The Stan Clark Financial Team's

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Business owners: You can diversify by buying shares of public companies

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If you're a successful business owner, you may have reached the point where you're generating more cash than is needed for your business. This means you now have financial options. With the extra cash flow, you could: expand your business; start another business; pay down debt; buy a piece of property. Or, you could invest in shares of other businesses which you can select, but don't have the headache of managing.

In this article we will discuss the benefits for business owners to diversify by investing in shares of well-established, publicly traded companies.

Starting a new business is hard, no doubt about it. Nearly half of new businesses don't survive past five years[i]. Lack of financing and adequate cash flow cause many failures. From a financial perspective, new businesses are often constrained, with few options.

However, if you've made it past 10 or 15 years, ideally you have reached the point where you're generating more cash than you need in the business. Maybe you've paid off your expensive debt and only have a moderate amount of low-interest bank debt. Congratulations! You're now in the situation I described: You have options regarding what to do with your extra cash flow. If you're interested in increasing your wealth, but not keen on working much harder or taking on more big risks, you might consider diversifying by investing in shares of well-established, publicly traded companies.

Publicly traded companies are not that different in concept from your own business. Almost all of them started as small businesses. They succeeded and grew; they put in systems, processes and internal management. And they continued to succeed and grow.

Larger public companies, as a group, have been very good at making money. Over the past 140 years, in aggregate, they've never had a year where they've lost money. And that even includes the Dirty Thirties.

By owning shares, you own those profits. The profits are returned to you by dividends, or are re-invested, thus increasing the value of the shares you own.

Returns from investing in public companies have been far better than almost any other investment. Over the past 100 years, the average return, if you had invested in equal amounts of the largest 80% of U.S. companies, was 11.5%. That's 7.2% higher than if you had bought bonds, 8.3% higher than inflation, 7.3% higher than gold and 7.8% higher than the average increase in house prices.[ii]

The returns have been good. Perhaps not as good as the returns you've produced in your business, but they have been achieved by investors without the work, the risk or the headaches you have put into your own business.

One of the main advantages of buying shares of public companies is that it's easy to diversify. This helps to reduce your risks but still achieve good returns. Rather than have all of your money tied up in your one company, you can own small slices of many companies. No one can forecast the future. You never know what curve balls might hit your particular business. By owning parts of many businesses, you reduce that risk greatly. And the nice thing is that each comes with its own built-in management. You select the businesses and they run on their own.

You can invest in shares using the retained earnings within your company. If you have money in a holding company, that's even better. Of course, as with all important financial decisions, you should discuss this with your tax advisor before proceeding.

Investing in shares of well-established, publicly traded companies can be a great option to grow your wealth and reduce your risk. It's important that it be done properly to achieve the benefits of good returns and lower risk. If you would like to learn more about the benefits, historical returns and how to properly invest, please get in touch with us. We'd be happy to hear from you.

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[i] Industry Canada: https://www.ic.gc.ca/eic/site/061.nsf/eng/rd02473.html
[ii] Source: Jeremy Siegel, CRSP, Barclay's Capital, U.S. Dept of Labor, U.S. Dept of the Treasury, Robert Shiller.

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