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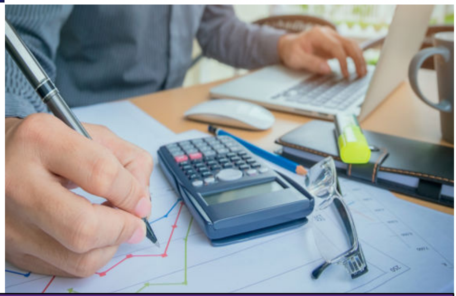
Stocks in Ecuador



Stocks are securities that represent a part or quota of the equity capital of a corporation, which, once acquired by the investor, provide them with various political and economic rights over the issuing company. It is considered variable income since its future performance is not predetermined as it depends on various economic and financial factors on the nature and dynamism of the business.

Companies issues shares with the main objective of raising funds from the public. Being a method to obtain non-reimbursable capital in the immediate future, it works efficiently to finance productive projects without increasing debt. Unlike the international financial markets, stocks are not a widely used instrument in the national securities market since approximately 99% of transaction in the stock market of Ecuador correspond to the supply and demand of fixed income securities. However, as we will see later, there are several reasons to promote that market.

Types of stock

There are two types of stocks in the national market. Ecuadorian legislation precisely establishes the rights that each one provides to the investor according to the nature of the security. The characteristics of each type of stock are briefly explained below.

- ***Ordinary or common stocks:** The holder of this type of stock has the right to speak and vote at shareholders' meetings, in which various issues of interest are decided of the dynamics of the company. However, it does not have privileges in terms of economic collection rights.*

- ***Preferred stocks:** The holder of a preferred stock does not have the right to vote at the shareholders' meeting. However, it has a higher degree of hierarchy in the collection of dividends or in the distribution of assets in the event of bankruptcy by the company.*

For the investor, the existence of two classes of stocks provides them with flexibility in choosing the security that best suits their expectations in relation to performance and risk.

Earnings from investing in equities

The return generated by investing in equities comes from two sources. The payment of dividends and the increase in the stock price. It will be explained in more detail below.

- ***Cash dividends:** If the company generates a profit in the fiscal year, the shareholder may access a part of said profit in proportion to the number of shares he has in the company.*

- ***Stock price:** An increase in the stock price is commonly referred to as a capital gain since, if the price of said share increases significantly, the investor will be able to sell said share at a better price than he had negotiated.*

Stock return example

Having explained how investors make a return from investing in equities in a theoretical way, it is valuable to present a real case. Therefore, through the use of stock market statistics, we will expose the return obtained by investing in one of the most recognized companies in the national economy.

The mentioned company is Corporación Favorita, which is considered the largest non-governmental company in Ecuador. Thus, if $1,000 had been invested in stocks of Corporacion Favorita on January 1, 2019, the attached table shows the expected earnings at the end of 2019. The approximate return is 13.85%, which is significantly higher than the offered returns by other securities or traditional banking.

Inicial Investment Amount	$1,000
Cash Dividend Received	$38.34
Initial share price	$2.44
Final share price	$2.5
Dividend capitalization	30 stocks
Approximate Annual Return	13.85%
Final Investment Amount	$1,137.75

Considerations of investing in stocks

Once the dynamics and benefits of executing investments in the stock market have been analyzed, there are several fundamental considerations for the investor to mitigate various risks and to develop efficient strategies in relation to the purchase of stocks in the Ecuadorian market. Being a high-yielding market, several experts in the financial market have developed and determined several important rules when investing in equities, among which are the following:

1. *It is preferable to invest in stocks for long periods. Investing in stocks for three years or more will be more profitable than investing for a short period of time. According to statistics, there is a greater probability of stock appreciation if the investment time interval is extended.*
2. *Investing in a diversified range of stocks is critical. In more exact words, it is essential to avoid investing the total capital in companies of a single industry or economic sector. In this way, unsystematic risk is minimized as much as possible.*
3. *Making regular (month-to-month) contributions when investing in stocks is a proven strategy in the stock market as it allows for better diversification over time.*
4. *It is essential to carry out a detailed analysis of the company's business trajectory and have a clear understanding of the economic dynamics of the sector to which it belongs. In this way, the investor will have better tools to select the asset and for its respective monitoring.*

Benefits of issuing stocks as a financing mechanism

Issuing equity securities as a financing mechanism has become a widespread practice in developed financial markets. Large corporations in the international market seek capital through this method due to the following reasons:

1. Alternative to raise capital without incurring the obligations of accessing bank debt as exaggerated guarantees.
2. The issuing company obtains financing without the obligation to return the capital in the short and medium term.
3. It makes the issuing business a more attractive option as an investment destination since most investors avoid businesses whose support is purely bank debt due to the intrinsic risk that exists.
4. It allows to improve the business valuation process due to the various existing mechanisms in relation to the listing of stocks.