Chapter 15
Globalization of Financial Risks and Evaluation of Common Stocks

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ABSTRACT

Risk can be defined as uncertainty about the events that will occur in the future. Risks are encountered in all areas of life, and become more important when it comes to financial markets. Risk in financial markets is defined as investment securities. If the investment vehicle is government bonds or treasury bills, they are considered to be free of risk. Because of the sudden changes in exchange rates in the process of globalization or fluctuations in interest rates influencing the cash flows of companies, most companies consider hedging as a viable part of the globalization strategy. Risk management policies to ease problems and disasters, which may arise from the use of instruments. The stock market serves as a bridge between economic activity and finance under favor of functions such as reducing the risk of investment, and it meets the capital needs for companies. For this reason, the development of stock markets plays an important role for the global economy and finance. Thus, the aim of this chapter is to introduce financial risks and their effect on common stocks.

INTRODUCTION

In the era of Global Economic Crisis, ambiguities and volatilities in capital markets were significantly intensified having deep impacts on stock markets. Risks in volatile credit mechanism related to subprime mortgage system simultaneously affected financial markets. Volatility in stock prices and sharp asset price changes transmitted into a credit mechanism and consequently dysfunctional giant sectors disseminating stress in financial system around global economic activity.

Global recession resulted in sharp slowdowns in financial and economic activities across the world. Famous giant banks, financial institutions and insurance companies in advanced economies declared bankruptcy. However, Central banks, legal authorities and governments were challenged by volatile financial stress. With the new monetary policies, capital injections and implications of simultaneous maneuvers limited the negative effects of global recession on growth, development and employment. Notwithstanding this cost and size of measures taken and capital injections to fight

DOI: 10.4018/978-1-4666-4635-3.ch015
against economic crisis devastated the fiscal balance of European economies. Consolidating fiscal adjustments in advanced economies signals partial reversal in growth-enhancing reforms which in turn worsens the funding pressures for sovereigns in euro zone. As a result, the progress of economic recovery has been stalling its effect on global economic activity once more time. Moreover, financial stress in advanced economies and in the euro area has spilled over to financial system and banking activities again having negative impacts on trade and global activity not only financial system. By the increase in overall macroeconomic risks around the globe, weaker growth rates and higher risks attached to sovereigns and funding markets have contributed to concerns about financial stability and fiscal discipline in advanced economies including economies in euro zones.

The latest financial situation in capital markets in advanced economies, emerging markets and euro zones within a political economic perspective illustrates us that volatility and risks related to global economic activity and global financial markets have impact on local capital markets and directly affects the value of company stocks even though an investor diversified his/her risk by investing in a portfolio.

THE NATURE OF STOCK: STOCK TYPES, RIGHTS AND VALUATION

Stock is a financial asset, which represents and expresses the shares at limited partnership divided into shares with joint stock company (Weston, et al., 1996:281-329; Gitman and Madura, 2001:551-580; Sarıkamış, 2000: 31). In a joint stock company, the amount of capital divided into shares and each stock represents to participating nature and pro-rota hosting (Hoover, 2005:28-38; Rodoplu, 2001:291). Join stock companies supply with export to their stocks for provide to shareholder’s equity. Business may not release to public to all of the stock issued ((Hoover, 2005; Fabozzi and Mann, 2005; Gitman and Madura, 2001; Ceylan and Korkmaz, 2000:91).

On the contrary of bill of exchange, stock is a document of partnership. With this state, stock is a financial asset which is senior security on the stage of establishment and it is the latest reimbursement in case of dissolution of a partnership by Joint Stock Company (Weston, et al. 1996:295-297; Sarıkamış, 2000:31). Stock yields money to shareholder during to continue of joint stock company and during to make a profit. But stock’s income isn’t fixed as well as bill of exchange (Karslı, 2000:362).

According to legal system, shareholder is accepted as partner of company. For that reason, share is abstract legal status which is separate from the owner’s personality. Thus stock is indivisible whole in the face of company (Rodoplu, 2001:292).

Stock Market in which equities are issued and traded has significant role in economic development. Economic functions can be mentioned as follows (Gitman and Madura, 2001:22-44):

STOCK TYPES, RIGHTS AND VALUATION

Registered Shares and Bearer Stocks

Identity of partnership is written on the registered share and such a stock is arranged in the name of written person at the company’s stock ledger. These are only handover by financial turnover and transfer (Canbas and Doğukanlı, 1997:33).

Advantages of these stocks are to determine the number of partners, to identify and follow up of partners, to protection of assets, to prevent to alienation of association, to participate in general meetings and to prevent loss of tax. Besides these advantages, registered stock has got some disadvantages. These are: difficulties in the transfer of partnership shares, to prevent to going public and inability to provide privacy (Gitman and