

Wall Street is the New York equivalent of the London Stock Exchange and what happens on Wall Street has a profound influence on what happens on the London Exchange. This has always been true but never more so than since the effect of 'Big Bang' and markets in stocks and shares going 'global' in 1986.



# WALL STREET

What happens on a Stock Exchange such as Wall Street and Throgmorton Street in the City of London?

Both are market places where buying and selling takes place and the main market is in ordinary shares in companies (equities) and Government bonds (known as gilts or gilt-edged securities). Other types of paper assets are also traded-in options, debentures fixed-interest loans raised by companies) and preference shares. Every time a deal is struck it is referred to as a 'bargain', whether or not it is a bargain in the sense of being value for money.

It is important to note that a school trip to the Stock Exchange today would reveal that there is little face-to-face trading - most bargains are struck over the telephone and share prices are completely computerised. Another important fact is that Stock Exchanges trade largely in second-hand shares - none of the money gained in share bargains accrues to the companies whose shares are involved. There is a primary market, in new shares, but it is small in comparison to the secondary market.

## FIND OUT:

1. Which famous economist spoke of the Stock Exchange as a 'casino'?
2. Why could the Stock Exchange be considered as a casino?
3. What is the difference between a. preference and cumulative preference shares? b. debentures and preference shares?
4. From the current price. For a small outlay, an investor can buy the right to buy shares at this price whatever happens to the price by the expiry date of the option. Why do you think options are so popular? Why might options be popular with 'insider traders'?
5. How do ordinary shares differ from preference shares?
6. Find out how money can be made from shares by a. Dividends b. capital gain

## THE FILM

Bud Fox is a STOCKBROKER (or MARKET-MAKER) - an individual employed by a COMPANY OF STOCKBROKERS - and his job is to buy and sell stock (groups of shares) on behalf of clients. In the early stages of the film he spends some of his time on 'cold sales' - trying to drum up business for the company by telephoning possible investors.

A broker charges commission on the bargains he or she (predominantly he) undertakes. He can supplement his income by trading in shares himself if he has the capital or can cheaply borrow money with which to speculate. The odds against successful speculation are reduced if the broker has inside information. Inside information includes any facts which are generally unknown but which are likely to cause an increase in the share price of the company concerned.

1. What first piece of information does Bud bring to Gordon Gekko which allows Gekko to make a profit?
2. Why is this piece of information likely to cause an increase in the Blue Star share price?
3. Share prices are very volatile. In this country how and why are the following likely to affect share prices?
  - a. Pre-election opinion polls indicate strong support for the Conservatives
  - b. rumours of one electrical goods retailer taking-over another
4. Since 'Big Bang' the distinction in the UK between JOBBERS and STOCKBROKERS has ceased to exist. Previously, both had SINGLE CAPACITY. Jobbers bought shares and tried to re-sell at a profit to themselves - the JOBBER'S TURN. BROKERS bought from JOBBERS on behalf of clients, charging COMMISSION on the value of the sale. The percentage commission charged fell the higher the value of the bargain. Nowadays British brokers act as MARKET MAKERS - they do both jobs, hoping to make up in share deals what they lose under the new system of NEGOTIATED COMMISSION. Competition for business on the Stock Exchange became fierce, especially as American and Japanese firms were gaining membership of the Stock Exchange
  - a. Having bought 5000 shares in a company at 110p each, a jobber sold them to a broker for 115p each. The broker charged his customer 1.65% commission.

Calculate

- a. the jobber's turn
  - b. the broker's commission
  - c. the total cost to the customer?
- b. Following 'Big Bang' the same shares are sold to another customer by a MARKETMAKER - who charges 1% commission on the deal, selling the shares at 2p more than the buying price, 110p. How much would the MARKETMAKER make? How much would the deal cost the customer?

## KEY TERMS

When Gekko receives the information from Bud about Blue Star shares he buys - he is a BULL, buying in the belief that the share price will rise. The odds against the price rising are reduced if you have INSIDE INFORMATION. Also, an increase in demand for shares is likely to increase their price anyway, especially if the buyer has a FAN CLUB. A FAN CLUB is what the name suggests - a group of supporters of a previously successful speculator who try to cash in on his/her success. This may or may not be within the law. If the FANS expect future favours then the latter is more likely.

A TAKE-OVER occurs when one company buys a controlling interest in another. Do not confuse a TAKE-OVER with a MERGER, in which companies join together on equal terms. The cost of TAKE-OVER may be reduced by a CONCERT PARTY institutions buy shares, often through NOMINEES (disguising the true buyer), on behalf of the PREDATOR (Gekko is a PREDATOR). He buys the shares off them at a profit to them but acquires a % shareholding both stealthily and cheaply. Once a take-over bid becomes known the share price of the threatened company increases rapidly.

Why would one firm take-over another? Some of the possible reasons are outside our scope here but ASSET-STRIPPING may be one motive.

Bud is conned by Gekko into thinking that the TAKE-OVER of Blue Star is motivated by a desire to streamline and improve the profitability of the company. Gekko intends to ASSET-STRIP - sell off the company ASSETS at profit, closing the company down in the process. He stands to make a particular profit from the company PENSION FUND.

A company is more susceptible to take-over if it has untapped earnings potential and if its shares are undervalued. Remember how Bud poses as a worker in a company in order to try and find out some inside information from the company books.

An ARBITRAGEUR is an individual who acquires share holdings in companies threatened with take-over. He may simply sell at profit but may act as a WHITE KNIGHT, acting to counter the unwelcome take-over bid. When Sir Laurence Wildman visits Gekko at home the purpose of the visit is for Wildman to buy the share in Annacott Steel that Gekko has acquired, at considerable profit to Gekko.

Bud Fox has acquired the information that Wildman was buying the shares in Annacott whilst on probation with Gekko after the original piece of information about Blue Star proved successful. Finally in this section we must refer to GREENMAIL - a word that crops up several times in the film. Greenmail is blackmail using 'greenbacks' - dollar bills. In a take-over the threatened company is offered the chance to buy back some of its own shares from the attacker - at an inflated price. This is illegal in the UK as was proved in the scandal over Guinness in 1986.

Reference is also made to JUNK BONDS. Companies poised to take-over may issue bonds (paper assets) in order to raise finance. Junk bonds offer high rates of interest to the buyer but are not a long-term investment. The interest available, higher than market rates, will be recouped by the company if its take-over bid is successful.

## EXERCISES

1. A normal demand curve slopes downwards from left to right. Why might the D demand curve for shares be upward sloping from left to right?
2. Explain in your own words the difference between a fan club and a concert party.
3. Why will a predator make use of nominees when launching a share bid?

## DISCUSSION POINTS

- Is ASSET-STRIPPING immoral or just good business?
- Is INSIDER TRADING any different morally from stealing from shops?
- What events in the UK economy in the last few years have made the Government particularly anxious to erase insider trading?
- Bud's solicitor friend is guilty of insider trading. How many of you sympathise with him? Why?

He is caught by STOCKWATCH, Government monitors of suspicious share dealing and the US equivalent of the DTI. If he had used NOMINEES or transacted with several bank accounts he may not have been caught but some large-scale insider traders in the US have been caught because they did not wish to incur the charges involved in running several bank accounts!

# WHAT THE SHARE TABLES ACTUALLY MEAN

On several occasions during the film we see Bud perusing the lists of share prices in the newspaper. Using shares in UK companies as an example he will have seen:

STOCK PRICE CHANGE ON WEEK YIELD P/E HIGH LOW

What does each of these entries mean?

STOCK is simply the name of the particular company.

PRICE is the current second-hand price per share. Remember that shares cannot be traded-in ones

CHANGE ON WEEK, + or -, indicates the change in the share price over the last week of trading.

YIELD indicates the earnings on the share as a % of their current price, not the ISSUE or PAR price upon which any DIVIDEND is paid. This will be fully explained shortly.

P/E refers to the PRICES/EARNINGS ratio. Companies share profits with shareholders (owners). If a company has 50,000 shares owned by shareholders and has € 15,000 to distribute, its earnings per share is 30p. If the market price of the shares is £2 (most shares are issued at € 1 each) then the PIE ratio is 200p divided by 30p or 6.66. This means that the shares are selling at 6.66 times their earnings.

HIGH means the recent highest price for the shares, LOW, the lowest. These indicate whether, say, a falling share price has bottomed out.

So - an extract from the financial pages might read:

STOCK	PRICE	CHANGE ON WEEK	YIELD	P/E	HIGH	LOW
X	245	+5	2.6	15.8	280	165

## EXERCISES

1. Explain each of these entries in your own words
2. If a company announces a 15p DIVIDEND per share (issue price £1) but the current price is £1.50 then the YIELD is:

$$\frac{15p}{£1.50} \quad \% = 10\%$$

What would the YIELD have been at the HIGH and LOW prices given above?

3. Why might shareholders be interested in shares offering a low yield only.
4. If a share sells for £2.50 and its P/E ratio is 10
  - a. What is its Dividend?
  - b. What does P/E ratio mean?

Shares are by no means certain to make money ! The company may not declare a dividend and shares may fall in price. A falling share price market is termed BEARISH. A BEAR is a speculator who sells when prices

Star the episode following Bud's realisation that Gekko plans to ASSET-STRIP Blue Star, he deliberately drives the price down to make Gekko lose money, then buys back to spark off the share price revival. Clearly, only concerted action by many interested speculators/shareholders can bring about wild fluctuations in individual share prices.

## THE ANNUAL GENERAL MEETING

Most ORDINARY SHAREHOLDERS play no part in the day-to-day running of the company in which they own shares. Shareholding is an investment for them, an alternative to having a deposit account with a bank. Bank accounts do tend to be a more predictable source of income though. Shareholders can vote at the company WE annual general meeting, usually to accept or reject the dividend declared by the company and to re-elect the Board of Directors. Proxy votes are allowed (somebody you nominate votes in your place) but the voting rights are not equal. The greater your shareholding, the greater the weight of your vote. Small shareholders cannot realistically plot to overthrow the Board unless they have the support of others with a sizeable shareholding.

## THE TELDAR PAPER AGM

The current Chief Executive Officer of the company advises the shareholders to accept a new deal offered by the company in preference to the buy-out price per share offered by Gekko -his TENDER. The company has borrowed heavily to try to see off his bid - is LEVERAGED to the hilt.

When Gekko takes the microphone he wryly thanks Cromwell for allowing him to speak a right of the chief shareholder. Gekko compares the plight of the company under its existing management to the plight faced by the US Govt., with its FISCAL and TRADE DEFICITS. He recalls the days when America was 'a top industrial power' under the workings of the FREE MARKET: he recalls great financiers and industrialists of the past, Carnegie and Mellon, men who ensured the success of their enterprises because it was their own money at stake. He disparages the BUREAUCRATS running the company on inflated salaries, lavish expense accounts, lucrative contracts to soften the blow of being taken-over (GOLDEN PARACHUTES -to come down to earth gently!), men with a combined stock holding of 3%.

Teldar Paper, he continues, made a loss of \$11m last year, some of which might be explained by paying thirty three Vice-Presidents annual salaries of \$200,000 each. Having spent two months trying to 'figure' what they did to earn the money he had drawn a blank. Certainly excessive paper work could explain 'half' of the annual loss.

Gekko continues by quoting the \$12b profits enjoyed by 2.5m shareholders in his last seven deals. Companies like Teldar would not currently survive a 'battle of the fittest' - he is a LIBERATOR, not a destroyer of companies. Finally, he appeals to the common currency of greed, greed for life, greed for money to persuade the shareholders to his cause, but he had long since persuaded any doubters.

1. Why does Gekko make great play of

- a. the similarity between the problems of the USA and Teldar?
- b. the excesses of the current Board?
- c. his role as a liberator?
- d. the value of greed?

## THE BLUE STAR EPISODE

The meeting at Bud's apartment is for the purpose of trying to begin organising a take-over of the Blue Star Airline by Gekko - present are Carl Fox, Bud's father and representatives of the Unions involved. Gekko outlines his case: losses, zero dividends and market share being eroded by bigger companies. A bankruptcy would hurt the Unions most, as management has 'parachutes' similar to those available for the Teldar board. His plan involves a 20% 'across the board' wage cut to be restored within a year if loss becomes profit coupled with an employee profit-sharing scheme. Bud outlines the marketing scheme - the plan to improve sales and profitability. These include higher prices charged to customers willing to pay more (PRICE DISCRIMINATION), better computer facilities, more cargo carried per flight, new routes, aggressive advertising adding up to increased revenue and the ability to withstand a PRICE WAR with the majors. Alone, Carl rejects the offer, recognising that Gekko has no love of the industry or this airline but simply a greed for money, including money gained from an ASSET-STRIP. He does agree to offer the suggestion to his men.

1. What evidence is there above to suggest that Blue Star is nearly bankrupt?
2. How would Blue Star improve its market share and profits under the proposed scheme?

As Carl Fox suspected Gekko is to ASSET-STRIP the company. The assets of Blue Star are to be sold off - even the typewriters have buyers | The commercial banks that have lent money to finance the take-over will be paid back following the sale of the assets - the hangars for building land, the planes, routes and gates to former competitors. Gekko stands to make a net profit on the overfunded company pension fund. The pension fund is committed to paying monthly income benefits to policy holders, worth a total of \$50m.

The fund is worth at least \$70m more. Bud has been betrayed by Gekko and feels that he has betrayed his Father. Gekko, confronted by Bud tries to appease him, claiming that sentiment in business loses money and that, as President of Blue Star, Bud will 'parachute out' (see earlier references) and his Dad (unlike the men his Dad represents) will be financially secure for life.

'Capitalism at its finest' is how Gekko justifies his actions. Speculation is responsible for two-thirds of the five trillion dollars in wealth owned by 1% (I) of the American public. They create nothing, they merely buy and sell assets for profit, they own.

Suggest as many examples of UNEARNED income that you can.

## THE COUNTER ATTACK

Bud has decided to try to out-manoeuvre Gekko over Blue Star. Gekko is buying Blue Star shares at up to \$24 each, knowing that with support buying that the price will go higher. When the price reaches \$23 per share, Wilmore (one of the Union reps in on the initial meeting with Gekko) is to inform Gekko of the withdrawal of Union co-operation. At the lower share price (\$18) Sir Lawrence Wildman will step in, buy the company as a working airline. Bud, with help, succeeds in driving the price of the shares upwards, spoiling the market for Gekko, alerting buyers to the take-over. The stock reaches \$23 and now is off-loaded, pushing the price down. Wildman buys stealthily as the price falls and in large quota once \$18 is reached. Gekko is forced to sell his shares at a large loss just before trading ceases for the day - instructing Bud to sell. The closing price was \$17 - lower than Wildman's buying price because more shares were being sold than Wildman was buying back.

Gekko learns from the TV News that Wildman has been buying the shares and the rapid fluctuations in the share price were orchestrated by Bud Fox; he realises that he has been duped

## THE FINAL MEETING

Arrested for insider trading, Bud agrees with the SEC to secretly record his conversation with Gekko in the park. Gekko berates Fox for the betrayal, citing several instances when Fox received useful information from Gekko. Thus Gekko incriminates himself with the SEC. Fox has turned against former colleagues to reduce his own punishment. Perhaps the word of a broker is no longer his bond.