Sources of Corporate Funding

- Operating Funds: (use company profits to finance the company's operations)
  - Pro:
    - Does not lead the company into debt
  - Cons:
    - Company has to have sufficient profits to meet operating expenses and salaries
    - Cannot use that money for dividends

- Take out loans from banks
  - Pro:
    - Relatively painless way to raise cash and postpone the repayment
  - Cons:
    - Requires good credit to get a significant loan
    - Too much debt on the corporate balance sheet is not good (the corporate profits might be swallowed up trying to pay off the loans)

Sources of Corporate Funding 2

- **Issue shares of the company**
  - Pros:
    - Can raise a lot of money without getting the company into debt
  - Cons:
    - Must comply with strict SEC Regulations
    - Dilutes the value of the shares held by the current shareholders

- **Issue corporate bonds** (loans to the company by private people)
  - Pro:
    - Can raise a lot of money without diluting the shares
  - Cons:
    - Must comply with strict SEC Regulations
    - Adds to the company debt

The SEC Acts- An Overview

- These laws were passed on 1933 and 1934 in response to the stock market crash of 1929 and the ensuing Great Depression

- **Reasons for the passage:**
  - Rampant Speculation based on faulty information had led to the stock market "bubble" of the last 1920s.
  - The faulty information had come from companies who essentially said anything they wanted to get people to buy their shares, with little oversight

- **Goals of the Securities Laws**
  - Assure the accuracy and completeness of information given to the investment public
  - Organize a system by which there should be full disclosure of accounting information to the public
  - Regulate all forums in which securities are exchanged

Going Public - The Offering Process

- The key elements to the SEC rules regarding a company going public are:

- **Disclosure:**
  - A full and complete disclosure of all sorts of information relating to the company's finances, business, prospects etc.

- **Organization:**
  - The rules require that the company get its books in order before going public

Initial Public Offering

- **The Prospectus:**
  - This is the documents that makes these disclosures and explains how the company is organized and gives investors the information they need to make their investment decisions
  - The prospectus must be approved by the SEC before the issuance can take place
  - A prospectus is NOT an advertisement; it may not try to "condition the market" by bragging too much about the company or making predictions; it must stick to the facts!
  - The one section that can prognosticate a little is the "Management's Discussion and Analysis" section; but that must not be misleading

- **The Issuance:**
  - Occurs only once the SEC has given its approval
  - The corporation or its bank sets the initial price (at which the company offers it to the public); and the free market will soon set the "true" price of the stock

QUIZ TIME!

The Securities Markets

- A securities market is the “place” at which exchanges of securities take place. They can be physical or on a computer

- **Securities Exchanges**
  - These are very heavily regulated by the SEC and are licensed and approved by the SEC to allow people to exchange securities in their “markets”

- **Major Examples:**
  - **New York Stock Exchange** (NYSE): the biggest one, it has its own very strict requirements for its companies, including large public floats and restrictions on who can make up the companies’ boards of directors
  - **American Stock Exchange** (AMEX)
  - **National Association of Securities Dealers Automated Quotation (NASDAQ):** Runs electronically. Thus, the NASDAQ’s requirements are less stringent, and so they’re often used by new companies or those that are not so wealthy or established
  - **Over-the Counter Stock trading:** This is trading done privately without an exchange. (remember that the SEC requirements for going public do not include becoming listed on an exchange)

Insider Trading

- **Rule 10-b-5**
  - This rule prohibits using any fraud or dishonesty in stock trading
  - It also includes people who use “insider information” to make a trade
  - “Insider information” means information gained in the capacity as officer or director of the company

- **Rule 16-b**
  - The “short swing” rule; which is designed to prevent insider trading
  - This rule says that if any transaction is made by an insider up to 6 months before a major announcement that causes a big price fluctuation in the stock, the insider must give back profits made on that transaction

- **Remedies:**
  - Civil and/or criminal penalties
  - Disgorgement of profits made on the insider transaction