Reconsider investing in your company

Q: I work for a large company in Roanoke. Call it ABC Inc. to keep it anonymous. My company offers a 401(k) plan and allows me to buy company stock for the plan. Currently, 10 percent of my 401(k) plan investment is in my employer's stock. Is there an optimum amount that I should invest in company stock?

A: Unless your employer gives you significant extra incentive to invest in company stock or requires you to invest as a condition of employment, my recommendation is that your investment in company stock should be zero. That's right, no investment at all in your company stock. In fact, if you do have any investment in company stock, you should liquidate all of it as soon as possible and transfer it to index funds or alternative investments.

This recommendation is based on the simple logic of diversification. Remember the saying "Don't put all your eggs in one basket." This saying is particularly relevant to investing where the greater the number of baskets (or stocks), the better. Most mutual funds invest in many stocks to enable you to diversify without the need of your buying individual stocks. As far as possible, use no-load index funds where you don't have to pay the broker.

Unfortunately, most employees overinvest in their companies. On average, employees invest 19 percent of their 401(k) assets in company stock, which is 19 percent more than what they should.

You may ask why you shouldn't invest money in your company's stock. Famous investors such as Peter Lynch and Warren Buffett routinely advise investors to put money in companies they know best. I know the company I work for better than any other company, you say, so why shouldn't I invest in my employer's stock?

That is a good question. You should invest in your employer like you invest in any other company. Because you work for your employer, you are already heavily invested in the company. Your earnings depend on your employer. How much you earn, whether your compensation improves or whether you get that overdue promotion depends on how well your employer performs. If Wal-Mart or another competitor drives your employer out of the market, you will be out of a job. So, your human capital, which is a large and important component of your wealth, already depends on your employer's performance. Why risk your investment capital on your employer in addition to your human capital?

As for Buffett and Lynch, remember that there is a difference between us and mortals and them. Warren Buffett's company portfolio is worth more than $150 billion. He owns 100 percent of more than 40 different companies including Geico insurance. He has major holdings in Coca-Cola, American Express, Gillette, H&R Block and The Washington Post. Buffett's purpose is not passive financial investment, but active investment. That is, he invests with the objective of guiding the company, helping it become better and generating higher profits. If you had to select a business for ownership, you would do the same.

You would select a business that you understand and where you can add value or run it more efficiently. If you are the chief executive officer of your company, then you must own company stock because you can influence the company's overall performance and owning that stock gives you an added incentive. But if you are just one of 100,000 employees, you are better off treating company stock as a passive financial investment. Follow Buffett's advice when you will own or have a controlling interest in the company. Otherwise, you may be better off owning no shares of your employer's stock.

Vijay Singal is head of the Department of Finance, Pamplin College of Business, Virginia Tech (vsingal@vt.edu). The opinions expressed here do not necessarily reflect the views of the department or Virginia Tech and should not be construed as specific investment advice.
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Unfortunately, most employees overinvest in their companies. On average, employees invest 19% of their 401(k) assets in company stock, which is 19% more than what they should.

You may ask why you shouldn’t invest some money in your company’s stock. Famous investors like Peter Lynch and Warren Buffett routinely advise investors to invest in companies that they know best. I know the company I work for better than any other company, you say, so why shouldn’t I invest in my employer’s stock?

That is a good question. You should invest in your employer like you invest in any other company. Since you work for your employer, you are already heavily invested in it. Your earnings depend on your employer. How much you earn, whether your compensation improves, or whether you get that overdue promotion depends on how well your employer performs. If Wal-mart or another competitor drives your employer out of the market, you will be out of a job. So, your human capital, which is a large and important component of your wealth, already depends on your employer’s performance. Why risk your investment capital on your employer in addition to your human capital?
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