

# HOW THE SHAREMARKET WORKS: 3

## THE SECONDARY MARKET

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After a company has listed on ASX and shares have been issued to investors through the primary market, the shares can be sold to other investors in the sharemarket.

Listing of companies on the market and the daily trading of their shares is the main activity of the Australian Securities Exchange.

### Market forces

Demand refers to how many people want to buy something and how much they are prepared to pay. Supply refers to how many people are prepared to sell something and the price they want for it.

The sharemarket is like any other market - price is decided by the forces of demand and supply.

When you are next shopping, take a look at the price of some of the goods and think about the factors that have determined the price for a particular item.

For example, if you are going to buy a pair of jeans you will most likely consider the following:

- The price of the jeans
- Fashion: do the jeans suit your particular taste? Are the jeans a popular brand?
- Price of other jeans or perhaps other pants. What do you think is the reason for the different prices of different pairs of jeans? Is it quality, size, extra features or perhaps brand popularity?
- How much money you have or your income. If you had less money which would you buy? If you had more money which would you buy?

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### QUICK QUIZ

1. What happens to the price of fruit when it is in season?  
A. Prices fall  
B. Prices rise
2. Tickets for some concerts sell out very quickly. Do you think this means that they could have charged higher prices? What are the reasons for and against charging higher prices for concert tickets?
3. China has been experiencing slower growth and has been building fewer houses and factories. What do you think this has done to the price of iron ore?  
A. Prices have gone up  
B. Prices have gone down  
C. No change

### KEY DEFINITION

#### THE SECONDARY MARKET:

Shares are first issued on the primary market. From then on shares are traded on what's called the secondary market.

### 3 HOW THE SHAREMARKET WORKS: SECONDARY MARKET

Now think of the supplier of jeans and what factors may have affected the decision to supply those particular jeans for retail sale. The supplier may have considered the following:

- Expectations of the price customers are prepared to pay for jeans both now and into the future. A higher price will encourage the supplier to supply more goods.
- Brands tend to go in and out of fashion.
- Production costs such as the costs of materials and labour to make the jeans. If production costs are too high, manufacturing the jeans may not be a profitable concern.
- Technological change may mean that jeans may be able to be produced more quickly with new and better sewing machines, reducing production costs.
- Whether the brand and type of jeans face a lot of competition particularly from imported goods.
- What price you might receive for producing another piece of clothing using the same resources.

#### ACTIVITY ONE

1. Can you think of a consumer item that was very popular but is no longer as fashionable? How do you think this might affect the price a supplier could charge?
2. These days a lot of clothes are produced overseas in countries where labour costs are much lower.
  - (a) How do you think this will affect the cost of the clothes imported from overseas?
  - (b) What sort of impact would it have on the price of similar clothes produced here in Australia?
  - (c) Name some countries where you think clothes would be produced more expensively and also name some countries where you think they would be produced more cheaply.
3. What effect does an increase in the price of oil have on the price of plane tickets? What would this do to demand for overseas travel?
4. These days everyone is concerned about climate change. List some products or industries that might suffer lower demand as a result of these concerns and prepare a list of products or industries that might benefit from these concerns. You might like to prepare a list of those benefiting while a partner makes a list of those disadvantaged.
5. When a business is closing down, you often see prices heavily reduced. Why don't they increase prices to make more money before they close down?



#### FAMOUS QUOTE

*"A market is the combined behaviour of thousands of people responding to information, misinformation and whim."*

Kenneth Chang

#### HERE'S AN IDEA

Create some classroom chaos. Make up pairs of buy and sell cards which contain:

1. the word "BUY" or "SELL"
2. the name of the company
3. the price the share will be bought or sold at (you can make this up if you like).

For example, if there are 20 students in a class, you may choose ten different companies. It is good to pick companies that you know and know what they do. For each company you will have one buy and one sell card, both with the name of the company and the same share price on each card to ensure a match or trade occurs.

Distribute the cards and find your perfect match by locating the student who is either buying or selling shares in the same company you have. Discuss why an electronic trading system would be much more efficient.

#### MORE INFORMATION ON

how our electronic system works can be found on [www.asx.com.au](http://www.asx.com.au)

If you are all enjoying this activity you could come up with some news events that might have an affect on the companies and discuss how the price people would pay for shares in the company might change.

# 3 HOW THE SHAREMARKET WORKS: SECONDARY MARKET

## How the sharemarket works

Buyers and sellers in the sharemarket exchange shares for a particular price. When both buyer and seller agree on a price per share a trade takes place.

Let's take a simple example to show how shares are traded on the secondary market.

TABLE 1: COMPANY XYZ

BUYER	BID PRICE	SELLER	ASK PRICE
Buyer A	\$1.00	Seller D	\$1.05
Buyer B	99 cents	Seller E	\$1.00 → =Trade
Buyer C	98 cents	Seller F	\$1.06

You can see from the Table 1 in this lesson that there are three buyers and three sellers of shares in XYZ Company. Buyer A is prepared to buy XYZ shares at \$1.00 per share. Buyer B and C prefer to pay less so Buyer A has placed the highest "bid". For a trade to take place there needs to be a seller wishing to sell the shares at \$1 per share and that is Seller E.

The lowest price a seller is willing to accept for their stock is sometimes called the "Ask" price (because that is the price that the seller is "asking" for the stock).

Seller E has agreed to sell XYZ shares at the lowest price being \$1 per share. Seller D and F are expecting to sell their shares at a higher price so will either have to wait for a buyer to agree to buy the shares at that higher price or they will have to drop their asking price in order to sell the shares.

The price of shares on the secondary sharemarket is determined by demand and supply just like other markets. When the demand for a stock is greater than the number of shares available at a particular price, the price of the stock increases. When there is no demand for a stock at a particular price, the price falls.

## ACTIVITY TWO

Read Table 2 below and complete the answers in the paragraph below.

TABLE 2: COMPANY DEF

BUYER	BID PRICE	SELLER	ASK PRICE
Buyer A	50 cents	Seller D	51 cents
Buyer B	40 cents	Seller E	54 cents
Buyer C	41 cents	Seller F	50 cents

A trade for DEF Company shares will take place as Buyer \_ and Seller \_ have agreed to trade the shares at a price of \_ cents per share. Buyer B wishes to buy the shares at 40 cents and Buyer C will purchase them for 41 cents. However, Seller D and E have different ideas as they wish to sell their shares at 51 and 54 cents respectively.

Both Buyer B and C will have to pay more / less (circle the correct answer) per share if they wish to buy the shares or they will have to wait until a seller lowers their asking price to suit their expectations.

### DID YOU KNOW?

Watching the news on TV you might see images of the stock exchange with people waving their arms and shouting. This is either archive footage or footage from overseas. These days trading on the Australian Securities Exchange (ASX) takes place on computers with all orders from around Australia all traded on one big electronic market. There is no trading floor in Australia.

### WEBSITES TO VISIT

Check recent company announcements at [www.asx.com.au](http://www.asx.com.au) > Announcements.

Choose two company announcements and state what affect if any the announcement may have on the share price for that company. Test your theory by looking at the share price history over the last week to see if there have been any significant changes in share price (if the announcement doesn't seem very significant, choose another one).

### FAMOUS QUOTE

**J.P Morgan**, when asked what the sharemarket will do, replied: "It will fluctuate".

### KEY DEFINITIONS

#### BID PRICE:

Price buyer is prepared to pay per share

#### ASK PRICE:

Price seller is prepared to sell