Fact Sheet 1: What is a Stock?

Stocks represent a share of ownership in a publicly held company. The stockholder has a claim on the assets of a company in exchange for the money paid to purchase the stock. As an owner, the stockholder is sharing the wealth AND the risk of ownership with other owners of the company. No matter how few shares of stock you own, you are part owner of the business.

Typically, a company issues stock in order to raise money to expand and build their operations. The company goes to a financial services firm that specializes in underwriting an initial public offering (IPO) of stock to help them with this process. The financial firm gives the company the money it needs to expand, and issues stock. This stock is sold to the public in what is known as the secondary market. Stockholders, also called shareholders, are people who buy the stock.

People buy stock to earn dividends and with hope of selling the stock at a higher price than they originally paid. Stockholders may receive part of the company's profits through dividends. Public companies are not obligated to pay dividends, but most do. Stockholders have limited liability; that is, while they can lose the money they invested to buy the stock, they are not responsible for the company's financial debts should the company fail.

A stockholder should make investment decisions based on his/her "risk tolerance." All investments have some risk. A somewhat risky investment with great growth potential might be a good for someone who is 28 and financially stable, but not for someone who is 60 and plans on retiring in five years. A 28-year-old has time to regain losses before retirement; the 60-year old may not.

Stocks are traded on stock exchanges. The two major U.S. exchanges are the New York Stock Exchange and the NASDAQ. Both are located in New York City. Stocks usually trade in lots of 100; anything less than 100 called an "odd lot." Stocks can range in price from a few dollars to hundreds of dollars per share.

A publicly traded company pays increased taxes in the form of corporate income tax. Each state has its own rules regulating public companies. Public companies must also comply with rules and regulations imposed by the securities industry as well as the federal Securities and Exchange Commission (SEC). They must also submit an annual report to the SEC outlining all their financial information.

There are two types of stock, common and preferred. When you own common stock your shares represent ownership in the corporation. They give you the right to vote for the company's board of directors, and benefit from its financial success. Some corporations issue preferred stock in addition to common stock. Preferred stocks often pay a fixed dividend on a regular schedule. The price of preferred stock tends to be less volatile than that of common stock. Preferred stocks tend to move with changing interest rates. Unlike owners of common stock, owners of preferred stocks are not entitled to vote on corporate matters.

