Keir Digest
with
Assessment Questions
For
HS 328

To be used in conjunction with 7th Edition 2013 text

Published by:
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Assignment 1

Securities Markets and Market Mechanics

Learning Objectives

1-1. The primary market is where corporations and businesses raise capital by issuing new securities. An investment banker helps the issuer sell the new securities to institutional and individual investors. Therefore, the primary market is where funds flow from investors to the issuing business.

When a business offers new securities to the public for the first time, the sale is called an initial public offering, or IPO. Since the business is changing from private to public ownership, it is said to be going public. A business can issue additional new securities after the IPO.

When a new issue is offered, an investment banker may underwrite the offering or put together a syndicate, or group of investment bankers, to assist in the offering, in which case, the members of the syndicate share the risk, obligations, and compensation. If the investment banker or syndicate offers to underwrite the new issue on a firm-commitment basis, the banker or syndicate buys the entire offering from the issuer and sells it to investors. If an underwriting is on a best-efforts basis, the investment banker acts only as an agent on behalf of the issuer and does not take the risk of investors not buying the securities.

Before the new issue can be sold, the investment banker and issuing corporation file a registration statement with the SEC. Copies of the registration statement can be distributed to advertise the offering, but the securities cannot be sold until the SEC reviews the registration and allows the sale to proceed. Registration statements that are distributed while the SEC review is still pending are called red herrings. After the SEC completes its review, the investment banker distributes a prospectus to potential buyers instead of a red herring.

A shelf registration allows an issuing company to sell an offering to institutions over a 2-year period. A private placement refers to an offering to a small number of investors instead of to the public at large. Private placements are usually sold to institutional investors.

Assignment 1

Securities Markets and Market Mechanics

1. Which of the following statements best describes the primary market for securities?

(W 1.2)

(A) Investors trade securities with other investors.
(B) Institutions trade securities with other institutions.
(C) Businesses sell securities to investors.
(D) Specialists sell securities on exchanges to investors.

2. Which of the following statements concerning an initial public offering (IPO) is correct?

(W 1.2)

(A) Any sale by an issuer of new securities is an IPO.
(B) Any sale of securities in the primary market is an IPO.
(C) Any sale of new securities in a private placement is an IPO.
(D) Any sale of new securities to the public by a privately owned company is an IPO.

3. Which of the following statements concerning a public offering in the primary market is (are) correct?

(W 1.2-1.3)

I A syndicate is a group of investment bankers who share the underwriting of an offering.
II The registration statement distributed before SEC approval is called a tombstone.

(A) I only (C) Both I and II
(B) II only (D) Neither I nor II

4. Which of the following statements is true when an investment banker performs an underwriting on a firm-commitment basis?

(W 1.3)

(A) The investment banker acts as an agent for the issuing firm.
(B) The investment banker buys shares from the issuer and sells them to the public.
(C) The investment banker makes his or her best effort to sell shares for the issuer.
(D) The investment banker receives a commission which is added to the offering price.

5. Which of the following statements concerning special kinds of primary offerings is (are) correct?

(W 1.4)

I A shelf registration requires the issuance of lettered stock that restricts resale.
II A private placement is a sale, usually below the public offering price, to a small group of institutions.

(A) I only (C) Both I and II
(B) II only (D) Neither I nor II

6. All of the following are techniques for selling securities in the primary market, EXCEPT:

(W 1.4)

(A) Underwriting by an investment banker
(B) Private placement
(C) Shelf registration
(D) Block trade

Assignment 1

Securities Markets and Market Mechanics

1. C is the answer. In the primary market, issuing businesses sell securities to investors and cash flows from the investors to the businesses.

2. D is the answer. Any sale of new securities by a privately owned company to the public is an IPO. A sale of new securities in the primary market is not an IPO when the issuing company has previously issued shares to the public.

3. A is the answer. A syndicate is a group of investment bankers who share the obligations, risk, and compensation in a public offering. A tombstone is an advertisement for a public offering and contains the names of the underwriters. The registration statement distributed before the SEC has completed its review is called a red herring.

4. B is the answer. If an underwriting is done on a firm-commitment basis, the investment banker buys the shares from the issuing corporation and sells them to the public. The underwriter deducts his or her fee from the price paid to the issuer, so a commission is not added.

5. B is the answer. A shelf registration allows a firm to file one registration statement for a large block of stock that can be sold over two years. It does not require the issuance of lettered stock that restricts resale. A private placement is a sale, usually below the public offering price, to a small group of institutional investors.

6. D is the answer. Block trades are used in the secondary market.