CHAPTER 16

STOCK EXCHANGE

Objectives

At the end of this chapter, the students should be able to explain the meaning of stock exchange; state the functions; explain the organizational set-up; explain the stock exchange procedure; explain the meaning of speculators and make a list of them; state the importance of the stock exchange and state the operation.

16.1 Meaning of Stock Exchange

Stock exchange is the capital market where stocks, shares and other securities are bought and sold through brokers. That is, it is a capital market where capital for finance of industries can be raised by means of selling shares, stocks and securities. It is a market for second-hand shares, stocks and other securities.

The Nigerian Stock Exchange (NSE)

The Nigerian Stock Exchange was created on 5th June 1961 when the Lagos Stock Exchange Act of that date was passed by the Federal Government of Nigeria. It is not a government agency, but a limited liability public company by guarantee (not by shares). Like any other limited liability public company, the NSE is governed by its articles and Memorandum of Association.

The NSE is owned by about seventy-three members, made up of financial institutions, stock-broking firms and private individuals. Like any other stock exchange, it provides a continuous market for governments and corporations wishing to raise funds for long-term finances either by selling of debentures (loan stocks) or shares and other securities.

Under the indigenization programme of 1979, shares and stocks worth about ₦300 million belonging to about 80 companies were sold on the NSE.

The Act that created the NSE, in addition to guaranteeing its members certain protections, also imposes certain strict legal codes of practices that are expected to make its operations fraud-proof. Such codes of conduct regulate the activities of the members dealing with one another, to the exchange and to the investing public. The NSE is legally required to submit periodic reports and statements of its activities to the government through the Central Bank of Nigeria.

The Nigerian Stock Exchange had only three operating branches as at April 30, 1981. These branches known as trading floors were in Lagos, Kaduna and Port-Harcourt. The NSE is not yet as developed as those in the Western World - in USA, UK Germany, Switzerland, etc. For instance, as at 1981, there were ten stockbrokers operating in Nigeria. For reasons of the low level of development, there are no strict divisions of functions between the *jobbers* and the *brokers* as differentiated in this chapter and as practiced on the stock exchanges of the Western World. On the Nigerian Stock Exchange, the same people act as jobbers and brokers. It also deals mostly in government securities (gilt-edge securities), accounting for about 80% of all its dealings.

However, the NSE has become quite active since the enactment of the Indigenisation Acts of 1974 and 1979 by which Nigerians were encouraged to take over most shares in industries from foreign shareholders. The NSE was, about the only one in West Africa and sixth in the whole of Africa as at 1981.

Types of Securities Sold on the Stock Exchange

The following are the types of securities sold on the Stock Exchange:

(i) Joint stock companies in form of shares, stocks and debentures.

(ii) Federal, State and Local Government securities.

(iii) Foreign Government securities.

(iv) Foreign companiesâ€™ stocks and shares.

The body charges with the registration of securities for subscribing itâ€™s Securities and Exchange Commission.

N.B. Government shares and stocks are known as *gilt-edged* securities.

16.2 The Functions of the Stock Exchange

(i) It provides a unique market through which the vast funds of a great number of investors spread all over the country and indeed the world at large are made available for profitable investments.

(ii) It provides opportunities for granting quotations to new shares, stocks and other securities.

(iii) It facilitates purchase and sales of securities, and thereby helps to reduce possible liquidity (cash) problems for businesses and the investing public who hold shares, stocks and other securities. Business can readily raise needed capital, while the investing public can easily turn their shares, stocks and other securities into ready cash.

(iv) Through the stock exchange, public investment in different types of securities is facilitated. The general public is encouraged to own shares and partake in the financial and economic development of the nation.

(v) Stock exchange strictly prohibits fraudulent dealings in securities and other dubious practices on the exchange.

(vi) Stock exchange ensures a high standard of company administration for any organization that requires its shares to be quoted on the exchange. It also instils high discipline in member dealers so that they play the game according to the legal rules.

N.B: The activities of the Nigerian Stock Exchange are regulated and controlled by the Securities and Exchange Commission.

16.3 Members of the Stock Exchange and Speculators

The Brokers: These are the middlemen between sellers and buyers of shares. They are otherwise referred to *as agents of the sellers and buyers.* They get the best bargain of share for their clients and they are on commissions called *brokerage* payable (on a fixed sale) by their clients. They deal in any type of shares as required by their clients. They offer advice on investment options to their clients.

The Jobbers: The jobbers operate on their own accounts. They buy shares when the prices are low in order to resell them when prices are high. They live on the differentials between the buying and selling prices. Such differentials is known as *jobbersâ€™ â€˜marginâ€™ or â€˜turnâ€™* which is determined by changes in the demand for and supply of shares or securities. Jobbers do not deal directly with the public as such, they deal only with other members of the stock exchange.

Jobbers do specialize in certain categories of securities. In the Lagos Stock Exchange, the traditional principle of division of duties between the jobbers and the brokers is ignored. The members act as both jobbers and dealers. This is because, the volume of daily business transactions is not large enough to make for outright specialization.

The Speculators: Some of the activities of the stock exchange are speculative. Consequently, other members of the stock exchange are speculators. They are known as the *bulls, the bears and the stags.*

The Bulls: Rush to buy shares in anticipation - note, in anticipation only - that they would make a profit on a resale. They pay an interest, known as *â€˜antangoâ€™* to their brokers for holding on to shares, which they have not paid for and which prices have not risen until the following settlement period, when the prices of such shares would have risen. The bulls can be regarded as optimists since they buy in anticipation of increase in prices.

The Bear: Operate contrary to the bulls, they sell in anticipation of price fall and hope to buy again at lower prices and thereby, make a margin profit. They can be referred to as *pessimists* since they operate in opposite direction to the bulls. When the bears sell more shares than the bulls can buy, the bears pay a fee known as *backwardationsâ€* (to the bulls) for carrying over such shares to such a time that they would be demanded.

N.B. *A Bull* market indicates a state of good financial business and rising prices, while a *bear* market indicates an uncertain economic trend and the expectation that prices would fall.

The Stags: Buy a bulk of newly-issued shares in anticipation of a quick profit by turning them over once the prices of the shares rise on the stock exchange. The price is assisted by making a small initial down payment on newly-issued shares, while only paying the balance later on when it is called for. Stag dealings in new shares have been frowned upon since the practice leads to

oversubscription of shares, even up to about 100 times sometimes. Sales of shares by tender has been introduced to take its place.

Options: Apart from speculative dealings, there are dealings in options. These are the purchases of the right to buy and sell specified stocks at a fixed price known as *striking price* at or within a stated period, with a maximum of 5 months.
There are different types of options viz:

(i) *Put and call options* - the right to buy and sell.

(ii) *Put option* - the right to sell.

(iii) *Call option* - the right to buy.

The Effects of Speculation on the Stock Exchange on the National Economy

Speculations on the stock exchange have the following advantages:

(i) Some speculators buy when prices are low and prevent a situation where prices of securities are wholly depressed.

(ii) Some sell when prices are getting high, and thereby eliminate a condition of skyrocketing prices of securities.

(iii) Consequent upon (i) and (ii) above, speculators try to bridge the possible wide fluctuation in the prices of securities on the stock exchange.

N.B. Speculative dealings on the stock exchange are usually frowned upon. The introduction of capital tax in countries like the United Kingdom is used to curb speculative transactions by wiping off parts of the profits so made.

16.4 Organizational Set-up

The Trading Floor: This is the physical market area of the stock exchange where members get in touch with one another. On the trading floor, there are various communication devices like lighted signalling boards for inviting members to the telephone, indicators of exchange rates for various international currencies, and important bank rates all over the world.

Position dealings: These are the locational points for jobbers dealing in particular types of shares. Consequently, on the floor of the exchange, there are different congregation for jobbers dealing, for instance, in oil shares, banking shares, gilt-edged (government) securities, etc. This is similar to how retailers of different articles congregate at different locations in the markets, at Ibadan, Onitsha or Kano, such local arrangements make the detection of jobbers much easier for their clients.

The Intermediaries: For **a** particular type of securities, members of the public are not admitted to the trading floor. Members of the public must go through the brokers if they wish to buy shares. Mention has been made of the brokers and the jobbers as intermediaries. Other members allowed on the floor of the exchange are the *authorized* and the *unauthorized* clerks, and the *attache.* Authorized clerks are those employees who are allowed to make business transactions on behalf of their employers. Unauthorized clerks are those employees that work in the exchange, but are not allow to make bargains. They can only watch proceedings. The attache is also a full-time employee of his principal (the clerk). He is charged with finding clients for his principal. He is not allowed to deal in, but can watch, stock exchange transactions.

16.5 The Operational Procedures

A member of the public who wishes to buy or sell shares (say 200 shares) would contact a broker to whom is given precise instruction as to such shares. Such instruction can be passed to the brokersâ€™ authorized clerk. The broker or his authorized clerk would start to approach a jobber in the appropriate position dealing or market. The jobbers would quote two prices - the lower one (say 70 kobo) for buying and the higher one (say 75 kobo) for selling. There would be a sort of bargaining known as *banker.* If the offer is not acceptable, the broker would turn to other jobbers, in search of a better bargain. However, if the offer is acceptable the deal is completed. The contract is mostly verbal and without any exchange of paper work on the floor of the stock exchange.

Making of Price: This is the quoting of prices by the jobbers. Price quotations are not arbitrary, but are determined by the market mechanism of demand and supply. For instance, when supply (sales) of shares is more that demand (purchase), the jobber would have to quote lower prices in order to discourage more supply and encourage greater demand. Conversely, if demand is greater than supply the jobber would quote *higher prices* in order to induce greater supply and reduce demand. Shares that are in great or strong demand are known as *blue chips.* These are very safe shares for investment purposes.

Making the Deal: Although the verbal contract is effective on the floor of the exchange, nevertheless, the official listing of the deal is written down. The details of the dealings are entered on a slip and dropped into one of the boxes provided for this purpose. From the box, the details are entered into the official record of the stock exchange dealings.

The Contract Note: This is a document by which details of the transactions are conveyed to the broker. The contents of the contract note are as follows:

(i) Statement that the shares have been bought or sold.

(ii) The name of the company involved and the price of the shares.

(iii) The brokersâ€™ commission, the stamp duty on the contract and on the transfer (this is paid by buyer if on sale).

(iv) The total consideration and the total amount due or payable. The buyersâ€™ cheque must reach the broker in time to be paid in and cleared by the settlement date, which always appears on a *bought note.*

The Transfer: The morning after the bargain, the brokerâ€™s clerk and that of the jobber would meet in *the settling room* of the exchange to confirm that the details are correct. The selling broker would have to inform the selling company that the ownership of the shares has changed and would request his client to sign and produce the share certificate. The buyersâ€™ broker would enter the buyersâ€™ name and address on the form and then send it to the registered office of the company.

Cum-Div and Ex-Div: Shares could be sold *cum-div* or *ex-div.* Shares sold *cum-div,* i.e, *with dividend* means that the buyer is entitled to receive any dividend which might be declared. These are shares sold before the dividend are declared and, therefore, unpaid. Shares sold *ex-div,* i.e. *without dividend* means that the seller, not the buyer, is entitled to receive the dividends declared. Such shares are sold after the dividend has been declared.

16.6 The Stock Exchange Account

The stock exchange has 24 accounts or settlement periods in the year. Twenty of them cover fortnight tradings and four, three weeksâ€™ tradings. The exchange is closed on Saturdays, Sundays and bank holidays. The settlement for the previous account period is made at the beginning of the following one.

A typical accounts period is organised thus:

Date	Title (Terms)	Actions
Monday	Contango Day	Parties complete bargain or postpone settlement until the following accounts period.
Tuesday accepted	Making-up day	Council decides on prices to be as the closing prices of all stocks.
Wednesday	Ticket or name day	Buying brokers pass particulars of the buyers to sells so that transfer can be arranged.
Thursday Friday Monday	First, second and third intermediate days	All documents about the sales are completed and handed over.
Tuesday	*Settlement* or *Account* day	Final payments are effected and stock are delivered.

Contango is interest paid by the buyer for postponing payment. Backwardation is interest paid by a seller who postpones delivery of the shares.

16.7 The Importance of the Stock Exchange

The stock exchange facilitates the re-distribution of securities by assuring investors that there is reasonable expectation that they will convert their securities into money whenever they wish. It also serves as an intermediary through which money flows into the hands of public companies and governments. This is the situation when investors sell through the stock exchange securities already owned by them in order to obtain money with which to buy new issues. Through the stock exchange organisation which have large surplus funds like pension funds and insurance premium funds collected from the public could make such funds available to companies having needs for such funds.

Finally, listing of securities on the stock exchange improves the inavailability of such securities.

Summary

Stock exchange is a capital market for buying and selling of second-hand Securities. The first stock exchange in Nigeria came into being in June 1961 as the Lagos Stock Exchange.

Different types of securities are traded on the floor of Stock Exchange, e.g shares, stocks, debentures of limited liability companies, Nigeria and foreign government securities.

Membership is strictly limited to the brokers, the jobbers, the speculators such as the bulls, bears and stag.

The stock and shares once bought are transferred either â€œcum-divâ€, when accrued dividend on such shares are payable to the current buyer or â€œex-divâ€ when the accrued dividend is payable to the seller. The settlement of accounts is by a time table stretching over seven working days, i.e. from Monday to the following weekâ€™s Tuesday.

Revision Questions

A. Essay Questions

1. Explain the functions of each of the following on the stock exchange.
   (a) Brokers
   (b) Jobbers
   (c) Bulls
   (d) Bears
   (e) Stags

2. Describe briefly the procedures involved in the buying of shares on the stock exchange by a member of the public.

3. What are the functions of Nigerian Stock Exchange?

4. (a) What is the Stock Exchange?

(a) Explain any FIVE functions it performs in the country in which it serves.

(c) Who are the â€˜bullsâ€™ and â€˜bearsâ€™ in the stock exchange?

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5. Describe each of the following.

(i) Stockbroker (4 marks)
(ii) Bull (4 marks)
(iii) Stag (4 marks)
(iv) Issuing House (4 marks)
(v) Securities (4 marks) *WASSCE (1999)*

B. Objective Questions

1. The bears on the stock exchange

A. sell shares in anticipation that prices will fall
B. buys shares in anticipation that prices will rise
C. sell shares in anticipation of steady and stable prices
D. are not bothered by the rise and fall od share price

2. The three main types of speculation found in the stock exchange market are

A. Bears, Brokers and Jobbers.
B. Bulls, Bears and Stag.
C. Bulls, Brokers and Bears.
D. Jobbers, Brokers and Agents.
E. Stags, Agent and Jobbers. *NECO (SSCE) 2002*

3. The stock exchange market is for the sale and purchase of

A. contraband goods.
B. essential Commodities.
C. luxury goods.
D. second-hand goods.
E. securities.

4. Dealing on the stock exchange may be either

A. â€˜for cashâ€™ or â€˜for hireâ€™
B. â€˜for jobberâ€™ or â€˜for brokerâ€™.
C. â€˜for cashâ€™ or â€˜for accountâ€™.
D. â€˜for cashâ€™ or â€˜for creditâ€™.
E. â€˜for bullâ€™ or â€˜for bearâ€™. *NECO (SSCE) 2001*

5. In the stock exchange what is the day when all parties to a transaction decide whether the bargain should be completed or held over until the next settlement?

A. Account
B. Contango
C. Making-up
D. Name
E. Ticket

NECO (SSCE) 2001

6. Making-up day is the day on which the

A. Ticketsâ€™ bearing the ownersâ€™ name are handed over to the selling brokers to facilitate transfer of ownership.
B. Documents are prepared for the completion of the transaction,
C. Parties to a transaction decides whether the bargain should be completed or held over until the next settlement.
D. Payments are finally made for all kind of transactions, completed or carried over.
E. Stock exchange fixes prices at which shares are to be carried forward.

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7. In stock exchange, the buyer is NOT entitled to the dividend when the stock is quoted,

A. Clean
B. Cum-dividend
C. Double barrelled
D. Ex-dividend
E. Firm

NECO (SSCE) 2001

8. The market where existing securities are bought and sold is

A. Money market
B. Mini-market
C. Foreign exchange market
D. Stock exchange market

WASSCE (2000)

9. A market for buying and selling existing securities is provided by the

A. Stock exchange
B. Central Bank
C. Chamber of Commerce
D. Commodity market

WASSCE (1999)

10. Which of the following is a function of a â€˜Bullâ€™ in stock exchange?

A. Subscribes for new shares only.
B. Buys shares in anticipation of a price rise.
C. Sells shares in anticipation of a fall in price.
D. Records proceedings in the stock exchange.

WASSCE (1999)

Project

Make a research into some of the companies in your locality and state which ones are quoted on the stock exchange.