

When we buy a share we are buying part of a business.

Over time if that business is profitable it will pay dividends as well as retain money to invest in the business to grow profit in future years.

Let's start a company named ABC with 1 shareholder who tipped in \$100. Therefore his share would be worth \$100 and it would be backed by the cash in the companies bank account.

Now ABC wants to start a business selling "widgets". In the first year if they make a 10% profit they will make \$10. They may pay half as a dividend (\$5) to the shareholder and retain the other half (\$5) to grow the business. This means the company ABC will now have assets of \$105 making the shareholders 1 share worth \$105.

Fundamental Maths of Buying a Share				
<i>Year</i>	<i>Business Assets</i>	<i>Profit (R.O.E.)</i>	<i>Dividend</i>	<i>Retained Earnings</i>
1	100.00	10.00	5.00	5.00
2	105.00	10.50	5.25	5.25
3	110.25	11.00	5.50	5.50
4	115.75	11.60	5.80	5.80
5	121.55	12.20	6.10	6.10
6	127.65	12.80	6.40	6.40
7	134.05			

In the second year if they make a 10% profit they will make \$10.50 (10% of \$105). They may pay half as a dividend (\$5.25) to the shareholder and retain the other half (\$5.25) to grow the business. This means the company ABC will now have assets of \$110.25 making the shareholders 1 share worth \$110.25.

As you can see this process continues. This is how you can get increasing dividends as well as capital growth over time by holding profitable companies.