



# How the sharemarket works: the secondary market

## Lesson three

### The Secondary market



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.

The daily trading of shares in the secondary market is the main activity of the Australian Stock Exchange.

#### Market forces

The sharemarket is like any other market in which price is determined 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:

- price of jeans
- fashion: do the jeans suit your particular taste?
- price of related products
- how much money you have or your income

### Learn about

- Market forces
- The secondary market

#### Quick Quiz

Circle the correct answer

1. What will eventually happen to the price of videocassettes as many consumers switch to DVD's?  
A. Price likely to fall  
B. Price likely to rise
2. The contents of Sir Elton John's London home was auctioned in September 2003. If there were many bidders at this auction, the price of items sold would be likely to  
A. Rise  
B. Fall  
C. Stay the same
3. Coral Trout, one of Australia's most popular exports to Asia normally fetched US \$25 per live fish but prices were below \$10 at the height of the SARS epidemic in April 2003. Restaurateurs in Hong Kong and Singapore were not buying Australian seafood. The price of fish dropped because  
A. Demand was greater than supply  
B. Demand was less than supply

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 you to supply more goods.
- 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.
- government taxes or subsidies paid to the supplier.
- what price you might receive for producing another good, such as shorts using the same resources.

The forces of demand and supply summarised above determine the price for a particular item.

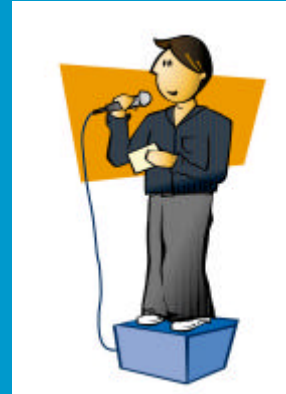
### Activity 1

1. Cricketing legend, Sir Donald Bradman's baggy green cap was reported to have sold for over \$300,000 Australian Dollars in July 2003. Bradman wore the cap on his final tour of England when he scored his final test century. Given that caps cost less than \$20, why do you think the price of Sir Donald Bradman's cap was so high?

2. Days before Harry Potter's novel was to go on sale around the world, thousands of copies were stolen from a truck parked outside a warehouse in London. The cover value of a Harry Potter novel retails for approximately \$35 Australian dollars but would have fetched a much higher price if sold on the black market (illegal market) before the official publication date. Explain why a Harry Potter novel would be worth more before it was officially released around the world.

### Famous quote

“A market is the combined behaviour of thousands of people responding to information, misinformation and whim.” Kenneth Chang



3. Russian caviar, the salty black eggs from the sturgeon fish are considered to be a delicacy by some. Importing caviar to Australia was banned in 1988 due to a breakdown in regulation in the Russian Caviar industry. A Brisbane business “Black Pearl Epicure” had been importing 1.2 tonnes of caviar a year before the ban. Overnight, fish eggs went from representing 90 per cent of the business to just 10 per cent as attention was turned to producing other exclusive products.

A. What affected the decision by the Brisbane business to supply another product?

B. Due to the ban of Russian Caviar in Australia a black market for the product sprang up. In 2000 it was reported by the *Australian Financial Review* that Russian caviar was selling for as much as \$3,000 a kilo for a container, roughly the size of a shoe box. Why do you think the price for this product was so high?

4. What effect would the SARS outbreak and terrorist attacks in America and Bali have had on the price of airfares to overseas destinations from Australia? Explain reasons for your answer.

## 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. You can see from the Table 1 in this lesson that there are three buyers and three sellers of shares in ABC Company. Buyer A is prepared to buy ABC shares at \$1.00 per share. Buyer B and C prefer to pay less so Buyer A has placed the highest “bid”. In order 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 his or her stock is sometimes called the “Ask” price. Seller E has agreed to sell ABC 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.

### Here's an idea!

Create some classroom chaos! You or your teacher will make up pairs of buy and sell cards which will 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. 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 by [clicking here](#)



The price of shares on the secondary sharemarket is determined by demand and supply. When the demand for a stock exceeds 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.

**Table 1**

ABC Company			
Buyer	Bid Price (Highest price buyer is prepared to pay per share)	Seller	Ask Price (Lowest price seller is prepared to sell per share)
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

## Activity 2

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

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. Either 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.

**Table 2**

DEF Company			
Buyer	Bid Price (Highest price buyer is prepared to pay per share)	Seller	Ask Price (Lowest price seller is prepared to sell per share)
Buyer A	50 c	Seller D	51 c
Buyer B	40 c	Seller E	54 c
Buyer C	41 c	Seller F	50 c

### Do you know?

Trading on the Australian Stock Exchange (ASX) now takes place electronically via the Stock Exchange Automated Trading System (SEATS). SEATS matches buy and sell orders then trades them automatically.

By the end of 1990 all share trading on ASX took place on SEATS and the trading floors were closed.

### Websites to visit

Check recent company announcements at [www.asx.com.au](http://www.asx.com.au) Click on the company research icon and choose “Recent company announcements” or just [click here](#). Choose two company announcements and state what effect 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 (this can also be found under the company research icon) to see if there have been any significant changes in share price.

### Famous Quote

J.P Morgan, when asked what the sharemarket will do, replied, “It will fluctuate”.



# Teacher notes and answers

## Lesson three: the secondary market

### Approach

Either read through the first page of the lesson with your students or ask your students to think about what factors may influence the demand and supply for jeans. For example, why might a pair of “Levis” cost more than a “no-name” pair of jeans? When discussing factors that influence the supply of jeans you might make up a brief list of the production costs involved in manufacturing jeans and then ask students at what price they would consider selling the jeans to the retailer in order to make a worthwhile profit. When you have briefly covered some of the issues influencing demand and supply, get students to complete the “Quick Quiz” and then Activity 1 to provide further reinforcement of how market forces interact to set price.

It is important that students understand how any market works before launching specifically into how the sharemarket works. A simple example of how the sharemarket works is given where you can see three buyers and three sellers interact and one buyer and a seller make a TRADE. Follow up the theory by getting students to complete Activity 2 and then look at the Stock Exchange Automated Trading System (SEATS) to see the system for placing orders in the real sharemarket. “Here’s an idea” is a useful way of fostering a discussion regarding the efficiencies of SEATS.

### Answers – Lesson three

#### Quick Quiz

1. A 2. A 3. B

#### Activity one

1. Demand for Sir Donald Bradman’s cap was extremely high and supply was low given there was only one Bradman Baggy cap on the market.

2. This is a case of demand exceeding supply. Many buyers wishing to purchase the book but because the book hadn’t officially been released the supply was limited or non-existent, driving the price on the illegal or black market higher.

3. A “Black Pearl Epicure” was unable to supply the product to its consumers and therefore had to look at alternative products to satisfy the type of customers it had.

B. The price of Russian Caviar was driven higher because supply was low relative to demand.

4. SARS and terrorist attacks may have resulted in reduced airfares for a short period of time to encourage consumers to travel again.

#### Activity two

A TRADE for DEF Company shares will take place as Buyer *A* and Seller *F* have agreed to trade the shares at a price of *50* 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* 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.

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