, Stock Owners and firms that issue the stock.

- i. The owner of the stock is called Stock holder or sometimes called Share holder.
- ii. The profits that the company distributes to the stock holder is called dividends.
- iii. So essentially dividends are the proportional profit or right that the buyers of the stock holders receive depending on the percentage of investment that they have made in terms of the total number of stocks that are actually issued.

Properties of Dividends.

- (i) Dividends are generally random., that is these are not known in advance. which is basically the contrast to ~~nominal~~ Bond where the creditor already is or aware of that what will be the nominal value i.e. how much will they receive after the maturity.

So, there is a greater amount of uncertainty as to what returns the stock holder will get upon the investment.

- (ii) Dividends depends on the firm's profit and policy.

From the definition of Dividend it is very clear that Dividend depends on the ~~policy~~ Firm's profit.

It is also dependant on the policy because whether the company want to hand out the dividends to the stakeholders @ i.e. Share holders

or they want to reinvest the ^{existing} amount of money in order to expand their business. or in further enhance the business in other diversified area.