The Stock Exchange Corner

by George Edwards

The Risks involved in Owning Shares

Last week we gave you the benefits of owning shares in a company. Although there are benefits to be gained by investing in a well-run company, there are also risks involved in owning shares in a company. Of course there is the problem of being misled by "creative accounting" - i.e. the misrepresentation of a company's true financial position as was done in the case of Enron. We have seen other instances of this in the international business arena. However, the Stock Exchange and the Securities Council/Commission are both mandated to oversee the securities industry to ensure the protection of the investing public. In Guyana, these are represented by the Guyana Stock Exchange and the Guyana Securities Council respectively.

The two main risks that investors may face are:

1) Although the value of your shares can go up, over a period of time, the value can also decline. This would be influenced by the company's financial performance, investor's confidence in the future prospects of the company and economic conditions in general.
2) If a company's financial performance is poor in any year, then a dividend may not be paid in that year.

It is therefore important that investors follow the fortunes of the companies in which they invest to decide whether to hold on to those shares or to shift their investment.

Listed below are some more FAQs as promised.

Frequently Asked Questions (FAQs) - continued

Who pays for the Stock Market?

Initially most of the costs of the GSC and GASCI were paid for by the British Government. They are currently supported by the Government of Guyana. In the longer term the main contribution to financing GASCI is expected to come from issuers, through listing fees.

What does "Listing" mean?

"Listing" literally means being admitted to the Stock Exchange Official List which indicates that the stocks and shares that are listed are freely transferable and validly issued – not non-transferable, or forged, or otherwise tainted; it also means that the issuer meets the requirements of law and regulation in the management of its business and in the disclosure of adequate, timely and accurate information about its business to investors.

How can the Exchange enhance a company's access to new capital?

Listing makes companies more credit-worthy and reduces the cost of borrowing. Listing also permits institutional investors who are not permitted to hold unlisted securities to buy a stock. Listing also increases the visibility of a company.

Why should companies want to be "listed"?

"Listing" is a seal of approval; it is good for a company's image; it may reduce its cost of borrowing from banks; it may make it eligible to be invested in by major financial institutions like certain US mutual funds which are only permitted to buy listed securities. Listed shares are usually more highly valued than unlisted; this usually makes the cost of new finance for listed companies lower than for unlisted.

When should a company consider listing on the Exchange?

When the conditions for raising money at advantageous rates are favourable – because the market is buoyant, or because the company is doing well, or both.

How does a company prepare to list on the Exchange?

It consults its professional advisers – lawyers, accountants and bankers. It starts a dialogue with the Exchange or the listing authority. It starts preparing as early as possible.

Why should companies issue shares to the public?

At first companies may be reluctant to issue shares because they may think that it dilutes the ownership and that it requires them to disclose information about their business that they would not otherwise have to reveal. But there is a trade off; they can obtain additional capital and they can increase the value of their business through public issue; they may also be able to issue new shares to merge with or acquire other businesses. Most important of all, they can reduce over-dependence on bank borrowing which can be very risky.

What else can companies issue besides shares?

They can issue bonds which can replace borrowing from the bank at a lower interest rate and for a longer term before repayment.

Will unlisted companies also be traded on the GASCI stock market?

Yes.

How can a stock market succeed if the economy is doing badly?

Stock markets can function in bad times as well as good. Prices are lower and trading less active, but the task of providing buyers and sellers with a service can continue to be met. The important thing is to avoid excessive operating costs which lead to the market organisation operating at a loss.

How can a stock market succeed if there are very few stocks?

Most stock markets round the world – excluding the senior markets of New York, Tokyo, London and Frankfurt – concentrate the major volume of trading activity on a relatively small number of stocks. This is particularly true in the Caribbean. Whatever the size of the market and whatever the number of securities traded, it is essential to match costs to expenditure. Very small informal exchanges can succeed and fulfil their economic function just as well as large formal exchanges.

How can investors obtain reliable information from companies?

Under the law all publicly held companies are required to be "Reporting Issuers" subject to strict requirements on disclosure to investors and the market, under the regulation of the Guyana Securities Council.

What information must issuers provide investors?

Issuers must provide investors with the information specified in the Securities Industry Act making regular periodic reports and special ad hoc disclosures when there has been a significant change in their business or their prospects.

What factors are important when analysing a company?

Profits, dividends, assets, management and prospects.

Next week: Glossary of terms used in the industry

N.B. – More information may be accessed on our website: www.gasci.com