

Step 6: Discover Great Businesses

Description

When you buy a stock, you're purchasing a stake in a living, breathing business. Buy shares of your favourite fast-food joint and you own the place. Literally. Every time someone gets fries with that shake, a tiny bit of cash drops to your company's bottom line.

Finding great stock ideas is as simple as opening your eyes. Your fridge, medicine cabinet, wallet, computer: all hotbeds of stock ideas. Behind virtually every successful product or service lies a publicly traded company that's cashing in on that success — and that you can join as a business partner.

Better know a better business

But a great service or product does not a great investment make. Again, think of buying shares of a company just like buying a stake in a local small business. Does the business have staying power? How much cash flows in and out? Do you trust the management and employees to do right by you as an outside investor? Do they have a hilarious television advertising campaign??? Kidding on that one. These are hardly questions you'd need a Harvard MBA to spell out for you, right?

Fools take the same common sense approach to investing. We're interested in the strength of a business, not past performance, charts, or whether the shares have [split](#).

Specifically, here are a few things we look for:

1. **A sustainable competitive advantage:** Some businesses have unique, lasting competitive advantages that allow them to earn outsized profits. The more durable a company's competitive advantage, the larger the "moat" that surrounds its financial fortress. Broadly speaking, a competitive advantage can consist of any or all of the following; scale and high switching costs, a network effect, unique assets, and intellectual property. The Canadian banks, for instance, have a sizeable competitive advantage over other lending institutions in this country.
2. **Cash aplenty:** Cash is the lifeblood of any business. It pays the bills and covers the tab for new growth projects. Fools look for low-debt, cash-rich balance sheets and steady cash flows. Specifically, [free cash flow](#) — the cash left over after funding operations and growth — fuels share repurchases and those sweet, sweet dividends that show up in your brokerage account on a regular basis.
3. **Strong leadership:** Is management invested alongside you? Do they have a history of creating value for shareholders? Do they have years and years of relevant experience? Do they treat outside shareholders (business partners) with respect?

If you stumble across a company that nails all of the above, odds are good that you're looking at a great candidate for your hard-earned cash.

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