

Reasons for Business Owners and Investors NOT to Use Royalties ©

Arthur Lipper

Royalties increase the taxable income of investors once there is a recapture of principal. If the royalty issuing company is successful, the royalty issuer is required to make increasing royalty payments.

For some business owners it is personally more satisfying to enrich new investors and exiting shareholders than themselves. Royalties result in an increased top-line expense, while the capital received allows managers to grow the business. The royalty holder receives the agreed percentage of revenues while the business owner retains all the profits, and has the risk of becoming attractive to an acquirer.

Royalty holders do not vote and therefore do not have the ability to express their possible concerns or influence executive compensation, in addition to other possible conflict issues with the controlling shareholders..

Owners and managers of royalty-issuing companies are not required to inform royalty investors of all aspects of the company's success or failure. They do not have the excitement of releasing periodic per-share earnings or predicting what they may be in the future; they only need to report periodic gross revenues.

Investors are spared the exercise of determining what the actual profits of a company might have been, if tax saving or other accounting-motivated actions had not been taken.

Though it is satisfying for some investors to be critical of the terms of executive compensation and expense accounts, hiring preferences or the terms of possible relationships with companies affiliated with controlling shareholders, royalty owners are restricted in their area of knowledge or interest since they do not have the rights of minority equity shareholders.

Business owners and managers of businesses using royalties to obtain growth capital are spared the privilege of becoming fiduciaries to the providers of the capital, as is the case when equities are involved in a financing.

**Arthur Lipper, Chairman
British Far East Holdings Ltd.**

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