Review of Main Financial Concepts

Finance

- The study of how money is managed and it is considered the actual process of acquiring needed funds.
- It involves main institutions: banks, stock markets and main instruments: loans and shares.

Financial Institutions

Organizations engaged in any of the many aspects of finance including:

commercial banks, investment banks, securities brokers and dealers, and insurance companies.

Banks

A bank is a financial institution licensed to receive deposits and make loans. It is considered an indirect finance.

There are three types of banks: commercial (retail) banks, specialized banks and investment banks.

Commercial banks: National Bank of Egypt, Bank of Alexandria, Commercial International Bank (CIB), and Faisal Islamic Bank of Egypt

Specialized banks: Bank for Development and Agricultural Credit and Export Development Bank of Egypt

Investment banks: Al Ahly for Development and Investment and Arab Investment Bank.

Stock Markets

The stock market refers to a market where the trading of equities (stocks of publicly held companies), bonds and other sorts of securities takes place.

- It is known as the secondary market
- Is is considered a direct finance

Example:

Cairo and Alexandria Stock Exchange

The Primary Capital Market and the secondary capital market

Primary market: When a company publicly sells new stocks and bonds for the first time, it does so on the primary capital market. This takes the form of an initial public offering, or IPO.

Secondary market: When owners of the securities want to sell them.

In the primary market, investors buy securities directly from the company issuing them, while in the secondary market, investors trade securities among themselves, and the company with the security being traded does not participate in the transaction.

Loans and Collateral

A loan is the act of giving money to another party in exchange for future repayment of the principal amount along with interest.

It is a short term to medium term debt contract that requires a collateral.

Collateral is a property or other asset that a borrower offers as a way for a lender to secure the loan.

Stocks and dividends

They represent an **ownership** interest in a corporation.

Stocks pay dividends (coupon rate) to the owners, but only if the corporation declares a dividend.

Dividends are a distribution of a corporation's profits.

Bonds

They are a form of long-term debt in which the issuing corporation promises to pay the principal amount at a specific date.

Bonds pay interest to the bondholders. Generally, the bond contract requires that a fixed interest payment be made every regular basis.

Face Value and Market Value

Face value is the **nominal value** of a security stated by the issuer.

- It is the value printed or depicted on a security
- It is also known as "par value"

Market value is determined based on principles of supply and demand, often governed by what investors are willing to buy and sell a particular security.

An initial public offering (IPO)

An initial public offering (IPO) is the first time that the stock of a private company is offered to the public. IPOs are often issued by smaller, younger companies seeking capital to expand, but they can also be done by large privately owned companies.

Liquidity

It refers to having lots of cash or assets easily converted to cash.

✓**Liquid asset:** An asset that can be converted into cash in a short time, with little or no loss in value.

✓**Illiquid asset:** An illiquid asset is an asset that can't be converted into cash quickly. If it is sold in short time, it will significantly and negatively affect the price received.

Creditor

Party that loans money or other assets to another party.

A shareholders- Stakeholders

<u>A shareholder</u> owns part of a company through stock ownership,

<u>A stakeholder</u> is interested in the performance of a company for reasons other than just stock appreciation.

Stakeholders could be: employees who, without the company, would not have jobs.

The free rider problem

- The **free rider problem** is a market failure that occurs when people take advantage of being able to use **<u>a common resource</u>**, or **<u>collective good</u>**, without paying for it, as is the case when citizens of a country utilize public goods without paying their fair share in taxes.
- The **free rider problem** results in an underprovision of those goods or services. So, it is important to limit free riding and its negative effects in these situations.

A takeover

A takeover occurs when an **acquiring company** makes an ask in an effort to assume control of **a target company**, often by purchasing a majority stake.

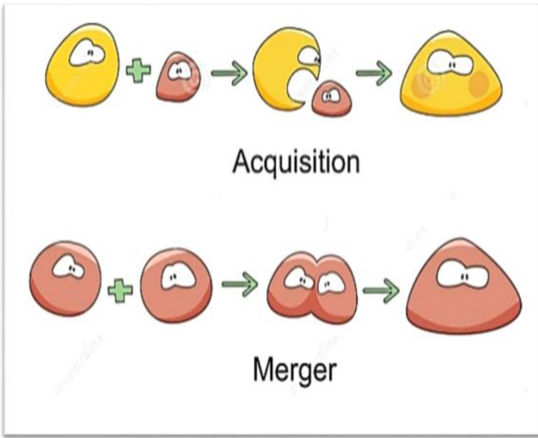
- If the takeover goes through, the acquiring company becomes responsible for all of the target company's operations, holdings and debt.

A Merger and An Acquisition

- **A merger** occurs when **<u>two</u> separate entities** combine to create a new, joint organization.
- a merger requires two companies to consolidate into a new entity with a new ownership and management structure

- **An acquisition** refers to the **takeover** of one entity by another. The smaller company's assets become part of the larger company.
- An acquisition occurs when a buyer acquires all or part of assets of a selling entity.
- An acquisition takes place when one company takes over all of the operational management decisions of another.

Acquisitions – sometimes called takeovers.




Acquisition


Merger

Volatility and Spread

Volatility is a statistical measure of the dispersion of returns for a given security or market index.

Spread refers to the difference between the lowest ask price and the highest bid price

A liquid market

A liquid market is a market with:

Many bid and ask offers, low spreads and low volatility.

Numerous buyers and sellers.

Liquid market, it is easy to execute a trade quickly

Note: The opposite of a liquid market is called a "thin market" or an "illiquid market."

Denominate - Tranche- A road show

Denominate: (of sums of money) be expressed in a specified monetary unit.

Tranche: a portion of money

A road show is a presentation by an issuer of securities to potential buyers.

Asymmetric information (information asymmetry)

Asymmetric information, sometimes referred to as information failure, is present whenever one party to an economic transaction possesses greater material knowledge (more or better information) than the other party.