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Lesson 3: Dealers and Brokers in the Stock Market

The Stock Market

Before identifying what 'the stock market' is, we need first to define the following related terms:

- **The market:** is an actual or nominal place where buyers and sellers interact directly or through intermediaries to trade goods, services, contracts or instruments for money. It includes the mechanisms of determining the price of the traded item, communicating the price information and facilitating deals and transactions.
- **The stock:** is an equity capital that is raised of shares
- **The shares:** units of ownership that represents an equal proportion of a company's capital. The holder of shares is called the shareholder

The **stock market** is a place where shares are bought and sold by investors. Stock market transactions happen with the help of **professional intermediaries** who trade shares on behalf of their clients because buying and selling stock requires a license. For example, Mr.Joe is interested in buying some shares of stock after seeing news headlines about the New York Stock Exchange. But how do individual people like Joe buy and sell shares of stock? So a regular individuals like Joe has to use these professionals to participate in the market. These professional intermediaries are called **dealers** and **brokers**.

➢ Dealers

Joe cannot make purchases on the exchange or go to a company to buy stock by himself, but one way for Joe to purchase stock is to contact a **'dealer'**. A dealer is a business that builds an inventory by purchasing shares from individuals when they wish to sell their stock. Then when a customer like Joe wants to buy a stock, the dealer sells it to that customer from its existing holdings. In the event of a sale, the dealer holds onto the stock until someone else wants to buy it. The dealer functions independently from the stock exchanges. Sometimes these businesses are called **market makers**, because they create a new venue for stock trades outside of the established exchanges. A dealer that buys and sells stock makes a profit on stock purchases by marking up the share price to investors and marking down the price for sales.

- **Brokers**

A broker is a person that acts on behalf of a specific client order. When Joe wants to buy a stock, the broker executes the order by finding someone willing to sell that stock on one of the exchanges. The broker charges a commission fee for making the trade.

One major difference between a dealer and a broker is that a broker transaction only involves the client's order. The broker places an order for the exact number of shares the client wants to buy or sell. A dealer orders for itself first, and then may resell some of those shares to other investors outside of the market. Another difference is that brokers operate within the stock exchange system, while dealers operate outside the exchanges.

Lesson Summary:

Because individuals cannot buy or sell stocks without a license, they must use the system of **dealers** and **brokers** to participate in the stock market. Brokers and dealers are terms associated with stock shares. Though both have almost the same work as intermediaries, they are different in many aspects. The main difference between a broker and a dealer is in respect of their role in the market. A ***broker*** is a person who executes the trade on behalf of others, whereas a ***dealer*** is a person who trades business on their own behalf. A dealer is a person who will buy and sell shares on their account. On the other hand, a broker is one who will buy and sell securities for their clients.