

33 UK Stock Market



Case description

The stock market is a classic example of an economic market. It is a market for the purchase and sale of securities – intangible products. Securities come in two major forms: stocks and shares. A stock, sometimes known as a gilt-edged security or gilt, is a security with an associated interest rate. The most important type of stock is the government bond. Shares are a type of security that pay no interest, but pay a dividend to shareholders at regular intervals. Shares are normally issued by companies to raise financial capital for investment.

The modern UK stock market is an eMarket (Blakey, 2008). No physical Stock Exchange exists any longer. The Stock Exchange is therefore a network of economic actors that exchange securities using ICT. Persons or institutions that deal in securities on the stock market are known as financial intermediaries. There are two main types of financial intermediary: brokers and market makers. Securities are bought from certain registered market makers. Market makers are normally financial institutions that opt to deal in a limited number of securities. The collection of such securities held by a market maker is known as the market makers' 'book'. Nowadays financial intermediaries tend to engage in eCommerce in order to trade securities. Trade between financial intermediaries themselves can be seen as a form of B2B eCommerce. Trade between financial intermediaries and investors can be seen as a form of B2C eCommerce.

All securities are initially placed on the stock market at an issue price: a price in pence per share. Once a share has been issued it can be traded: that is, bought and sold on the stock market.

Stocks can have variable interest rates or fixed interest rates. Fixed interest rate stock is sometimes called debenture or loan capital. Similarly, shares can offer fixed or variable dividends. Fixed dividend shares are sometimes known as preference capital; variable dividend shares are known as equity capital.

Each market maker will define the state of each type of share it holds in terms of two prices: the offer price and the bid price. The offer price is the price a market maker is willing to sell a share; the price at which an investor will buy. The bid price is the price a market maker is willing to pay for a share; the price at which an investor can sell to him. The difference between the two prices is known as the market

makers' 'spread'. Different market makers will quote different spreads on shares depending on the state of their book.

For example market maker A might have an offer price of 102p and a bid price of 100p for Allied Metals. In contrast, market maker B might have an offer price of 103p and a bid price of 101p for Allied Metals.

Brokers act as intermediaries between investors and market makers. Market makers act as intermediaries between corporations and brokers. Brokers purchase securities on behalf of investors, and/or sell securities to market makers on behalf of an investor. On both such transactions brokers normally charge a commission, normally a percentage of each share price. Under the recent reorganisation of the market, market makers may also act in the capacity of brokers. However, if a market maker deals with itself, in its role as market maker it must equal the best price offered on the market.

To conduct a deal, an investor issues a broker with an order specification. Such a specification normally includes: the name of the security, whether the order is to purchase or sell securities, the size of an order, the time for which the order is to remain outstanding (day orders should terminate at the end of days trading; open orders remain in force until filled by a broker or cancelled by an investor) and the type of order (A market order indicates that the broker should get the best price at the time; a limit order specifies a price below which the broker should buy or above which the broker should sell; a stop order is the reverse of a limit order).



Commentary

The stock market is essentially an information-based activity system. Securities are information assets (intangible products) and deals are effectively transactions recording economic exchanges. Hence ICT systems and infrastructure are critical to the modern financial services industry and to trade in financial products.



Issues

- ▶ The UK Stock Market forms part of a global financial system. ICT infrastructure enables rapid flow of trading activity accompanied by rapid flows of money around the world. This is hence a critical enabler of globalisation. It also means that difficulties experienced in particular local markets more rapidly diffuse their effects to others than

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in the past. Investigate the relationship of ICT infrastructure to global trade in this manner.

- ▶ From the description above it should be possible to draft a high-level activity model and high-level information model for the stock market.



Keywords

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| Organisation | Private Sector Organisation |
| Activity System | |
| Intangible Goods | Securities |
| Information System | |
| Market | eMarket |
| | Transactions |



References/Sources

Blakey, G. (2008). *A History of the London Stock Market 1945–2007*. London, Harriman House Publishing.