Investing with an entrepreneurial mindset

The choice of an investment and the associated costs are of crucial importance to an investor. A long-term entrepreneurial approach makes it easier to maneuver the biggest obstacles.

For many individuals, investing is a complicated and a with risks associated matter. Funds, structured products, derivatives or similar investments are issued by banks and sold to the client. The benefits often do not lie with the customer. Depending on the chosen model, the bank's interest is either to invest customer money in as many (own) products as possible or to encourage customers to frequently undertake transactions. Both activities have been proven to have a negative impact on investment performance.

Passive-managed ETFs (index funds) track the overall market or sub-sectors and are enjoying ever-increasing popularity thanks to their low costs. By investing in an index, one essentially invests in the best as well as the worst companies in the market. Another disadvantage of ETFs is that highly valued, expensive sectors make up a large proportion of the overall market. For instance, the technology sector had the highest weight just before the bursting of the technology bubble in 2001 or the financial sector just before the financial crisis in 2008. Actively managed investment funds could avoid these problems, but high administrative costs and short-term pressure to succeed often dictates the manager to stay close to the index. There is however the possibility to do it different while remaining inexpensive.

Direct participation in companies

By buying shares, an investor becomes a co-owner of the company and is thus directly participating with the success of the company. By combining the world's best firms from different sectors in one portfolio, an individual an across all economic cycles resilient conglomerate is created.

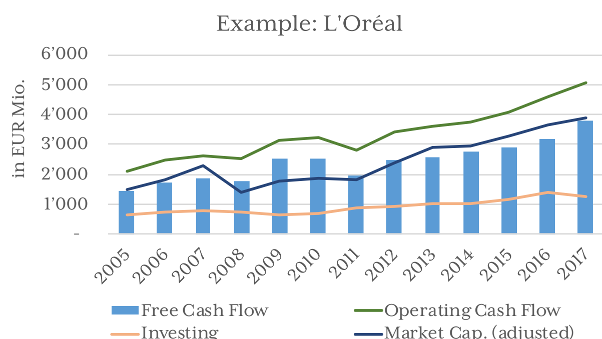
Compared to all asset classes, equities historically offer by far the most attractive returns. This does not come as a surprise since companies use the money productively to improve or expand their own activities. Many people are deterred by the daily price fluctuations, which could easily be disregarded since the relevant price development happens over the entire investment period. Real estate or even the own, commonly unlisted company are not less risky only because their price fluctuations are not daily apparent. Nevertheless, many people still elect to disregard the privilege of investing in companies through shares. This has a long-term adverse effect on the development of an individual's wealth and thus on the capital available at the time of retirement.

Focusing on cash flow

In order to make the best possible use of capital in the long term, one has to reduce the concerns about investing firstly and secondly, one has to identify attractive companies to invest in. Both can be achieved by using an entrepreneurial approach when investing. This is in some contrast to more commonly used analyses, which are primarily based on traditional valuation parameters such as price-earnings ratio, price-book value ratio and the like. These ratios have lost their significance in recent years due to diverging accounting practices worldwide and the growing importance of intangible assets.

A business owner is mainly interested in how much money is left in the account at the end of the year and not how high the accounting profit was. The operating cash flow results from the revenues of sold products or services minus the expenses for the production of goods and services. After deducting investments, such as the construction of a new factory, as well as in some

cases servicing the cost of debt, the free cash flow results (FCF). This FCF corresponds to what the company has effectively earned and what is left to distribute to the shareholder. Historically, the stocks of companies with the highest FCF relative to the enterprise value have returned the most.



Example L'Oréal: As the chart above shows, the company has a steady operating cash flows throughout crises, while maintaining relatively small levels of investing. The development of the firm's market value over the years is a reflection of this fact.

In addition to the company's valuation, the overall quality is of crucial importance. Aspects of quality assessment include amongst others market positioning, competitive situation, indebtedness and growth prospects for the coming years. If the quality proofs to be good in addition to strong and stable free cash flows, the chances for success increase substantially.

Other success factors

Discipline is another essential success factor. In particular the prevention of emotionally influenced actions is important that would otherwise negatively influence the investment goal and make it even more difficult to remain true to the investment strategy. Acting like an entrepreneur can once again provide guidance. In an economic downturn, he is unwilling to sell his company at a low price, since he is well aware of the long-term strength of his company. Also, an entrepreneur does not attempt to buy his competitor if he assesses the asked price as too high.

With a diversified portfolio comprised of the best companies in the world, whose products and services are understood and have good prospects for the future, this discipline can be implemented without the need to be nervous in the face of market fluctuations. By contrast, investing in non-transparent investment products makes it difficult to remain true to the long-term strategy in turbulent market phases. The prerequisite for this is that a clear distinction is made between investing and trading right from the start. Trading is predominantly based on a short time horizon, where both the entry and exit point must be correctly timed. Statistically, it is highly unlikely to be able to do this successful over a longer period of time. It also deprives the individual from profiting of the significant compounding on interest effect. The Swiss stock market for instance has generated an annual return of 8.3% over the past 15 years. But if the ten best market days were missed out due to trading, i.e. potentially not being invested at that point, the annual yield would have nearly halved to 4.3%. If an entrepreneur purchases or participates in a company, he does so after a thorough examination and because he is convinced of its future prospects. Consequently, this requires a longer time horizon and allows for a sustainable and secure increase in value over several years. Investors are well advised to base their investment decisions on the cautiousness and farsightedness of entrepreneurs.

Implementation possibilities

When it comes to investing, many individuals rely on an expert opinion. The client advisor of one's principal bank is an easy first access point in this case. It is however important to distinguish between independent advice and a sales pitch. Is the client advisor actually providing the best solution or the solution that benefits him best? The nature of the business arrangement can help to shed some light on this matter as fee models should avoid possible conflicts of interest. It is vital that the proposed solution achieves the greatest added value for the customer as opposed to generating the highest fees for the provider. A fee model that transparently and explicitly only compensates for the advisor's consulting activities without any links to product choice or trading activity and thus commissions, ensures that the interests of the provider and the customer are aligned. Providing the advisor does a good job in the selection of the companies, nothing stands in the way of successfully building a portfolio in accordance with an entrepreneurial mindset.

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