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# Taking advantage of Dividend Reinvestment Plans

## Wise investors make use of DRIPs if they don't require income

Wise investors have dividend-paying investments in their portfolios and, if they don't require the income, are even wiser to consider dividend reinvestment plans (DRIPs). Instead of delivering cash payouts, DRIPs reinvest the money to purchase additional shares. There are many advantages.

To begin, DRIPs are a cost effective long-range approach to purchasing shares. Most plans are free of charge and bypass brokerage fees. Some companies encourage DRIPs by offering discounts to the market price on shares. For the investor, that's like getting a little extra return on the investment.

Most DRIPs allow single share purchases with immediate reinvestment. Others permit fractional shares, which means that investors aren't waiting for cash to accumulate before buying more shares. And, of course, the regularity of DRIP reinvesting provides the advantage of dollar-cost-averaging with more stock acquired during market dips.

DRIP investors can also gain through the power of compounding by buying companies with a history of raising dividends, as the compounding effect will accelerate with dividend increases.

Consider an investor whose RRSP has $20,000 worth of a company trading at $50 with a dividend yield of 3%. Assume the stock price increases by 5% per year and the dividend also grows by 5% per year. After 20 years the investor who chose reinvestment would have about $92,000 while the investor who instead spent the cash dividends would be left with $53,000.

Those employing the strategy outside their registered plans reap the benefit of tax-efficiency because reinvested dividends are taxable in the same manner as cash dividends. Investors report tax payable as dividend income and benefit from the dividend tax credit. When the position is eventually sold, DRIPs will need to be accounted for when calculating the capital gain or loss.

There are different ways of participating in a DRIP. Registered shareholders can enroll directly through the participating company. Investors holding shares at a brokerage firm can also enroll. Non-registered shareholders simply contact their advisor and ask to participate in a company's plan.

DRIPs are not available on all dividend-paying stocks so investors will have to do their homework. Also, they should be careful when constructing their portfolios to ensure they maintain proper diversification. Companies who offer DRIPs tend to be larger, more mature companies and there tends to be wide representation by the financials and utilities sectors. Investors who invest in companies solely because they offer DRIPs can miss out on other important sectors.

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## Taking advantage of DRIPs

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Some investors prefer products like ETFs to achieve diversification across market sectors, because of their simplicity and low fees. There is a growing range of ETFs now offering the added advantage of easy and inexpensive distribution reinvestment through DRIPs.

As a long-term strategy, DRIPs have proven successful. They can be a very effective way to accumulate wealth while reducing the impact of volatility on portfolio performance.

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