

# Defining Stock

by Sophia



## WHAT'S COVERED

In this lesson, you will learn about the nature of stock and the implications of ownership. Specifically, this lesson will cover:

## 1. The Ownership Nature of Stock

The capital stock, or **stock**, of a business entity represents the original capital paid into or invested in the business by its founders. It serves as a security for the creditors of a business since it cannot be withdrawn to the detriment of the creditors.

Stock is different from the property and assets of a business, both of which may fluctuate in quantity and value. Stock of a company is valued according to market demand and overall business health and this value will fluctuate over time.

Ownership of stock represents a stake of ownership in the business entity. The stock is a security that represents the equity in the company.

Owners of shares of stock are documented by the issuance of a stock certificate. This certificate is a legally binding document that indicates the amount of shares possessed by the shareholder. It also informs of other aspects of the shares such as share classification and its par value. Other documents will specify what rights come with ownership of certain classes of stock.

**Shareholders**, otherwise thought of as stockholders, include both individuals and corporations that own shares in a private or public corporation. Some consider stockholders to be a subclassification of stakeholders, as stakeholders include anyone that possesses a direct or indirect interest in the corporation.



## TERMS TO KNOW

### Stock

The original capital paid into the business by its founders and serves as a security for investors.

### Shareholder

An individual who legally owns at least one share of stock in a company and has rights with regards to the company because of this.

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## 2. Control and Preemption

The stockholders, whether an individual or a corporation that possesses legal ownership of a corporation, are granted certain rights. These rights and privileges vary depending on the classification of the stock. These privileges can include:

- The right to sell shares
- The right to vote on directors nominated by the board
- The right to nominate directors (although this is very difficult in practice because of minority protections) and propose shareholder resolutions
- The right to dividends if they are declared
- The right to purchase new shares issued by the company
- The right to what assets remain after a liquidation

Owners of common and preferred stock generally have to wait until debt-holders receive assets after bankruptcy to see any assets after liquidation.

Control and preemption are particular stockholder rights. The right of **preemption** is a right granted to certain stockholders granting the ability to acquire specified property before it can be made available to any other entity or person.

This right is frequently applied for shareholders of a business entity as they are usually offered the first chance to buy newly issued shares of stock before it becomes available to the general public. While shareholders are offered the option of early purchase, they do not necessarily have to take it. The incentive to exercise this option is based on the desire to protect individual ownership or stake in a company from dilution. The conditions of preemptive rights will vary from company to company and share type to share type.



#### TERM TO KNOW

##### Preemption

The right of a shareholder to purchase newly issued shares of a business entity before they are available to the general public so as to protect individual ownership from dilution.



#### SUMMARY

In this lesson, you learned that **the ownership nature of stock** means that when an investor buys stock, he or she purchases a stake of ownership in the business. With stock ownership comes certain rights and privileges related to **control and preemption**, which are determined by the class of stock that was purchased. The former can include the right to vote on directors, while the latter refers to a stockholder's right to purchase newly issued shares of stock before they are marketed more broadly.

Best of luck in your learning!

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#### TERMS TO KNOW

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