Why Chinese And Other Investors Make A Mistake In Buying Stock in U.S. Privately Owned Companies©

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First, let's consider why investors invest. They invest to make a profit by selling in the future that bought in the present at a higher price than paid.

Business owners sell a percentage of their company to investors at a price sufficiently attractive to investors believing in the projections made, but well above what the free market would pay for the whole company were it to be available. Also, business owners believing in a future increase in value of their company would naturally only sell a percentage of ownership if they were unable to borrow money on reasonable terms.

So before we start to analyze the specific investment opportunity we see a situation where the seller seeks a higher company valuation based on existing results, than the market would pay and only does so as loans are not available.

Now, we have the issue of what makes a company more valuable in the future than at present. The answer is greatly increased reported per share earnings. First, the prediction of future profits is an art and not a science, as it is the confluence of factors applied to predicted revenues, which determines profitability. Professional security analysts are great at understanding what has happened regarding reported profitability, but have difficulty in predicting that which will happen. People plan and the God's smile.

In privately owned companies the least expensive money the owner has to finance growth of the company is the money which does not have to be spent in paying taxes. Therefore, it is usual that business owners use legally acceptable strategies and practices to reduce the level of reported profitability. These tactics include accounting policies relative to depreciation, prepayment of expenses, increased funding of training and marketing programs and, of course, executive compensation.

One of the great benefits of owning a business is the freedom to make decisions impacting the future of the business without reference to others.

Determining tax saving strategies and important decision making without having to consider the differing needs and expectations of investors is not possible or practical once shares of the company have been sold to investors. The investors want ever-increasing reported profits as it is the level and trend of earnings which will allow them to sell their shares at favorable prices. Every dollar paid the CEO or any other employee is a dollar of profit, which cannot be reported.

Although there are legal and contractual safeguards, which are intended to be management influential, the controlling shareholders in privately owned companies can usually find ways of doing what they want to do. The best interest of the shareholders will continue to be determined and implemented by those controlling the company, even with the nuisance of minority shareholder rights and having differing views of what is in their best interest.

Please note that I have not indicated that investors should not participate in the growth of privately owned companies. Indeed, the greatest growth and overall social benefit will come from privately owned companies, which are able to grow their business, and that means grow their revenues.

Therefore, why not focus investments on the growth of revenues and not reported profits? The answer is royalties, a contract providing for an agreed percentage of revenues to be sold by a company to investors, is the better way of both investing in and financing privately owned companies.

The royalty holder does not own any part of the royalty issuing company and does not have an interest in the level of reported profits. The royalty holder does not have a vote or ability to influence management. The royalty holder simply wants the company to grow in size, as measured by revenues, and to pay the royalties as agreed.

Those interested in learning more about royalties and the risk reduced means of achieving relative highly attractive returns should review the articles and website calculators described at www.Royalties.Website.

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