**Title: Homework 1**

**Your Name:**

**School or Institution Name (University at place or Town, State:**

**Title: Homework 1**

**1-2.When is a stock said to be in equilibrium? Why might a stock at any point in time not be in equilibrium?**

**Answer:**

Equilibrium is attained by a stock ordinarily when its required and expected returns are equal to or generally closer to zero. Equilibrium would not be attained by stocks at any point in time because when their fundamental positions change, stocks especially of large companies adjust themselves rapidly. So these rapid changes in stock prices are merely an indicator of the changing conditions and expectations. In some cases, reaction of stocks could continue on for months. This is due changing favorable and unfavorable developments in the external environment. This indicates as information keeps increasing regarding a situation and information is readily available, the market adjusts to it.

**1-6.What are the various forms of business organization? What are the advantages and disadvantages of each?**

**Answer**:

Businesses can be divided into four classes. These include Proprietorships, Partnerships, Corporations and Limited liability companies (LLCs) and limited liability partnerships (LLPs).

**Proprietorships:**

A proprietorship is that type of business which has a sole owner and going into this type of business is easy. Its advantages and disadvantages are as follows:

Advantages:

1. Their formation is easy and not expensive
2. They have a very few governmental regulations that they have to operate under.
3. Compared to corporations, proprietors pay less income taxes.

Disadvantages:

1. They are subject to unlimited liability when it comes to paying off debts. So there is a high chance of losing more money than the money invested in the company.
2. The business’s longevity depends on the life of the creator of the business and if new equity is needed then a structural change is required in the business itself.
3. Proprietorships do not have access to huge capital because of unlimited liability and business longevity.

**Partnership:**

It is a legal agreement between a group of people (2 or more) who are going into business together. Its advantages and disadvantages are:

Advantages:

1. Are easily established and are not expensive.
2. Pro rata basis is used in dividing income of the firm whereas, taxation is done on an individual basis.
3. Corporate tax is avoided.

Disadvantages:

1. Unlimited liability is a concern in partnerships.
2. They also have problems in acquiring capital of large amount.

**Corporation:**

State creates a legal entity whose identity is different from its managers and owners. Advantages and Disadvantages are as follows:

Advantages:

1. Separation allows limited stockholder losses
2. They have unlimited lives
3. Have access to raise high amounts of capital.

Disadvantages:

1. Earnings of corporations are double taxed: once at after-tax earnings and then after dividends are paid out as personal income.

**Limited Liability Company (LLCs) or Limited Liability Partnerships (LLPs):**

LLCs are a hybrid concept of partnership and a corporation. Furthermore, LLPs are also similar to LLCs. Their advantages and disadvantage are as follows:

Advantages:

1. Provide limited liability.
2. Voting rights for investors proportional to their ownership interest.

Disadvantages:

1. Taxed as partnerships

**Integrated Case:**

**a. What are the three primary ways in which capital is transferred between savers and borrowers? Describe each one**

**Answer:**

Direct Transfers:

In this way, without the help of any financial institution businesses sell and customers buy stocks directly from each other. So the firm acquires money it needs by selling securities to savers. Small amount of capital is generated by using this method. So it becomes more suitable for small companies to use.

Indirect Transfers through Investment Bankers:

Transfers in this form going through an investment bank who underwrite the issue by facilitating the issuance of its securities. Investment banks provide a passage for the movement of money of savers and securities of businesses. The investment bank is at risk in this form because they buy from businesses and keep the securities for a selected time limit and are highly unlikely to sell them to the savers for the price they paid for it.

Indirect Transfers through a Financial Intermediary:

In this form of transfer mutual funds and banks can be used. They are known as financial intermediaries. So in exchange for giving its securities to savers, funds are secured from savers by intermediaries for stocks sold. Using the capital obtained, business securities are held by intermediaries, while securities of intermediary are in held by savers. Intermediaries are a source of efficient working of money and capital markets.

**f. What are the two leading stock markets? Describe the two basic types of stock markets.**

**Answer:**

NYSE Euronext and NASDAQ are leaders of markets. Furthermore, stock market types are as follows:

Physical Location Exchanges:

These are physical places which have their own buildings and contain a limited number of people trading on their floor and includes a governing body. Today, trading licenses in exchange for seats on the exchange are auctioned for about $50,000 per year. So, brokerage firms are operated by large investment banks through which seats are purchased on the exchanges and officers are designated as members. Communication between buyers and sellers is facilitated by these exchanges. An example of this type of exchange is NYSE.

Electronic Dealer Based Market or Over the Counter Market:

A high number of stocks are also traded of the exchanges and they are known as over the counter markets. Exchanges operate as auctions where orders for buying selling of securities is matched with each other by exchange members. It is difficult to match such orders within a given period of time, so brokerage firms keep inventories of such stock. They then buy and sell according to the investor’s choice. These markets are also referred as dealer markets, where security transactions occur but not on physical location exchanges. An example would be NASDAQ.

**g. If Apple Computer decided to issue additional common stock, and Varga purchased 100 shares of this stock from Smyth Barry, the underwriter, would this transaction be a primary or a secondary market transaction? Would it make a difference if Varga purchased previously outstanding Apple stock in the dealer market? Explain**

**Answer:**

If Varga decides to purchase this new issued stock of Apple Computer then this transaction will occur in the primary market. This is because Apple computer has decided issue new common stock, which are generally sold in primary markets. If Varga decides to buy outstanding stock of Apple then secondary market will be the place for this exchange. The reason for this is that Varga is trying to buy already existing and outstanding stock of Apple, which are usually traded in secondary markets.

**h. What is an initial public offering (IPO)?**

An Initial Public Offering (IPO) refers to when stocks are held closely by corporations and the public is given a chance to buy. Initial public offerings is the market for initial offering for such stocks. The number of new IPO’s depends on the rise and fall of stock markets. Companies would want to go public to present an opportunity to the founders to sell part of their shares for cash increments when the market is strong. But IPOs are not all well received.

i**. What does it mean for a market to be efficient? Explain why some stock prices may be more efficient than others.**

**Answer:**

Efficiency of the market is high when its prices and intrinsic values are closer together and equilibrium is maintained in stocks. Intrinsic value refers to the selling price of the stock when all information about a stock is available to investors. The stock prices for larger companies is more stable compared to smaller companies. This is because larger firms have more analysts following the trends in different stock prices and are able to add new information faster. This faster addition of new information reflects in stock prices. Also, good communication between analysts and investors also plays a big part in the efficiency of stock markets.