

What is a Stock?

Suggested Grade & Mastery Level

High School - all levels

Suggested Time

50 minutes

Teacher Background

When you buy stock you become part owner of a public company—no matter how many shares you own. If the stock price exceeds what you paid for it, your investment increases in value. If the stock price goes lower than what you paid for it, your investment decreases in value. You risk only the money you invest.

Not all companies are public. Private companies are composed of an individual/family or a small group of investors that have private sources for funding growth; their shares are not for sale to the general public. Mars Corp, the snack food giant, is privately held. Google, the search engine company, was privately held until 2005, when it went public, offering its stock for sale.

If a company's product or service is in great demand, demand may outstrip the ability of banks and venture capitalists (who privately supply funding) to provide money for the company's expansion to meet that demand. At that point company leaders may decide to "go public."

Company management goes to investment bankers to negotiate an agreement to underwrite a stock offering known as an IPO (Initial Public Offering). The investment bankers buy all the shares that will be offered to the public at a set price (primary market). In other words, they underwrite the IPO. The investment bankers then sell the stock to the general public (secondary market) in the hopes of making a profit.

In addition to finding underwriters, company management must register its stock with the Securities and Exchange Commission (SEC) before "going public." Generally, companies can offer two types of stock, common and preferred. Common stock entitles the owners (called stockholders or shareholders) to collect dividends, if the company declares them. It also entitles the owners to vote in company elections and decisions. Stockholders who purchase common stock share in most of a company's profits and losses.

Stockholders who purchase preferred stock are usually guaranteed a dividend payment. This payment is made before any payments to common stock holders. If a company fails, preferred stock holders are repaid before common stock holders. Preferred stock holders do not share in most of a company's profits or losses. Preferred stock holders also do not have any voting rights.

An important difference between common stock and preferred stock is that the price of the preferred stock tends to be more stable, changing little over time, than that of common stock.

Stocks are bought and sold on exchanges. The Stock Market Game program is an electronic platform in which students buy and sell simulated shares on the three different major U.S. stock exchanges: the American Stock Exchange (AMEX), the New York Stock Exchange (NYSE) and the NASDAQ Stock Market.

It is important for students to understand the functions and properties, advantages and disadvantages of stock in preparation for learning about risk and reward and prior to making their Stock Market Game investments. Young investors as well as old will always be faced with the question: How much risk do I want to assume when buying stock in a company?

Vocabulary

Common Stock: Shares of a company that do not guarantee a dividend and have more risk and volatility than preferred shares. Common stock holders have the benefit of providing shareholders with the right to vote for the board of directors as well as on issues that come before the board at the annual meeting of shareholders.

Corporation: A business that is owned by stockholders and has right and responsibilities as if it were a person.

Dividend: Part of a company's profits (earnings) that it pays as money to stockholders.

Earnings: The amount of money that remains after subtracting the company's expenses from its revenue.

Investor: Someone who risks funds by purchasing financial products with the hope the investments will increase in value over time.

IPO: Initial Public Offering; the initial sale of stock to the public by investment bankers.

Preferred Stock: Shares of ownership of a company in which the share holder is guaranteed a dividend if one is declared and whose shares are usually not as volatile as common stock. Preferred stock holders do not have voting rights in company elections and decisions.

Private Company: A company that is owned by a person, family, or small group of investors that does not sell shares of stock in the company to the public.

Public Company: A company that is owned by investors who buy shares of stock, partial ownership of the assets of a business, in the corporation usually through one of the stock exchanges.

Risk: The chance of losing all or part of an investment.

Stock: Ownership of shares in a business.

Stock Exchange: Place where shares of publicly held companies are bought and sold.

Tombstone Ad: An announcement appearing in financial publications such as the *Wall Street Journal* announcing a company's Initial Public Offering (IPO.)

Underwriter: Typically an investment banker, buys an entire new securities issue from the company or government offering it, and resells the issue as individual stocks or bonds to the public.

Volatility: Indicates how much and how quickly the value of an investment, market, or market sector changes.

Performance Objectives

Students will be able to:

- Define and give examples of: common stock, investor, risk, public corporation, private company, preferred stock, earnings and dividends.
- Explain why there is risk involved in stock ownership.
- Make decisions as a group on the benefits of investing in stocks verses costs/ and or loss of use of capital.
- Calculate gain and loss from sample stock sales.
- Explain the differences between common stock and preferred stock.
- Explain how a company will "go public" by issuing an IPO.

Subject Area

Economics, English Language Arts, Mathematics, Social Studies, Business, Technology

Materials

- Access to the Internet
- **Activity Sheet 1: What is a Stock?**
- **Activity Sheet 2: Stock Market Calculations**
- **Activity Sheet 3: A Tale of two Chocolate Companies**

Springboard Activity

ASK

- Which is the best sneaker on the market? Why?
- How do you know it is the best?
- If it is the best, would you want to own all or part of that company?

Procedure

Explain that today the class will learn how they can own parts of public companies by purchasing shares of their stock.

Have students speculate why the founders of companies like Nike, Apple, and Sony—that manufacture popular products like Air Jordans, the Ipod, and PS2—gave up a portion of their ownership to sell shares to the public.

Distribute **Activity Sheet 1: What is a Stock?**

Ask the students to use the reading to define common stock preferred stock and stock exchange.

Ask them to explain how a stock “goes public.” After a discussion of the responses discuss the advantages and risks of purchasing stock.

Novice Level:

Explain to the students that they already have one of several important tools needed when purchasing stock: knowledge of products people like.

Have the students, in their Stock Market Game teams; select five products with which they are familiar.

Have them research: Which companies make the products? Which companies are publicly traded and which are privately held? What other products do the companies make?

Each student on the team should choose a company that produces one of these five products and create a profile of that company. (See www.nyse.com or www.hoovers.com for an example of a company profile)

[Apprentice](#) and [Master](#) Levels:

Yahoo! Finance (<http://finance.yahoo.com>) lists Best and Worst IPOs from the past year in their Stock Research section.

Ask your students to review the lists.

- Are there companies you recognize?
- How did they perform (Best or Worst)?

In their SMG teams have students select a company from either list and research:

- What products and/or services does the company provide?
- Why do you think the companies choose to go public?
- What has happened to the stock price since the decision to go public?
- Would you invest in this company?

[Grand Master Level](#):

In their SMG teams have the students visit the IPOs in the Past Year list in the Stock Research section of Yahoo! Finance (<http://finance.yahoo.com>).

The three major US exchanges also report on new IPOs:

The New York Stock Exchange (<http://www.nyse.com>) - click About NYSE, then Listed Companies, and then IPO Showcase.

American Stock Exchange (<http://www.amex.com>) - Click Equities then Listed Companies, and then New Listings.

The NASDAQ Stock Market (<http://www.nasdaq.com>) - Click IPO from the top menu bar.

Have the team select two companies from the same industry and research:

- What products and/or services do the companies provide?
- Why do you think the company went public?
- Compare the results since their IPO. In which company would you invest? Why or why not?

Assessment

Mars Candy Company, producer of Milky Way and other candy, is privately owned. Have students write a letter to the president of Mars Candy Company explaining:

- The reasons for and benefits of going public.
- How a company offers its initial stock.

Application

[Novice Level](#):

Using **Activity Sheet 3: Stock Market Calculations: Costs, Profits and Losses**, have students complete problems 1 and 2 to practice calculating the profit or loss from sample stock sales.

[Apprentice](#) and [Master](#) Level:

Have a student from each group play the role of a financial advisor and convince the class that the newly public company their team has researched is worth the class' investment.

Grand Master Level:

Mars is a privately held company that individual investors cannot own. However, Mars and Hershey are not the only candy makers out there.

Have your SMG teams compare Hershey (Symbol: HSY) with Cadbury Schweppes (Symbol: CSG).

- What products/services do both offer?
- What are the last trade (closing) prices for both companies?
- Which would your team include in its SMG portfolio? Why?

Enrichment Activities

Have students read **Activity Sheet 2: A Tale of Two Companies**.

or

Steve wants to invest \$10,000 in PepsiCo (stock symbol PEP)—the company that makes snack foods, and beverages, including Pepsi Cola and Fritos. He must decide whether to buy common shares or preferred shares in PepsiCo.

When Steve looked at the stock, its common stock shares were selling for \$57.38 per share and preferred shares were selling for \$71.60. Common stock shareholders are paid a dividend of \$1.80 per share, while preferred stock holders earn \$2.30 per share of stock.

Have students give advice (oral or written) to Steve including:

- Which kind of stock do they think Steve should buy?
- Should Steve accept more risk by buying common shares or play it safe and purchase preferred shares of his favorite company. Justify your answer and be sure to explain the difference between common stock and preferred stock.
- How much Steve would earn in dividends if he invested the \$10,000 in common shares and held them for at least a year? How much dividend income would he earn if he invested in preferred shares?