You Can CHOOSE TO BE RICH

Robert T. Kiyosaki

Dear Friend,

Congratulations! You have taken the first step on the path to financial freedom. This Choose To Be Rich program has been designed to change the way you think about money, to provide you with the tools you'll need on your path to wealth, and to set you firmly on that path with a plan of action.

This is a journey that began for me at the age of nine. As a young boy, everything I learned about money came from two men. My own dad, whom I refer to as my Poor Dad, was highly educated, with a high paying job as Superintendent of Education for the State of Hawaii. As his income continued to grow, however, so did his debt; and he worked harder and harder, struggling paycheck to paycheck.

In contrast, my best friend's dad, who I call my Rich Dad, never finished high school. Yet he became one of the wealthiest men in the state of Hawaii. And his path not only led to great wealth, but also allowed him to spend more time with his family.

I admired both men very much, but when it came to money I decided to follow my Rich Dad's path. He taught me a new way of thinking about money and wealth—lessons I would now like to share with you.

My Rich Dad's greatest lesson of all was that the rich are not smarter than the rest of us—they just know things about money that the middle class and poor do not! He also taught me that there was nothing difficult about becoming rich; all I had to do was change the way I thought about money—different from everything I was taught at home ... at school ... even by bankers. And finally, he taught me it was just a choice. A choice I continue to make every day.

Based on the lessons of my Rich Dad, I was able to make my first million by the age of 30; and at the age of 47, I was able to retire with complete financial freedom! But as my own dad's—my Poor Dad's—son, I am a teacher at heart. And since school does not prepare us to become rich, my wife Kim and I have dedicated ourselves to teaching others the lessons my Rich Dad taught me. So this program is really a tribute to *both* my dads.

My number one goal for this program is to get you started and set you firmly on the path to wealth. I want to change the way you think about money. I want to show you how the rich think about money and what they do every day of their lives that is different from what most folks do. I want to provide a whole new way of thinking and give you a new set of tools so you can pursue your dreams. I want to give you the freedom to Choose to Be Rich.

Course Overview

Everything in this course is based on a three-step plan to wealth:

- Think It
- Learn It
- Do It

Your critical first step to becoming rich is to *Think Like the Rich.* You're about to discover that the wealthy view money in a very different way than the poor or middle class. You will be asked to change the way you view the world of money—to discard perceptions you have long held as fact, because if you really want to be wealthy it's as simple as changing the way you think!

You will soon learn that in most cases, the rich aren't smarter than anyone else, but there are things they have learned about money, business, investing and risk that others simply have not.

In part two of this program you will *Learn What the Rich Know.* You will gain the financial education that my Rich Dad shared with me and you will build your financial literacy.

Part three gives you step-by-step guides for developing your own plan of action to *Do What the Rich Do* so you can successfully begin to realize your dream of financial freedom!

Course Components

To make your Choose to Be Rich experience as rich and rewarding as possible, we have provided materials in a variety of formats:

The Home Study Course Binder: Here's all the information you need to take control of your financial future. Your binder is clearly divided into the three key sections for your success: Think It, Learn It, Do It. Page by page, you'll find easy, user-friendly reading, plenty of simple worksheets, and the materials to develop your plan.

12 CDs or Cassettes: Conveniently included in your binder, our audio program complements the text with specialized lessons from my own personal team of experts—each hand-picked by me!

One-Hour Bonus Video: I have given seminars to tens of thousands of people around the world. And now you can attend one of my lectures right in the comfort of your own home! Let me show you how to move beyond the relentless cycle of living paycheck to paycheck and start enjoying the power of having money work for you in this exclusive video.

Bonus Audio: Do you know the six simple obstacles people face on their path to wealth? Would you believe they have nothing to do with money? On this special bonus audio, I'll reveal these basic stumbling blocks and how to overcome them. Be sure to listen to this tape first!

Debt Eliminator: If you're like most people, you are currently carrying considerable debt—mostly credit card. Now with this practical tool, you can establish a realistic plan to eliminate debt and build on a strong foundation.

How to Get Started

To be sure you get the most from your Choose to Be Rich program, I recommend the following:

- Listen to your bonus audiotape, *Get Ready to Be Rich,* first. Here you'll discover the common obstacles to wealth and how to avoid them.
- Next, watch the video seminar, *60 Minutes to Getting Rich.* This private, at-home video seminar reveals Rich Dad's simple formula for real personal wealth.
- Next, read Section 1 and listen to the accompanying CDs or cassettes. Section by section, these companion audio programs will reinforce your understanding of the binder material and provide additional insights and inspiration.

Other Important Points

As you make your way through the program, be sure to:

- Highlight the key points of interest and make notes in the margins whenever necessary.
- Make photo copies of the worksheets so you can update your progress.
- Listen to the audiotapes at least twice to continue your learning and to stay motivated.
- Keep your dream for financial freedom a priority by setting a goal to read and listen to the program at least five times a week.
- Most importantly, take action. Put your newfound wisdom to work and start enjoying the financial freedom you deserve!

Be Sure to Give Back

Once you have begun your path to financial freedom, don't forget to give back. Throughout my life, whenever I have felt needy or short of money or short of help, I simply went out and decided to give it first. And when I gave, it always came back. I want money, so I give money, and it comes back in multiples. I want sales, so I help someone else sell something, and sales come to me. I want contacts, so I help someone else get contacts, and like magic, contacts come to me!

So that's why I say, "Teach and you shall receive." I have found that the more I sincerely teach those who want to learn, the more I learn. So if you want to learn about money, teach it to someone else. A torrent of new ideas and finer distinctions will come to you!

Let Us Hear from You

Just as my Rich Dad taught me, I now hope to teach you. In turn, you can inspire countless others. Please keep in touch. Tell us about your success stories and how this program has made an impact on your life. You can reach us at www.richdad.com.

Again, congratulations on your first step toward financial freedom! I hope that, just as I do, you will Choose to Be Rich each and every day.

Good Luck and Best Regards,

Robert Kiyosaki

You Can CHOOSE TO BE RICH

By Robert T. Kiyosaki
with Sharon L. Lechter, C.P.A

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Pillar 2: Accounting Basics
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Numbers Tell a Story • Understand the Numbers • Why You Need an Accountant • Assets and Liabilities • Audits • Income and Expenses • Your Financial Statement • Cash Flow Patterns

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AUTHORS

Robert T. Kiyosaki

Born and raised in Hawaii, Robert Kiyosaki is a fourth-generation Japanese-American, and one of the founders of CASHFLOW Technologies, Incorporated (CTI). After high school, Robert received one of only two congressional appointments from Hawaii to the Merchant Marine Academy in New York. After graduation, Robert joined the Marine Corps and went to Vietnam as an officer and helicopter gunship pilot. Returning from the war, Robert worked for the Xerox Corporation and then in 1977 started a company that brought the first nylon Velcro surfer wallets to market. Realizing that he had a passion for teaching, in 1985 he founded an international education company that taught business and investing to tens of thousands of students throughout the world. In 1994 Robert sold his business and retired at the age of 47.

During his early retirement, Robert wrote *Rich Dad Poor Dad*, which he followed soon afterward with *Rich Dad's Cashflow Quadrant, Rich Dad's Guide to Investing* and *Rich Kid Smart Kid*. All four books have made it to the best-seller lists of the *Wall Street Journal, Business Week, New York Times, USA Today,* E-Trade.com, and other distinguished lists. Robert also created the educational board game CASHFLOW™ to teach individuals the financial strategies his rich dad spent years teaching him—the same financial strategies that brought Robert financial freedom at the age of 47.

Robert and his wife Kim joined with Sharon Lechter to found CTI in September of 1997. Their mission statement: "To elevate the financial well-being of humanity." Robert continues to enjoy teaching seminars and has spoken to sold-out audiences around the world. He has appeared on *Oprah* and other major network television shows. Robert is often heard saying, "We go to school to learn to work hard for money. I write books and create products that teach people how to have money work hard for them ... so they can enjoy the luxuries of this great world we live in." You can contact Robert at www.richdad.com.

Sharon L. Lechter

C.P.A., co-author of the *Rich Dad* series of books, and CEO and co-founder of CASHFLOW Technologies, Sharon Lechter has dedicated her professional efforts to the field of education. She graduated with honors from Florida State University with a degree in accounting, then joined the ranks of what was then one of the big eight accounting firms and went on to hold management positions with companies in the computer, insurance, and publishing industries, all while maintaining her professional credentials as a C.P.A.

Sharon has been happily married to Michael Lechter for over 20 years and has three children, Phillip, Shelly, and William. As her children grew, she became keenly involved in their education and always served in leadership positions in their schools. She became a vocal activist in the areas of mathematics, computers, reading, and writing education. So in 1989 she was delighted to join forces with the inventor of the first electronic "talking book," and helped him expand the electronic book industry to a multimillion-dollar international market. Today she remains a pioneer in developing new technologies to bring education back into children's lives. As co-author of the *Rich Dad* books and CEO of CASHFLOW Technologies, Inc., she now focuses her efforts in the field of financial education. "Our current educational system has not been able to keep pace with the global and technological changes in the world today. We must teach our young people the skills, both scholastic and financial, that they will need to not only survive but to flourish in the world they face."

An avid philanthropist, Sharon "gives back" as both a volunteer and a donor. She runs the Foundation for Financial Literacy, and is a director on the Arizona board of Childhelp USA, a national organization formed to eradicate child abuse in the U.S. As an active member of the Women's Presidents Organization, she enjoys networking with other professional women across the country. She has also worked with the American Cancer Society, the American Heart Association, the Milwaukee Children's Hospital, and the Milwaukee Opera Club.

Robert says of her: "Sharon is one of the few natural entrepreneurs I have ever met. My respect for her continues to grow every day we work together." You can contact Sharon at sharon@richdad.com.

CONTRIBUTORS

Kim Kiyosaki entered the business world working with a top Honolulu advertising agency and by age 25, she was running a Honolulu magazine that served the city's business community. It didn't take long for Kim's entrepreneurial spirit to surface, and two years later she ventured into her first business – a clothing line marketed throughout the U.S. Shortly thereafter Kim joined Robert Kiyosaki as a partner in a company that taught entrepreneurial business throughout the world. The business started from nothing and grew to eleven offices in seven countries, teaching business seminars to tens of thousands of attendees. In 1989 Kim began her real estate investing career with the purchase of a small 2-bedroom, 1 bath rental house. Today Kim's real estate company buys, sells, and manages millions of dollars worth of property.

Kim and Robert sold their education business in 1994 and "retired." In 1997 Kim, Robert, and Sharon Lechter founded Cashflow Technologies, Inc. (CTI). To date CTI has launched four best-selling books, including the very popular *Rich Dad Poor Dad*, as well as the patented board game CASHFLOW®. You can contact Kim at www.richdad.com.

Diane Kennedy, CPA, author of *Loopholes of the Rich – How the Rich Make More and Pay Less Tax* in the Rich Dad's Advisors' series, is also the co-author of two college textbooks on accounting and computer topics and a past instructor at the University of Nevada, Reno. Diane is a popular public speaker, and as one of Robert Kiyosaki's select Rich Dad's Advisors' has traveled as far away as Australia to speak to sold out audiences. She has built a career based on educating others about financial investments and the tax advantages that are available. An outspoken proponent of building your own wealth through real estate, she clearly demonstrates that success in her own life: She bought her first rental property before the age of 25 and over the past two decades has owned over 100 properties. She is a past recipient of the prestigious Blue Chip Enterprise Award, given to the business owner demonstrating the most entrepreneurial spirit in the State of Nevada. She is also a past recipient of the National Chamber of Commerce award for Excellence in Business. Diane Kennedy's CPA firm, DKA (D. Kennedy & Associates), can be reached through her website at www.legaltaxloopholes.com.

Dr. Dolf de Roos began investing in real estate as an undergraduate student. Despite going on to gain a PhD in Electrical and Electronic Engineering from the University of Canterbury, Dolf increasingly focused on his flair for investing to the extent that he has never had a job. He has, however, invested in many classes of real estate (residential, commercial, industrial, hospitality, and specialist) in a variety of countries. Today he is the chairman of the public company Property Ventures Limited, an innovative real estate investment company whose stated mission is to massively increase stockholders' worth. Over the years, Dolf was cajoled into sharing his investment strategies, and he has run seminars on real estate and the psychology of creating wealth throughout North America, Australia, New Zealand, Asia, the Middle East, and Europe since the 1980s. Beyond sharing his investment philosophy and strategies with thousands of investors (beginners as well as seasoned experts), Dolf has also trained real estate agents, written and published three best-selling books on property, and introduced computer software designed to analyze properties quickly and efficiently. He often speaks at investors' conferences, appears on radio shows, and takes part in television debates. Born in New Zealand, raised in Australia, New Zealand, and Europe, and with 6 languages under his belt, Dolf offers a truly global perspective on the surprisingly lucrative wealth building opportunities of real estate. You can find out more about Dolf's willingness to share what he learns on his website www.dolfderoos.com.

Bob Chilton, President of CASHFLOW Technologies, Inc., is a builder of companies and a motivator of people. He has an advanced engineering and architecture degree from the University of California at Berkeley. After working in the engineering field for several years, he turned his attention to the business world, where he was able to use his keen analytical skills to redefine and focus small companies, automating and computerizing them in the process. On the human side, he recognized that success rests in defining the mission of any company, and unifying its personnel in fulfilling that mission. He has since pursued his passion for building and growing small- and mid-sized companies, focusing on systems development and corporate expansion of businesses in the retail, manufacturing, construction, and education industries. Bob's ability to break down complex business problems into simple systems and integrate them with a qualified, motivated team of people has enabled many companies to expand rapidly and to reach and exceed their corporate goals. You can contact Bob at BobChilton@richdad.com.

Kim D. H. Butler, CFP, is a highly successful financial planner and life insurance agent practicing in Phoenix, Arizona. Involved in financial services since 1988, she has a background in commercial banking and has been selected by the internationally known Strategic Coach Program to join their elite group of entrepreneurial coaches. She started her first business in fourth grade milking a cow by hand and selling the milk to neighbors and friends. Today as a financial planner, she focuses on entrepreneurs and specializes in maximizing wealth, turbo charging money, and helping clients implement the velocity of money multiplier. Her mission is to educate, counsel, and guide clients toward their maximum wealth. Kim and her team can be reached via her website: www.partners4prosperity.com.

Blair Singer, the author of *$alesDog* in the Rich Dad Advisors' series, is considered one of the best facilitators of personal and organizational behavior change in business today. He has earned global recognition through the development of a unique, high-impact approach to teaching, learning, and facilitating that virtually guarantees positive behavioral change and high performance. He is the founder of the international training firm, Blair Singer Accelerated Training (BSAT) and the founder of SalesDogs: a methodology that offers life-changing sales success. Since 1987 he has worked with tens of thousands of individuals and organizations ranging from Fortune 500 companies to groups of independent sales agents to assist them in achieving extraordinary levels of sales, performance, productivity, and cash flow. Blair was formerly the top sales person for the Burroughs Corporation (now UNISYS) and later a top performer in software sales, automated accounting sales, and airfreight and logistics sales both corporately and as an entrepreneur. He quickly came into demand as a presenter, trainer, and corporate consultant. For the past twelve years he has conducted thousands of public and private seminars with audiences ranging in size from three to three hundred to over 10,000. His professional activities have taken him to over twenty countries and across five continents. Overseas he has worked extensively in Singapore, Australia, and around the Pacific Rim. Blair can be found at www.salesdogs.com and at www.blairsinger.com.

Michael A. Lechter, author of *Protecting Your #1 Asset, Creating Fortunes from Your Ideas, An Intellectual Property Handbook* in the Rich Dad's Advisors' series, has specialized in intellectual property law since the early 1970s and is Counsel to the international law firm of Squire, Sanders & Dempsey L.L.P., and serves as an Adjunct Professor at Arizona State University's College of Engineering. He is a patent attorney who has been admitted to practice in a number of states as well as to the Patent Bar. Michael is also the author of *The Intellectual Property Handbook*, coordinating editor of *Successful Patents and Patenting for Engineers and Scientists*, and contributing author to the *Encyclopedia Of Electrical And Electronics Engineering.* He has lectured extensively throughout the world on intellectual property law. Upon request of the House Judiciary Committee he has submitted testimony to the Congress of the United States, and has participated in various United Nations and foreign government proceedings on intellectual property law and technology transfer. You can contact Michael Lechter at mlechter@richdad.com.

Introduction

Life is about choice. When you were young, choices were made for you. As you grew and matured you learned to make your own choices, a slow, steady process fraught with both joy and frustration. Now it's time to make one of the most critical decisions of your life: whether to take control of your finances. Why critical? Because if you take control of your finances, it will empower you to shape a new life for yourself. This choice is really a series of smaller decisions: the decision to change your financial future, a mere preliminary, and the decision whether to follow up, renewed each day you open your eyes. Will you see your choice through to the end?

This work/study book is a road map to your new life. You'll be navigating through three sections, a varied terrain of rich ideas, practical information, and exercises designed not to determine your direction, but rather to light your way. In Section 1, "Think Like the Rich," you'll shed old ways of thinking and adopt new ideas that have the power to propel you up the entrance ramp to financial freedom. In Section 2, "Learn What the Rich Know: The Five Pillars of Financial Literacy," you'll absorb the knowledge required to keep you moving down the road. And in Section 3, "Do What the Rich Do: A Step-by-Step Guide to the Financial Fast Track," you'll follow a detailed program intended to help you reach your destination.

But first things first. It's time to take stock of your financial situation. In the pages that immediately follow, you'll be confronting your fears, your stale habits of thinking, and other hidden obstacles that until now have prevented you from getting ahead. You'll be inventorying your strengths and your passions, those things you've always possessed but never acknowledged, whose power can lead you out of your financial maze. And you'll encounter new thoughts on the idea of money, thoughts meant to harness those inner strengths and steer you onto the road to your dreams.

Rich Dad said, "All of us have the power of choice. I choose to be rich, and I make that choice every day." Congratulations! You've made the choice to achieve financial freedom; the time has come for the effort.

Two roads diverged in a wood, and I–
I took the one less traveled by,
And that has made all the difference.

–Robert Frost

Change Your Mind, Change YOUR LIFE

"All of us have the power of choice. I choose to be rich, and I make that choice every day."

You're about to embark on this work/study program because you want to change your life. But before you change your life, you need to change your mind. Your thoughts and beliefs are deeply ingrained, so deeply ingrained that you may not even be aware of how much they've shaped your financial woes. If you harbor the hope of financial freedom, self-awareness is critical. In this chapter you'll be taking an inventory of your attitudes. You'll learn which ones are helping you and which ones are holding you back. And under Rich Dad's guiding influence, you'll encounter a wealth of new ideas that have the power to steer you in a different direction, down the path to financial freedom. Whether or not you travel this path is up to you.

WHAT ARE YOU THINKING?

RICH DAD'S TIP

▲

"Money is just an idea."

When you look in a mirror, what do you whisper? Do you berate yourself with comments like "I'm overweight" and "I'm getting old"? Or do you stand tall and say "I look great!" A mirror reflects much more than what your eyes see. A mirror reflects your inner thoughts and your beliefs—your soul. Listen to the thoughts that come from your soul. Are they negative? You'll never embark on the road to riches if you let such thoughts constrain you.

RICH DAD'S TIP

"There is nothing more powerful than an idea whose time has come, and there is nothing more vulnerable than someone who is still thinking old ideas."

THE NATTERING NABOBS OF NEGATIVISM

A well-known figure in the political world once coined the phrase "nattering nabobs of negativism" to refer to habitual naysayers. People will conjure up any number of excuses not to choose wealth, excuses that say more about their inner thoughts than about the difficulty of achieving wealth. Are you a nattering nabob of negativism? Take a look at these excuses, and see if any sound familiar:

"I can't give up a regular paycheck."

"Invest? You want me to lose all my money, don't you?"

"I don't have any money to invest."

"I tried that before. It'll never work."

"I don't need to know how to read financial statements.
I can get by."

"I'm not smart enough."

"My husband would never go for it."

"My wife would never understand."

"What would my friends say?"

"I'm young. I've still got time."

"It's too late for me.

"You can't do that."

TALK BACK

If you're harboring negative thoughts, you need to understand what they really mean. For example, if you tell yourself "I can't stop working and start my own business—I have a mortgage and a family to think about," you might really be saying "I don't have time, and I'm too tired to learn anything new."

It's time to dig deep down and unearth your personal truths. Jot down the negative statements you whisper to yourself and, after some honest soul searching, record the personal truth that lies beneath each:

NEGATIVE THOUGHT	PERSONAL TRUTH
(ex) "I can't do it."	(ex) "I am afraid of trying"

Sometimes we let negative statements play over and over in our minds like endless mantras. Once you know the truth beneath your negative statements, talk back to them. Start an argument with yourself! Think of ways to counter each one.

If you're having trouble identifying what's holding you back, keep a daily journal. Once your negative ways of thinking become clear, then repeat this exercise. Don't let buried thoughts sap your energy and motivation. Unearth them, and free yourself to move forward.

NURTURE YOUR BETTER SELF

Now that you've removed the mines blocking your path, consider the positive traits that will propel you forward on your quest for financial freedom. Here are some strengths that are common to people who succeed in business and investing:

- *Vision*—the ability to see what others do not see
- *Courage*—the ability to act despite fear
- *Creativity*—the ability to think outside the box
- *Self-confidence*—the ability to withstand criticism
- *Self-control*—the ability to delay gratification

Look at people around you who demonstrate these strengths. Try to emulate them. And don't forget to look within. Are there areas in your life where you've exhibited such traits? Nurture them and allow them to spread into your financial life.

PREPARE FOR OPPORTUNITY

So far, you've been focusing on internal things that you have the power to change. What happens when your internal self meets the external world over which you have so little control? In truth, you have more control over that world than you think. It has been said that luck is what happens when opportunity meets preparedness.

Imagine two men walking down the street on a windy day. A piece of paper blows along the sidewalk in front of one man, then the other. The first man ignores the litter, keeping his eyes on the block up ahead; the second man peers at the scrap, realizes it's a twenty dollar bill, and picks it up. Is that person luckier? No. The same opportunity crossed the path of both men, but only one of them was prepared to take action.

When it comes to financial matters, it's important to keep your eyes and ears open—and to know where you are. Only then will you spot opportunity when it crosses your path.

A NEW AGE

In a broader sense, it's important to know where you are in history and in the world at large. Christopher Columbus's voyage of 1492 eventually led to the start of the industrial age, a momentous historical shift. At the height of the industrial age it was people like Henry Ford and Thomas Edison who became millionaires. I believe that the fall of the Berlin Wall in 1989, some 500 years after Columbus set sail, marked the end of that great age and the beginning of another equally dynamic one: the information age. Generations from now, people will look back and remark what a thrilling, tumultuous era this must have been. Computer-industry figures such as Bill Gates and Michael Dell are the magnates who typify this new age. It took Henry Ford twenty-three years to become a billionaire during the industrial age; it only took Michael Dell three years to become a billionaire during the information age—and he started his business part-time.

These are heady times, and frightening for some. The economy's speedy adaptation to the demands of the information age has threatened the financial security of millions of people whose jobs have become obsolete or moved elsewhere. Take a look at the difference, for example, between an industrial age pension plan and an information age retirement plan. In the industrial age, companies would employ people for life and give them pensions once their working days were over. Today companies aren't giving out pension plans the way they used to; less-generous contributions to retirement plans are more common now. And people are retiring earlier and living longer lives. The rules have changed. Retirees need more financial security and thus more-sophisticated ways of building assets than were offered by the pension plans of the industrial age. Unfortunately, most people—those who can least afford to keep their heads stuck in the sand—are acting as if the rules haven't changed.

TAKE NOTE

Today retirees need more financial resources at retirement and more-sophisticated ways of building assets than were offered by the pension plans of the industrial age.

THE 90/10 RULE

Throughout history, 90 percent of the money has been made by 10 percent of the people. For instance, 10 percent of the athletes make 90 percent of the money made by all athletes. This is one of the rules of money that Rich Dad taught me. One reason the 90/10 rule has applied is that 90 percent of the people choose comfort and security over being rich. Most of these people do not realize they could choose to be rich.

While the 90/10 rule still holds, it's being challenged by the changing circumstances that the information age introduced. Thanks to the electronic revolution, it is now possible for more and more people to gain access to the world of wealth, for wealth now resides in information that flies over the airwaves and through television and computer networks. Information is not restricted to the few, as land and resources were in past ages.

The Internet epitomizes this new avenue toward wealth, for it enables the masses to gather information and interact with one another in almost complete freedom. Today it's possible for people to take their ideas and, with the help of this new-age medium, build products or services around them. Network marketing, the selling of consumer goods, investing, publishing—these are only a handful of the thousands of on-line activities that have been launched by aspiring entrepreneurs and savvy investors.

TAKE NOTE

The times are rapidly changing, and if you want to be rich, your approach to money and investing has to change too.

We've only just begun to see what kind of world is possible in this new age of information, but I'll wager that in the near future, the pressure of the information age is going to shatter the old 90/10 rule. It has never been easier to choose to be rich.

CHANGING WITH THE TIMES

When I was a boy, Rich Dad used to say, "If you want to get rich, you need financial literacy. You have to learn to be an investor." My educated dad disagreed. "I don't need to learn how to invest," he'd say. "I have a guaranteed government pension plan, a pension from the Teachers Union, and Social Security benefits. Why take risks with my money?" That's head-in-the-sand thinking. If you think your financial security is the responsibility of a company or the government, you're going to be sorely disappointed in the coming years. You need to switch from industrial age to information age thinking:

Industrial age thinking	Information age thinking
• Study hard and find a safe, secure job.	• Study hard but also become financially literate.
• Get a job and save money.	• Create assets on your own.
• Your pension and Social Security will protect you in retirement.	• Your pension and Social Security will not support you in retirement.
• Your income will go down when you retire.	• Your income should increase as you age.
• Diversify your investments.	• Concentrate your investments.
• Blue chip stocks and mutual funds are safe investments.	• Blue chip stocks and mutual funds will not protect you if there is a stock market crash.
• Put your investments in the hands of someone else.	• Watch your investments but seek competent advisors.

People get old or obsolete because they cling to old ideas. Rich Dad used to say, "You can't help but get older physically. That doesn't mean you have to get older mentally." If you want to stay young longer, adopt younger ideas.

RICH DAD'S TIP

▲

"You can't help but get older physically. That doesn't mean you have to get older mentally."

IT'S NOT TOO LATE

It would be great if everyone had a Rich Dad and grew up learning financial literacy. Most of you didn't have such an advantage. Don't let that discourage you. Regardless of what did or didn't happen in the past, when you're ready to make big changes, amazing things can happen in a short time. Many great fortunes have been built by determined people who started out later in life, even people who were in considerable debt. Look at Colonel Sanders-he was sixty-six and broke when he started Kentucky Fried Chicken.

In my years of teaching, I've had the good fortune to meet and hear from many wonderful students who have taken Rich Dad's advice and turned their lives around. No matter what stage of life a person is in, if the desire to change is there, change is possible. The following are comments from real people who have chosen the path to financial freedom:

"Rich Dad's approach is simple but very profound: You can take what's in your head and turn it into cash flow."

—David and Liz

DAVID AND LIZ

"The Rich Dad philosophy taught us that money is just an idea. Rich Dad's approach is simple but very profound: You can take what's in your head and turn it into cash flow. This approach is empowering because you know that when you see that little trickle begin, eventually it'll become a tidal wave.

"One of the biggest impacts Rich Dad's advice has had in our life is on our children. Our son used to think it wasn't a good thing to have a lot of money. Now he sees that when you have money, you can give to other people. He and my daughter have also learned that you can do whatever you set your mind to do. That's one of the most valuable lessons in life. Thanks to Rich Dad, we're leaving our children not just a legacy of money, but a legacy of mind."

MICHAEL

"I had my own real estate office and was working crazy hours, manning the phone twenty-four hours a day. I thought because I was working for myself that I was a business owner, even though I wasn't achieving the sort of success I wanted. Then I started reading the Rich Dad books and it hit me—I didn't own a business, I owned a job.

"That revelation made all the difference in the world. Up till then, I'd been doing everything on my own. Rich Dad taught me to draw on the talents of other people to help me reach my financial goals. That turned me from a self-employed person into a true business owner. Now I've got ten agents working for me, and I'm reaping the benefits of their efforts as well as my own."

"I thought because I was working for myself that I was a business owner.... Then I started reading the Rich Dad books and it hit me—I didn't own a business, I owned a job."

—Michael

DARRELL

"I was brought up with the idea of going to school, working hard, and accepting the limits that come with being an employee. I dropped out of college twice and started working for an insurance agency without much success. When I first saw Rich Dad's ideas in print, it had a huge impact on me. They made so much sense that I internalized them quickly, and I realized that for my whole life I'd been trying to fit into a mold that other people cast for me. I didn't want to be in that mold—I wanted to be a business owner and investor.

"Now I have a real estate company that buys a lot of properties. Thanks to the Rich Dad philosophy, we avoid buying property for the wrong reasons. We only buy properties that will put money in our pockets and not suck us dry. His concepts have kept me from going bankrupt several times in this year alone. Rich Dad has helped me focus my sights not on what others think is good for me, but on what I want—wealth."

"Rich Dad has helped me focus my sights not on what others think is good for me, but on what I want—wealth."

—Darrell

JONATHAN

"I grew up with the saying, Love of money is the root of all evil. That's hard to overcome. When I came across the Rich Dad approach, I saw that I was missing out in life because of my false ideas about money.

"I'm self-employed and although I'm making pretty good money, I know that the deck is stacked against my making more this way. The Rich Dad approach has motivated me to take a serious look at building a real business and making investments. One of the big challenges for me is learning the financial end of things. That's what is so phenomenal about Rich Dad: His information is so easy to digest and apply. Rich Dad has provided a nice stepping-stone for me as I re-direct my efforts away from self-employment toward business and investing."

"When I came across the Rich Dad approach, I saw that I was missing out in life because of my false ideas about money."

—Jonathan

"Rich Dad made me realize that I had the ability to do this—the confidence and the desire."

—Christine

CHRISTINE

"I was a sole proprietor of an accounting business when I came into contact with the Rich Dad way of doing things. That changed my way of thinking forever. I didn't have a lot of money so I said, 'Okay, I've got to take action,' and I approached someone with money who became my business partner in a real estate venture. He's the money side of it; I'm the one who finds the properties and manages them. We've put a great team of people together and the business has really taken off. In a year and a half, I've built up half a million dollars in assets.

"It's amazing. Rich Dad made me realize that I had the ability to do this—the confidence and the desire. After that, it was a matter of gaining knowledge and building my team. So far, I've been doing a series of small real estate deals. As Rich Dad would say, I've mastered one formula and now it's time to master a new one. Now that I've got the money, I'm preparing myself to do a big deal as soon as the opportunity presents itself."

LEARN FROM YOUR MISTAKES

Most of us grew up thinking that mistakes are bad and should be avoided at all cost. We tend to correlate mistakes with low intelligence: The more mistakes you make, the dumber you are. In Rich Dad's mind, however, mistakes were opportunities to learn something new. "There's a bit of magic hidden in every mistake," he told me. "That magic is called learning." Instead of telling me how to avoid mistakes, Rich Dad taught me the art of turning a mistake into an opportunity to gain wisdom.

It's not easy to learn from our mistakes and setbacks. How we react to them tells us who we are. Here is a cast of characters that Rich Dad drew up to describe different reactions to financial setbacks. Which character are you?

RICH DAD'S TIP

"There's a bit of magic hidden in every mistake. That magic is called learning."

CHARACTER	THE CHARACTER'S LINES
The Liar	**"I don't know how that happened."**
The Blamer	**"The customers are too stupid to buy my product."**
The Justifier	**"I didn't really want to be rich anyway."**
The Quitter	**"I told you it would never work. This is too complicated, I give up."**
The Denier	**"No, there's nothing wrong. What mistake? Things will work out."**

After recognizing that you've made a mistake, it's difficult not to let one of these characters take over. So go ahead, bang your head against the wall. Lie. Whine. Complain. If you're ever going to get your financial house in order, however, eventually you need to let another character, the Responsible You, take control of your thinking. The Responsible You asks, "What priceless lesson can I learn from this mistake?"

THINK
LIKE THE RICH

Think back on three financial mistakes you've made. What lessons can you learn from those mistakes? Take a few moments to record your thoughts.

MISTAKE	LESSON

RICH DAD'S TIP

▲

"Some of the biggest failures I know are people who have never failed."

MANAGING RISK

One of the valuable lessons I learned from my own mistakes was how to manage risk. Like it or not, risk is a part of investing, whether you invest in paper securities, the real estate market, or a business of your own. Everyone who has built a fortune from scratch has felt on the edge of a cliff at one time or another. If you're going to get rich, at some time you'll have get close to the edge of the cliff, too. But that doesn't mean you have to jump. It's quite possible to make investments that receive high returns with low risk, and you can learn how.

As I've said, too many people rely on big government or a big company to eliminate the financial risk in their lives. They play it safe in their jobs, buy houses and cars and, if they don't have pensions, put a little money aside monthly for retirement plans. This was the path of Poor Dad.

What's wrong with this scenario? Plenty. Today, more and more people are graduating with good grades and advanced degrees, but there are fewer and fewer secure jobs with benefits. Rich Dad taught me differently. He said that working for someone else just created the illusion of security—that it was much riskier than investing or starting your own business. To Poor Dad, investing was risky; to Rich Dad, not investing was risky.

As you move forward in this work/study program, you're going to learn that true investing is not a gambling game of hunches, but rather a plan. Once you become financially literate and

FEAR: I'm putting my money in a savings account. Investing is for high rollers.

FACT: Investing isn't a gamble, it's a plan. Once you become financially literate, your ideas about what is risky—and about how to invest your money—will have changed.

FREEDOM: Enact a sound plan, and you can turn risk into riches.

RICH DAD'S TIP

▲

"Investing isn't risky; not *investing is risky."*

begin enacting your own plan, whether through investing, building businesses, or both, it's likely that your ideas about what is risky and what is not will have changed.

A RISK SELF-ASSESSMENT

Before you reach that point, it's helpful to get a sense of your overall risk tolerance. No matter what you do in your financial life, there is always the possibility of losing some money. How comfortable are you with this possibility? The following questions are meant to get you thinking about your general attitude toward risk:

- Do you get bored easily? Are you usually looking for a new challenge, or do you like to stick with what you know?
- Do you feel confident that you can handle whatever comes your way, or do you tend to worry?
- When you lose something valuable, do you get anxious and obsess about it, or are you able to accept the loss and move on?
- How easily can you turn important matters over to others? Do you trust experts to act on your behalf, or do you prefer to handle everything yourself?

In Sections 2 and 3, you'll learn more about financial risk and how to handle it. The more financially educated you are, the less risk you'll face. By the time you complete the Rich Dad program, you'll know the truth of this statement: On the road to riches some risk is inevitable, but if you keep a cool head and improve your financial literacy, you can manage it.

OVERCOME THE SIX OBSTACLES

Knowing how to manage risk is one of the prerequisites of financial literacy. Once you've fulfilled all the prerequisites and become fully literate, does financial freedom follow? Not necessarily. Certain personal obstacles can prevent even the most financially literate from developing abundant wealth. Despite all their knowledge, they'll continue working full time just to pay the bills instead of living the life they dream. By learning to recognize these personal obstacles, you can overcome them. What are they?

1 Fear
2 Cynicism
3 Laziness
4 Bad habits
5 Arrogance
6 Disappointment

OBSTACLE 1: FEAR

RICH DAD'S TIP

▲

"The primary difference between rich people and poor people is how they handle fear."

Fear of losing money is the main reason 90 percent of the American public struggles financially. But fear isn't the real problem. It's how people handle fear that matters. Rich Dad used to tell me that the primary difference between rich people and poor people is how they handle the fear of losing money. Some people, when hit with a financial loss, give up. Others transform the loss into a win. As John D. Rockefeller said, "I always tried to turn every disaster into an opportunity." Losers are defeated by failure. Winners are inspired by it.

Rich Dad often commented that the real reason for lack of financial success was that people played it too safe. "People are so afraid of losing money that they do lose it," he would say. If they have some cash, they buy big houses and big cars rather than big investments. Or they invest all of their money in balanced portfolios—in CDs and low-yield bonds and mutual funds and a few individual stocks. These are people, driven by fear, playing not to lose. Of course, a balanced portfolio is a lot better than no portfolio. It seeks safety through diversity. Having a financial plan for security and comfort first are important. But if you have any desire to become rich, you must focus,

FEAR: I'll lose all my money if I invest in anything riskier than CDs, bonds, and mutual funds.

FACT: If you lose some money, you can learn from the failure. Once you become an educated investor you'll be positioned to reap potentially huge rewards.

FREEDOM: Financial failure can be transformed into financial gain.

not diversify. You must put a lot of eggs in a few baskets rather than putting a few eggs in many.

If the prospect of failure frightens you, then play it safe. Keep your daytime job until you have enough cash to buy bonds and mutual funds and consult with a financial planner. But if the prospect of failure inspires you to fight and win, maybe you should challenge yourself to change your financial habits. Educate yourself and take some financial risks. The more education you have, the less risk there will be.

OBSTACLE 2: CYNICISM

RICH DAD'S TIP

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"Cynics criticize and winners analyze."

All of us have some Chicken Little in us. You remember Chicken Little—the character in the children's fable who ran around the barnyard warning other animals that the sky was falling. Chicken Little had a doom and gloom attitude toward life. He was a classic cynic.

There are Chicken Littles everywhere, especially in the financial world. If you want to be rich, you need to stop listening to their clucking. The-sky-is-falling warnings from financial cynics are just a lot of empty noise. We hear that noise all around us, from friends, family, co-workers, and the media, and we tend to succumb to it because inside each of us there is a little bit of chicken.

Why should we ignore the cynics? Because cynics never win. They're do-nothing alarmists who spend all their time spreading fear. It's the people who read a situation correctly who end up winning—the analysts. Cynicism blinds you to opportunities, while analysis opens your eyes to possibilities. One leads to paralysis, the other to action. Peter Lynch of Fidelity Magellan recalls the time during the 1950s when the threat of nuclear war was so prevalent that people began building expensive fallout shelters and storing food and water. Had they used their hard-earned dollars to make some wise investments instead, those Chicken Littles would probably be financially independent today.

RICH DAD'S TIP

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"Losing is part of winning."

How good are you at filtering out cynical noise? Think of things you don't want to happen and things you do want to happen. If your I-don't-wants outweigh your I-wants, you may be letting doubt and fear close your mind instead of open your eyes.

CHASE AWAY CHICKEN LITTLE

If you're a Chicken Little, the story of Colonel Sanders might inspire you to change your attitude of doom and gloom. At the age of sixty-six Colonel Sanders lost his business and found that Social Security wasn't enough to live on. So he went around the country trying to sell his recipe for fried chicken. He was turned down 1,009 times before someone said yes. And he went on to become a multimillionaire at an age when most people are retiring with a small pension. If you're in doubt and feeling afraid, do what Colonel Sanders did to his little chicken—he fried it.

OBSTACLE 3: LAZINESS

Busy people are often the laziest. Busyness is a form of avoidance. If you stay busy you can avoid some of the things you don't want to face—like exercising, or taking care of your wealth.

What's the cure for laziness? A little greed. Wait a minute, you say. Isn't greed bad? Too much of it, yes. An excess of anything is bad.

The fact is, however, that all of us secretly harbor a desire to have new or exciting things. We've been told by our parents and others to suppress that desire. We've been made to feel guilty about it. How many children have asked a parent for something and gotten the response, "Do you think I'm made of money?" In truth, guilt is worse than greed. Guilt stifles dreams.

FEAR: I wish I could invest, but I'm too busy and can't afford to invest.

FACT: Busyness is a form of laziness and avoidance. Instead of saying, "I can't afford it," ask yourself *how* you can afford it.

FREEDOM: The question "How can I afford it?" opens up avenues to our dreams.

When we stop saying "Life is too hectic to change it" and say, instead, "It's time to exit this rat race and find new ways to earn wealth," we begin to cure ourselves of our busy laziness.

RICH DAD'S TIP

▲

"The words 'I can't afford it' close your mind, while the words, 'How can I afford it?' open your mind. The human spirit is powerful—it knows it can do anything."

Rich Dad used to say, "The phrase 'I don't want' holds the key to your success." I saw what he meant when I got into real estate and quickly learned that I didn't want to fix toilets. By finding a property manager who could fix toilets, I was freed up to buy a lot more real estate. And as a result, my cash flow increased.

Go ahead, be greedy, if that's what your heart is telling you to do. Make a list of what you really want, and don't limit it according to someone else's idea of what you shouldn't have—be truthful with yourself.

Things I Want

When your list is complete, step back and appraise it. Don't ask yourself whether you can afford the things on your list, but rather how you can afford them. This fresh appraisal will create a stronger mind and a more dynamic spirit, helping you to shed your lazy ways.

RICH DAD'S TIP

▲

"Pay yourself first."

OBSTACLE 4: BAD HABITS

When you pay your bills at the first of the month, do you have anything left over? Probably not. If so, that's the main reason you're struggling financially—you have bad habits. The worst financial habit is paying your creditors before you pay yourself. That doesn't mean you shouldn't pay your bills on time. What it does mean is that you should pay yourself first—even if you're short of money.

Rich Dad told me to do this once. I was perplexed. "How can you pay yourself first?" I asked him. "It's all a matter of motivation," he replied. "Who will scream louder if they aren't paid—you or your creditors?" The answer was obvious: the creditors. "Precisely," he went on. "Creditors are bullies. And because they're bullies, the pressure to pay them will be so great that it will force you to seek sources of income other than what you're making working for someone else." Rich Dad was right. What laziness won't get you to do, pressure will. By paying yourself first, you'll become mentally and financially stronger, and better equipped to vanquish the bullies.

OBSTACLE 5: ARROGANCE

Arrogance is ego plus ignorance. The ignorance is hidden behind the ego. Many people try to bluster their way through financial discussions when they don't know what they're talking about. They're not lying, but they're not telling the truth either. The world of finance is full of people who don't know what they're talking about.

RICH DAD'S TIP

▲

"Arrogance is ego plus ignorance."

In financial matters, it's easy to stumble over your own ignorance and fail. When you're arrogant you believe that what you don't know is unimportant. In truth, what you don't know is as important as what you do know. Instead of arrogantly hiding your ignorance and bluffing your way to failure, start educating yourself for success.

WHAT'S YOUR ARROGANCE BAROMETER?

How much do you *really* understand about:

- **Financial statements?**
- **Real estate?**
- **Stocks and bonds?**
- **Starting and selling businesses?**

For each of these subjects you could rate yourself on a scale of 1 to 10, then come up with a quantitative tally. But you don't need to. That's because the real measure of your arrogance is brutal honesty. In your heart you're aware of what it is you don't know, no matter how well hidden from the world it may be. Go ahead, admit your ignorance. Then instead of chastising yourself, read on. In

Section 2 you'll be absorbing knowledge that will empower you to act wisely.

OBSTACLE 6: DISAPPOINTMENT

RICH DAD'S TIP

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"Prepare yourself for disappointment, and you'll turn disappointment into an asset."

Do you react with disappointment when things don't go as you'd hoped? When I left the Marine Corps, Rich Dad recommended that I get a job that taught me to sell. He knew I was shy and that learning to sell would help me succeed.

For two years, I was the worst salesman in my company. My tendency was to blame my failure on the economy, or the product I was selling, or even the customers. Rich Dad would say, "When people are lame, they love to blame." To learn to sell, I had to face the pain of disappointment. Eventually I did learn how, and along with the skills of salesmanship came a priceless lesson: how to turn disappointment into an asset rather than a liability.

Many people turn disappointment into a long-term liability. "I should have known I would fail"—these are the words of people who have let disappointment stop them from learning. As you get ready to embark on your journey to financial freedom, I offer you the same advice Rich Dad offered me: "Prepare yourself for disappointment." Why? Because if you're prepared for disappointment, you have a chance of turning disappointment into an asset.

Preparing yourself for disappointment doesn't mean you won't still be upset and concerned. But if you're prepared, you won't beat up on yourself too hard. This is important, since being too hard on yourself will make you overly cautious about taking risks or trying new ideas. If you can face your failures, control your emotions, and use disappointment to learn new financial skills, you'll flourish.

FEAR: I've been disappointed one too many times. Never again.

FACT: Instead of running from disappointment, prepare for it. That doesn't mean preparing to accept failure passively. It means getting ready mentally and emotionally to learn.

FREEDOM: If you're prepared, you'll react with calm to failure, learn from it, and move on.

WILL YOU THINK LIKE RICH DAD OR POOR DAD?

Can you overcome the six obstacles? Let them hinder you, and you'll find yourself following the path of Poor Dad, working harder and harder for money and having less and less time with your family. Conquer them, and you'll find yourself following the path of Rich Dad, full of confidence and having your money work hard for you.

Poor Dad	**Rich Dad**
"Go to school and make good grades."	"Become financially literate."
"Get a safe, secure job."	"Build businesses."
"Work hard and save."	"Don't save, invest."
"Work for money."	"Let money work for you."
"Pay your creditors first."	"Pay yourself first."
"Save money by shopping for bargains."	"Make money by shopping for investments that will go up in value."
"Don't buy something you can't afford."	"Ask yourself how you can afford it."
"Investing is risky."	"Not investing is risky."
"Your house is an asset."	"Your house is a liability."
"The rich are greedy."	"The rich are generous."
"Money is a necessary evil."	"Money is power."

FINDING YOUR PASSION

Poor Dad's slogans are the words of fear; Rich Dad's slogans are the words of passion. While fear reflects disappointment and passivity, passion reflects confidence and energy. What builds wealth isn't fear, but passion. Sometimes it is called a strong business mission.

I know that from personal experience. In 1977 I launched a manufacturing company that was one of the first to make nylon and velcro wallets. The company's growth was meteoric, but stiff competition soon forced us to move our manufacturing operations to southeast Asia. When I inspected our new overseas factories and saw the cruel conditions under which people were forced to work, it drained some of my passion. I no longer wanted to become rich if it meant exploiting low-paid workers. My business began to sag.

RICH DAD'S TIP

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"Broke is temporary, poor is eternal."

Rich Dad recognized that my enthusiasm for the company was gone. "Let the manufacturing company go," he advised me. "It's time to build a business around your heart—around your passion. Have a strong business mission." We both knew what that passion was: teaching. I may not have acquired financial intelligence from Poor Dad, but I had picked up his love of teaching.

So in 1985, my wife Kim and I packed up everything we owned and moved to California to start an educational business based on exciting new teaching methods. It wasn't easy. We quickly depleted our savings and exhausted our credit cards. We lived in the basement of a friend's house. Uncertainty and self-doubt plagued us. We knew what we wanted—financial freedom—but we didn't know if this new business would enable us to reach that goal.

Despite our fears we followed our hearts and kept on, and in less than five years we had a multimillion-dollar business with eleven offices throughout the world. We had built a business around a new approach to education, and the market loved it. Our passion for the business and its mission made it happen.

Do you know what your passion or mission is? Many people don't, and they have a hard time finding it. To find your passion or mission you have to dig deep inside. Here are some questions to get you started:

- Are there any activities or thoughts that absorb you so thoroughly you lose track of time?
- What subjects do you find most exciting to talk about?
- Who are your heroes? What is it about them that you admire and want to emulate?
- Do you have any skills or talents that inspire self-confidence and pride?
- When you have a free afternoon, how do you choose to spend it?
- If you had all the money you needed to pursue a hobby or a special project, what would it be?
- Do you subscribe to magazines or read books? What sort of reading material excites you?
- If you could develop a "dream" business for yourself, what would it be?

It may help to talk about your passions with people whom you know well and trust. Sometimes other people can read our souls when we can't. Once you become aware of your passion, you can determine your mission and begin to feed it. This in turn will feed the drive that will make your dreams come true.

CHOOSE TO BE RICH

I have the passion to get rich, you might be thinking, but how do I actually do it? Getting rich isn't just a matter of luck, or inheritance, or having a brilliant idea. People who inherit wealth, and the few who win it by way of the lottery, assume the burden of watching over their new-found riches lest they lose them. As for brilliant ideas, they're nothing but dead ideas without a thriving business system to give them life. More than anything, getting rich is a matter of confidence—of changing your thinking from "I can't" to "How can I?" Once you commit to this way of thinking, once you make up your mind not to let anything get in the way of success, you'll be on your way. You won't get rich—you'll *choose* to be rich.

Rich Dad's Get Rich STRATEGIES

"The poor and the middle class work for money. The rich have their money work for them."

People who become trapped in the lifelong process of bill paying are like gerbils running in wheels. Their legs move furiously, their wheels spin on and on, and in the end they're in the same place they started—nowhere. They keep working and working and their incomes go up, but then so do their taxes and the charges on their credit cards. Buying a home and a car, going on vacations, paying for the children's education, saving for retirement—these successive challenges prevent the bill payers, no matter how well educated they may be, from ever getting ahead. This doesn't have to be your fate. You can escape the rat race. What you need to do is change the way you think about work and money.

In the following pages, you'll encounter some of the strategies Rich Dad taught me to get out of the rat race and become a business owner and investor. Read this chapter once, twice, as many times as it takes to absorb the radical way of thinking that was Rich Dad's gift to me. It took me years before I fully absorbed his lessons. I would jump off the wheel only to jump right back on, uncertain whether to follow his advice or Poor Dad's. But those years of indecision and struggle were well worth it. Thanks to Rich Dad's persistence as a teacher, eventually I absorbed his strategies and put them to work. After all the blood, sweat, and tears, at last I was able to jump off the wheel for good and start my journey down the path to financial freedom.

I am not saying, "Quit your job." I am saying, "Take responsibility for your financial future." Consider starting a part-time business on the side.

What were those priceless strategies that Rich Dad taught me? In a nutshell:

1 Become financially literate
2 Work to learn
3 Find mentors, build a team
4 Work for yourself
5 Create money
6 Give back

STRATEGY 1: BECOME FINANCIALLY LITERATE

The key to riches is becoming financially literate. It's a strategy Rich Dad drummed into my head every time we were together, even as Poor Dad was stressing the importance of reading books and going to school. Unfortunately, schools don't teach financial literacy. That's why my hard-working, educated dad was getting nowhere. Rich Dad may not have been school educated, but because he was financially educated, he left the rat race behind and became a business owner and investor.

Look at it this way: If you're going to build the Empire State Building, the first thing you need to do is dig a deep hole and pour a strong foundation. Most people, in their drive to get rich, try to build an Empire State Building on a six-inch slab. What they end up with is a Leaning Tower of Debt that threatens to come tumbling down. If you want to build riches and hold on to them, you need a strong foundation of financial literacy.

RICH DAD'S TIP

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"If you want to be rich, you have to be financially literate."

Financial literacy requires proficiency in several areas: economic history, accounting, taxes, investing, and building businesses. These are difficult subjects to master, particularly accounting and investing. But don't let the level of difficulty scare you off. Anyone can master these subjects, including you. It's a matter of choosing to do so, then moving through the subject material at a pace that suits your individual learning style. Becoming financially literate has nothing to do with how far you got in school. Don't worry if you weren't an A student. Don't worry if you're currently working as a janitor, or gardener, or garbage collector, or even if you're unemployed. What matters is whether you're willing to educate yourself. If so, you can become a business owner and investor and eventually achieve financial freedom.

How can you become financially literate? By opening your eyes and ears—your mind—to information that's all around you. Financial magazines like *Forbes* and newspapers such as the *Wall Street Journal* provide a wealth of information. So does the business page of your local newspaper. So do financial news broadcasts on television and the radio. Your real beginning, however, comes in

Section 2 of this work/study program. There you'll be learning the basics of economic history, accounting, taxes, investing, and building businesses—the foundation of your financial literacy.

WHAT'S YOUR FINANCIAL INTELLIGENCE?

Financial intelligence is how you approach, and solve, your financial problems. Estimate your general level of financial intelligence by determining which group you're in:

People with average financial intelligence know only:

- Bad debt, which is why they try to pay it off
- Bad losses, which is why they think losing money is bad
- Bad expenses, which is why they hate paying bills
- Taxes they pay, which is why they say that taxes are unfair
- Climbing the corporate ladder instead of owning the ladder
- Buying shares of a company rather than selling shares of a company they own
- Investing only in mutual funds or picking only blue-chip stocks

People with advanced financial intelligence know the difference between:

- Good debt and bad debt
- Good losses and bad losses
- Good expenses and bad expenses
- Tax payments and tax incentives
- Corporations you work for and corporations you own
- How to build a business, how to fix a business, and how to take a business public
- The advantages and disadvantages of various investment vehicles: paper securities, real estate properties, and businesses

RICH DAD'S TIP

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"My banker has never asked me for my report card. My banker wants to see my financial statement."

STRATEGY 2: WORK TO LEARN

As I mentioned in the last chapter, job security meant everything to Poor Dad. Learning meant everything to Rich Dad. Poor Dad thought I was going to the U.S. Merchant Marine Academy to learn to be a ship's officer. Rich Dad knew that I went there to study international trade. The academy sent me on cargo runs to the Far East and the South Pacific, where I learned the art of navigating large freighters, oil tankers, and passenger ships. By the time I graduated from the academy in 1969, I had acquired a wealth of information about trade, people, business styles, and cultures in Japan, Taiwan, Thailand, Singapore, and elsewhere—information that would play a crucial role in the success of my later business ventures.

RICH DAD'S TIP

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"When you're young, work to learn, not to earn."

I left the merchant marine for the Marine Corps, ostensibly to learn how to fly a plane, but really to learn how to be a leader. I went to Vietnam, and when I returned in 1973 I resigned my commission, though I loved flying, to take a sales job with the Xerox Corporation. I took this job not for the salary and the benefits, but to overcome my shyness and learn all about marketing and sales. Xerox has one of the best sales-training programs in America. Rich Dad was proud of me for taking the job; my educated dad was ashamed because he thought I should have looked for a more "intellectual" job.

Three years later, shortly before my thirtieth birthday, I left Xerox to form my own company. It was time to test all that I had learned. If I failed, I would be broke. My educated dad thought I was crazy to give up job security. Rich Dad thought it was a great idea to strike out on my own. "If you run the risk of going broke," he said, "you should do it before the age of thirty. You'll still have time to recover."

Most people focus on working for pay that rewards them in the short term; over the long term, this strategy can be disastrous because it doesn't build up enough assets for a stress-free retirement. If you want to be financially free, you need to seek work for what you'll learn, not for what you'll earn. The skills you learn when you work for someone else can be invaluable when you begin to work for yourself—and if you want to be financially free, you'll have to work for yourself. You'll have to become an investor. (But that doesn't necessarily mean you will have to start your own company, a subject that I'll address soon.)

THE SKILLS YOU'LL NEED

Are you working? Are the skills you're learning in your current job those you'll need to become financially free? To achieve that goal, you'll have to be experienced in the following:

- Leadership
- Management
- Sales and marketing

Leadership is critical. When I was in Vietnam, the commanding officer of my squadron said, "Gentlemen, your most important job is to ask your troops to risk their lives for you, your team, and your country." Leadership is just as important in business as in war. More businesses fail from lack of leadership than from any other single factor.

Management is twofold: management of cash flow and management of business systems. To manage a company's cash flow properly, you have to know how to read financial statements and analyze sales and accounts receivable and expenses and accounts payable. If you can learn to run a business on the basis of the numbers revealed on its financial statements, you'll be positioning yourself for success.

TAKE NOTE

More businesses fail from lack of leadership than from any other single factor.

To manage business systems properly, you have to understand that a company is a complex network of interdependent systems, everything from product or service development to computer systems to human resources. For the business to grow, all systems have to operate with maximum efficiency—a leak in any single one can cause the entire ship to sink.

Sales and marketing are no less important than leadership and management. To be good in sales and marketing, you have to learn how to communicate effectively. If you can't speak or write well, you won't convince people that your product or service is worth buying. I have friends who are geniuses, but because they can't communicate well with others, they're poor. The world is full of smart poor people.

All of these skills—leadership, management, and sales and marketing—are things you can learn through the experience of working. Take a moment to make an honest inventory of your personal business skills.

If your current job isn't teaching you these skills and you want to be financially free, then you may want to seek a new job. Remember, you're an apprentice. Find a job in which you'll be working to learn, not earn. The skills you develop as an employee can help you take control of your own financial life.

Skill	Your level of competence	Is your current job teaching you this skill?
Leadership		
Management Of cash flow Of business systems		
Sales and Marketing		

Again, I am not telling you to quit your job. Your personal financial life *is* your business. Even employees need to learn how to become investors and business owners.

STRATEGY 3: FIND MENTORS, BUILD A TEAM

In addition to working to learn—that is, while you are working to learn—you need to seek out mentors and advisors who can teach you the valuable skills you'll need to become a business owner and investor. No one climbs Mount Everest alone, and you shouldn't try to climb your personal financial mountain without the aid of others. Without support, you'll never reach the top.

WHAT IS A MENTOR?

A mentor is a successful person whom you'd like to emulate. A mentor is distinctly different from someone who tells you how to do something—someone who instructs but whose experience is limited. Rich Dad was my first real mentor. He didn't just dispense advice; by building his business and using it to invest, Rich Dad had actually accomplished what I wanted to accomplish.

Rich Dad wasn't my only mentor. Back in 1996, through a mutual friend, I met a man I'll call Peter. He is a distinguished and articulate man who has had his own companies listed on the American and New York Stock Exchanges and on the NASDAQ. During the course of his career, he's taken nearly 100 companies public. At the time of our meeting, Peter had done everything that I wanted to do. He was a man who guarded his privacy, and the challenge for me was how I could convince him to take me on as an apprentice.

Over the course of several months, I pressed my case with Peter and finally got him to agree to a meeting to talk it over. I told him that I could support myself and my wife with the income from my real estate investments and that I would work for him for free if he would teach me everything he knew. Naturally he was skeptical. But once he saw that I was serious, he decided to take my offer on a trial basis.

There was a bankrupt gold mine in Peru he was considering buying. He asked me to drop everything and fly to Peru at my own expense, inspect the mine, meet with a bank and find out how much it wanted for the mine, then fly home and give him a report. That caught me off guard! At first I hesitated. I had appointments scheduled for that week. Moreover, I wasn't sure I was up to the challenge. But deep inside I knew this was a defining moment for me.

FEAR: I have someone I'd like as a mentor, but he'd never give me the time of day.

FACT: That's your fear and self-doubt speaking. Work up the courage to approach this person by focusing on your goal of financial freedom. Be polite but firm—show him how sincere and determined you are. Then offer something in return for teaching you.

FREEDOM: Swallow your fear, and you'll find a mentor who will help guide you on your financial journey.

RICH DAD'S TIP

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"The world is full of smart poor people."

In those few seconds, I realized that if I chose not to go to Peru I would lose this valuable potential mentor. Setting aside self-doubt and swallowing all excuses, I decided to take a leap into the unknown. "Okay, Peter. I'll do it." I flew to Peru and inspected the mine. It turned out to be an unwise investment, and I recommended against his buying it. He agreed with my findings and, more important, agreed to teach me. For almost a year and a half I worked as an apprentice to Peter, after which he offered me a partnership in his private venture-capital company. Since then, my association with him has been personally rewarding and financially profitable. And it wouldn't have been possible if I hadn't asked him to be my mentor. By shunning doubt and excuses, I gained the courage needed to take the next step toward my financial goals.

WHAT IS A TEAM?

In addition to mentors, if and when you do finally start working for yourself, you'll need a team of competent, loyal advisors. A team assembled with care will help you as you set out on your quest for financial freedom. Your team is your protection and your technical expertise. You don't need to have all the answers as long as you know who to call.

Although you may not be aware of it, you already have a financial team in place. Members of that team include your family, co-workers, and friends—anyone you ask for financial advice. Question: Do these informal advisors share your goals, and is their advice sound in light of your goals? Just as important, have they practiced what they preach and met with financial success? If not, it might be time for you to assemble a new team.

RICH DAD'S TIP

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"Business is a team sport."

One thing is certain: When you do set out to work for yourself, you'll need more than just friends and family—you'll need a team of professional advisors. One secret of the rich is their humility. They surround themselves with people who know more than they do. They surround themselves with experts. Depending on the nature of the business you build or the investments you make, your team could include a mortgage banker, an intellectual property lawyer, a corporate lawyer, an accountant, an insurance agent, a tax strategist, a stockbroker, or a score of others. Bear in mind that the team list will constantly change along with the strategies and plans for your business.

You'll learn all about how to find advisors in Section 3. For now, suffice it to say that you should show your advisors the kind of respect and attention you want them to show you—and your business. The best advisors are those who care about you and your financial goals. I have certainly had good advisors along the path to financial freedom, and I'm thankful to each and every one of them for extending my business and investing horizons.

STRATEGY 4: WORK FOR YOURSELF

Rich Dad's central strategy for achieving financial freedom was to build a business of his own. His reasoning was that most people work first for the owners of the companies that employ them, then for the government through taxes, and finally for the banks that own their mortgages. No wonder they have little left at the end of their working days! To escape the rat race, Rich Dad would say, you need to work for yourself. You may be saying, "But the odds of a start-up succeeding are against me—nine out of ten companies fail within five years." Instead, say to yourself, "One out of every ten businesses succeeds within five years, and mine will be one!" You have to be very determined if you want to build your own business, but if you are, you'll have a head start down the path to financial freedom. If you choose not to start a business, then you can still achieve financial freedom, albeit more slowly, by keeping your expenses low, reducing your liabilities, and diligently building a base of solid assets.

RICH DAD'S TIP

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"If you want to be rich, don't work for a business—own a business."

You'll see what I mean in the list below. Check any assets you own:

- ❑ Businesses that don't require your presence (you own them, but they're managed or run by other people; if you're self-employed and have to work, your work isn't a business, it's a job)
- ❑ Stocks
- ❑ Bonds
- ❑ Mutual funds
- ❑ Income-generating real estate
- ❑ Notes (IOUs)
- ❑ Intellectual property, such as copyrights on books, music, and scripts and patents on inventions that may generate royalty income, just to name a few.
- ❑ Anything else that produces income or appreciates in value and can be readily sold

If you checked off all of the above, you can stop reading. Chances are, however, that you're here because you can only check three or fewer of these asset categories. If that's the case, then you're reading the right book. You'll learn all about these investments in Section 2.

STRATEGY 5: CREATE MONEY

"Money isn't real," Rich Dad once told me. "It's an idea." It took me some time to absorb this lesson, but I finally did, and then I used it to make myself rich. You can do the same. Here's a simple example: In the early 1990s, the real estate market in my hometown of Phoenix, Arizona, was horrible. Houses that were once $100,000 had plummeted to around $75,000. Although short of cash, I recognized that this was a good time to buy. Instead of shopping at the local real estate office, I began shopping at a bankruptcy attorney's office and at the county courthouse. Soon I came across a great deal: a $75,000 house for only $20,000. With a $2,000 ninety-day loan, for which I paid $200 in interest, I made a down payment on the property. Within days I resold the house for the still-bargain price of $60,000. I had created a $40,000 profit for myself out of essentially nothing. Total work effort: five hours over a few days' time.

RICH DAD'S TIP

▲

"Money isn't real; it is an idea."

In the last chapter, I talked a little about the information age. The information age allows some individuals to get ridiculously rich from nothing more than ideas and agreements. Just ask people who trade stocks for a living. They see it all the time. Today, it's not at all out of the ordinary for millions to be made instantaneously out of nothing. By nothing, I mean no money was exchanged. Deals are clinched with a hand signal in a trading pit, a blip on a trader's screen, a call to a broker to buy and a second call a few moments later to sell. Money doesn't change hands in these transactions—agreements do.

How can you create money? By doing any of the following:

- Finding an opportunity that everyone else has missed. A friend of mine bought a rundown house that nobody else wanted. He tore the house down, subdivided the property into five lots, and within two months sold the whole package to a builder for $75,000—three times what he'd paid for it.

- Learning how to raise money. The average person only goes to the bank. But there are many ways to raise capital that don't require a bank. Let's say you want to buy a piece of investment real estate but you don't have the cash for a down payment. You might be able to take out an equity loan on your home, or obtain seller financing, or sell your idea to an "angel," or form a group of investors to purchase the property. If there's a will and a promising financial deal, there's a way.

- Working with knowledgeable people to help you reach your financial goals. This goes back to the advice I gave you earlier about building a team. You don't want to jump at every money-making opportunity, just the smart ones. Having a team of skilled advisors can help you quickly identify the good deals.

STRATEGY 6: GIVE BACK

While you're pondering Rich Dad's get rich strategies, there's one more you should consider: charitable giving. Many people think the rich are all greedy. That's not true. Some rich people are greedy, just as some poor people are. But for every greedy rich person there is a rich person who understands the importance of giving, and society is the better for it. Rich Dad was no exception. He strongly believed that to make a fortune and then hoard it was a misuse of money's power. "When you create wealth," he said, "it's your responsibility to return it to society." Rich Dad practiced what he preached. He set up a foundation that gives generous amounts of money to charitable causes, including cancer research. The foundation is so well directed that it will continue to earn and donate money to worthy causes for many years to come.

Rich Dad taught me that giving back was a necessary step in getting rich. There are strategies for giving, and the richer you get, the more sophisticated your philanthropic strategies will become. Later, you'll learn that charitable giving reduces your taxable income, enabling you to give to causes close to your heart rather than just to Uncle Sam. But this is jumping the gun. For now, while you're thinking about Rich Dad's strategies for acquiring wealth, you should also be thinking about how you might best give away the wealth those strategies will reap for you. Indeed, even before you become wealthy, you should adopt the practice of giving. Why? Because giving will help teach you to take control of your cash flow. In section 3, you'll encounter a strategy for giving that, instead of risking your plans for financial freedom, will actually enhance them. But there's another, more important reason for giving. Newton's law states, "For every action there is a reaction." If you're a greedy Scrooge, people will respond to you in kind. You have to give money to get it back.

Remember, give and you shall receive.

FEAR: How can I give to charity if I can't even pay my own bills?

FACT: Charitable giving is a part of an overall strategy for taking control of your cash flow. If you start giving at the same time that you start building assets, your assets will still grow because you've chosen to adopt a fiscally responsible path for yourself.

FREEDOM: Instead of risking your financial freedom, giving will enhance it.

RICH DAD'S TIP

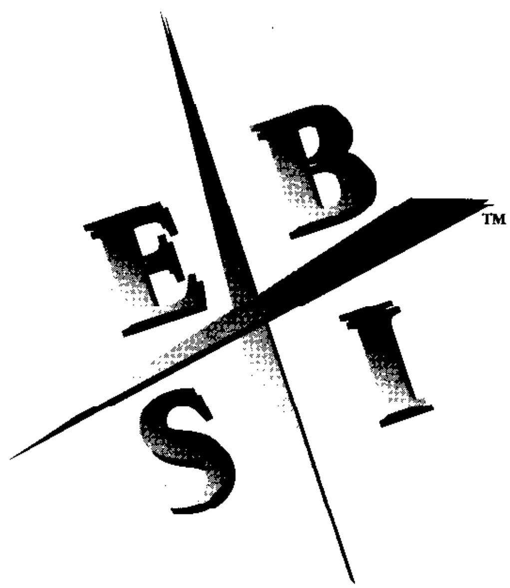
"When you create wealth, it's your responsibility to return it to society."

Where Are YOU?

"One of the reasons the rich get richer is that they make money as investors, not as workers. The rich are on the right side of the CASHFLOW Quadrant."

Chapter 3:
Where Are You?

Before putting any of Rich Dad's get rich strategies into action, you need to figure out where you are, for if you don't know where you are you can't know where you're going. To help you get your bearings, I've devised a diagram made up of four quadrants. You inhabit at least one of these quadrants; which of them depends on where your cash comes from. The diagram is called the CASHFLOW Quadrant. It looks like this:



Here are what the letters in each quadrant represent:

Employee

Self-employed worker

Business owner

Investor

Where you are in the CASHFLOW Quadrant is determined by how you generate income. Employees earn income by working for other people. Self-employed people earn income by working for themselves—they own their jobs. Business owners earn income from the businesses they own. Investors earn income from their investments—from money generating more money. Think about how you generate most of your income. In which quadrant do you primarily fall? Knowing the answer will help you chart your course into the future.

DIFFERENT QUADRANTS, DIFFERENT PEOPLE

Generally speaking, people in the B and I quadrants reach their financial goals more quickly than people in the E and S quadrants. The good news for you, if you inhabit the left side of the quadrant, is that you don't have to be stuck there. You can move to the right side. Indeed, if you want to be financially free you have to move to the right side—if not to the B quadrant, then at least to the I quadrant. Moving quadrants is a matter of choice and financial education.

TAKE NOTE

Changing quadrants means transforming who you are, how you think, and how you look at the world.

Changing quadrants means altering who you are, how you think, and how you look at the world. The change is easier for some people than for others simply because some welcome change while others fight it.

THE E (EMPLOYEE)

People in the E quadrant dread economic uncertainty and have a strong need for security. They're often heard to say, "I'm not that interested in money." What this really means is they're not interested in making the life-transforming changes necessary to leave the E quadrant nest. For them, job security—which may be just an illusion—is often more important than money.

Employees can be janitors or presidents of companies. It's not what they do or how much they earn that makes them Es, but rather the fact that they're working for others—and earning salaries and benefits. A benefit is a defined and assured compensation over and above salary. It is the E type's security blanket.

THE S (SELF-EMPLOYED)

S types are do-it-yourselfers and their own bosses. When it comes to money, Ss have fiercely independent souls. They don't like to have their income depend on other people. If they work hard they expect to be paid well. They also understand that if they don't work, they won't get paid. While E types often respond to the fear of not having money by seeking security, Ss respond by taking

QUADRANT COLLOQUY

How can you tell if a person is in the E, S, B, or I quadrant? One way is to listen to their words. Which sound most like you?

E Quadrant

"I'm looking for a safe, secure job with good pay and excellent benefits."

"You can't teach an old dog new tricks."

S Quadrant

"My rate is $35 per hour."

"Nobody can do it better than me."

B Quadrant

"I'm looking for a new president to run my company."

"Why should I do it myself when I can hire someone better to do it for me?"

I Quadrant

"Is my cash flow based on an internal rate of return or a net rate of return?"

"Risk doesn't scare me. If the numbers are right, I'll take it."

the proverbial bull by the horns, working ever harder to rack up hours and hourly wages.

RICH DAD'S TIP

▲

"S types respond to the fear of not having money by working harder. Eventually they may burn out trying to do everything themselves."

This group includes professionals such as doctors, lawyers, and architects, who spend years in school. It also includes small business owners—for example, retail shopkeepers, restaurant owners, consultants, therapists, travel agents, car mechanics, plumbers, and

RICH DAD'S TIP

▲

"For the E type, a benefit is a security blanket."

hair stylists—as well as direct-commission salespeople such as real estate agents.

S types tend to be hard-core perfectionists. That's why others hire them. When you hire a brain surgeon, you want the best. The same goes for hiring a dentist, hair stylist, electrician, or lawyer. Because of their perfectionism, they often have a difficult time hiring other people to work with them. To their way of thinking, no one else can do the work as well as they can. S types may also be hesitant to train other people out of fear that their trainees will wind up being competitors some day.

For people in the S quadrant, independence, the freedom to do things their way, and the desire to be respected are much more important than money.

THE B (BUSINESS OWNER)

Unlike the perfectionist S, the B type loves to delegate work. The motto of a B is, Why do it myself when I can hire someone better to do it for me? The true B can leave his or her business for over a year and return to find it more profitable than before. That's not usually the case with someone in the S quadrant. When an S leaves his or her business for over a year, chances are there is no business to return to.

Being a successful B requires technical business skills. B's motto is O-P-M (other people's money) and O-P-T (other people's time). Bs understand the concept of leverage. To succeed, Bs need to know more than just how to build superior products or services—they need to know how to build the solid network of business systems without which their offering won't sell. And they have to be skilled in the art of leadership. Successful Bs bring out the best in their people so that their people will carefully tend the network of business systems.

RICH DAD'S TIP

▲

"Many people have great ideas but very few have fortunes. To be a successful B, you have to do more than just have a great idea—you have to understand business systems."

A STORY FROM THE B QUADRANT

Henry Ford fit the mold of the B type perfectly. Once a group of intellectuals condemned the powerful industrialist for being ignorant. So Ford invited the group into his office and challenged them to ask him any questions they wanted—he'd answer them all, he vowed.

Ford listened carefully as his guests ran through their questions. Then he reached for his phone, called in some bright assistants, and repeated the litany of questions. His assistants delivered the answers one by one. When the inquisition ended, Ford informed his astonished guests that he surrounded himself with smart employees so he could leave his mind clear to do more important tasks—like thinking.

"Thinking is the hardest work there is," the industrialist was once quoted as saying. "That's why so few people engage in it."

RICH DAD'S TIP

▲

"I types use money to make money. They don't have to work because their money is working for them."

THE I (INVESTOR)

Regardless of which quadrant people make their money in, if they hope someday to be truly wealthy they must ultimately move in to the I quadrant, for it is here that money becomes converted to wealth. What is wealth? Wealth is measured in time, not money. It is the number of days you can survive without physically working and still maintain your standard of living. I types don't have to work because their money is working for them.

The I quadrant is the playground of the rich. That doesn't mean everyone in the I quadrant meets with financial success. You can be poor in the I quadrant as well as in the E, the S, and the B—and go bankrupt in any one.

WHAT DO YOU WANT TO BE WHEN YOU GROW UP?

When my educated dad advised me to get good grades and find a secure job, he was recommending that I enter either the E or the S quadrant. Poor Dad wanted me to become either a high-paid employee (an E) or a high-paid self-employed professional (an S) such as a doctor, a lawyer, or an accountant. He was very concerned about a steady paycheck, benefits, and job security.

RICH DAD'S TIP

▲

"To achieve financial freedom, you need to understand the difference between job security, financial security, and financial freedom."

My rich but uneducated dad offered very different advice. "Go to school, graduate, build businesses, and become a successful investor," he told me. He was recommending that I enter the B and the I quadrants. "Too many people focus only on the left side of the CASHFLOW Quadrant—the E/S side," Rich Dad said. He was right. We're taught this focus from a very young age. Think about how children respond to the question, "What do you want to be when you grow up?" Firefighter, ballerina, doctor, teacher—these typical answers fall squarely on the left side of the quadrant.

If you're like most people, you're in either the E or the S quadrant. But the simple fact that you've picked up this workbook means you're contemplating becoming a B or an I. You're getting ready to pull up your once-stubborn roots—to move beyond job security and toward financial freedom.

FROM JOB SECURITY TO FINANCIAL FREEDOM

If you're ever going to achieve your financial goals, you need to understand the difference between job security, financial security, and financial freedom. Many people believe that job security means financial security—at least, they believe that until they lose their jobs and can't find new ones. "Job security" wasn't a part of Rich Dad's vocabulary. Instead, he talked about financial freedom.

What have you opted for in your life, job security, financial security, or financial freedom? Find the answer by considering the following pathways in the CASHFLOW Quadrant.

THE PATH TO JOB SECURITY

If you've followed the path to job security (and most people do), you went from school to working for a company (the E quadrant) or for yourself (the S quadrant). The path you took looks like this (the arrow moves into the S quadrant if you're self-employed):

You may be highly educated and experienced. You may be very good at your job. But chances are you know little about the B and I quadrants. And chances are, despite your need to feel secure, insecurity haunts you because you've been trained for nothing more than the job you're performing.

How can you become more financially secure? First, by becoming educated in the B or the I quadrant—that is, by achieving financial literacy. If you have confidence in your knowledge of both sides of the CASHFLOW Quadrant, you'll feel more secure even if you have little money. That's because knowledge is power. Once you have knowledge, you can lay in wait for opportunity and seize it when it goes by.

RICH DAD'S TIP

▲

"Once you have knowledge, you can lay in wait for opportunity and seize it when it goes by."

THE PATH TO FINANCIAL SECURITY

If you've followed the path to financial security, you've got your feet planted on the left and right sides of the CASHFLOW Quadrant. For example, starting from the E quadrant, instead of just plunking your money into a retirement account and hoping for the best, you might have raised your financial IQ and learned to be a true investor. In that case your path looks like this:

If you're an S who has learned to be an investor, your path looks like this:

Are you an E type who has become a business owner? Then you've followed this path:

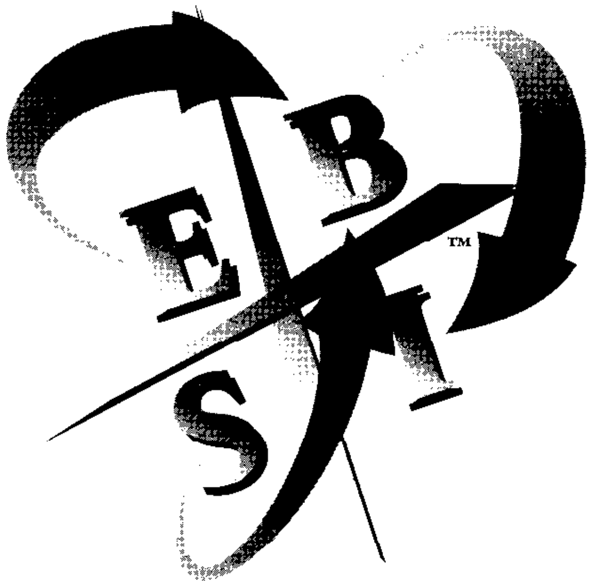
Or perhaps you're an S type who has entered the B quadrant. Here's your path so far:

Being good in more than one quadrant is much better than being good in just one. I have a friend who is a great example of this. He's a firefighter working for the city government. For his E-quadrant job he receives steady pay and excellent benefits. But he only fights fires two days out of the week. Three other days a week he's an investor. He buys old houses, fixes them up, and collects rent. His total monthly income from these investments is more than $13,000, or about $150,000 a year and growing. Because of his adventures in the I quadrant he's amassed enough money to retire on now, but he enjoys his firefighting work and would prefer to retire later with full benefits. My friend has achieved financial security because he learned how to be successful on both sides of the CASHFLOW Quadrant.

If you've taken the path to financial security, you've come a long way—but you can probably do better still. This path is littered with people who haven't fulfilled their financial goals as successfully as my firefighting friend. Consider the example of E types who try to gain financial security by entering the B quadrant. Many of these folks end up with S-type rather than B-type businesses. They wind up working for themselves, putting just as many hours into work as they did back in the E quadrant. The result? Like gerbils on their wheels, they're running and running but getting nowhere, stalled in their quest to move to the right side of the CASHFLOW Quadrant.

THE PATH TO FINANCIAL FREEDOM

The path Rich Dad recommended for me was the path to financial freedom. Why? Because in the B quadrant, people would be working for me, and in the I quadrant, my money would be working for me. The person who has knowledge in these two quadrants achieves what most people throughout history have yearned for: freedom from work. Here's what the path looks like:



Many of the super rich follow this path—people of legendary status such as Bill Gates, Rupert Murdoch, and Ross Perot. Can you? Yes, if you're sufficiently equipped with knowledge, experience, and determination. A word of caution, however: The B quadrant is very different from the I quadrant. Many successful Bs sell their businesses for millions and then let their newfound wealth go to their heads. Convinced that their dollars are a measure of their financial IQs, they go swaggering into the I quadrant and then lose everything.

FEAR: I have friends who've made lots of money and then lost it all investing. Why should I follow this path?

FACT: You don't have to follow this path. People who swagger into the I quadrant flush with cash and lose it are putting their egos ahead of their financial intelligence. Knowledge, experience, and a healthy dose of caution can prevent this sort of mishap.

FREEDOM: Reining in your ego will help keep you from veering off the path to financial freedom.

I've said it before and I'll say it again: You can go bankrupt in the I quadrant just as easily as in the E, the S, or the B—and more quickly.

Why, you might ask, should you enter the B quadrant before the I quadrant? You'd rather be an investor than a business owner, right? Here's my answer: If you have plenty of money, financial intelligence, and free time, then by all means go straight to the I quadrant. But if you don't, the path I recommend is safer. There are two good reasons to enter the B quadrant first:

RICH DAD'S TIP

▲

"On the right side of the quadrant, you gain time and therefore freedom—to make money, to give it away, and to be with your loved ones."

- Succeed as a B and you have a greater chance of developing into a powerful I. After all, investors invest in businesses. Once you gain experience in the B quadrant, you're better positioned in the I quadrant to identify businesses that would make good investment opportunities.
- If you have a business that's up and running on its own—that doesn't require your babysitting—then you'll enter the I quadrant with two prerequisites: the free time to hunt for good opportunities, and the cash flow to support the ups and downs of investing.

In Section 2, you'll learn much more about the B and I quadrants—and in Section 3, how to enter them.

THE PATH TO FREEDOM IS OPEN TO YOU

My highly educated dad worked hard, but on the left side of the CASHFLOW Quadrant. By working hard he got promoted and gained more responsibility, but as he climbed the ladder he had less and less time to spend with his children. He left for work at seven in the morning, and we were often in bed before he came home. On the left side of the quadrant, increasing success brings you less and less time.

Rich Dad worked hard on the right side of the CASHFLOW Quadrant. He climbed his own ladder, and the higher he climbed, the more time he had for his family. When his business reaped profits, he expanded the business and simply hired more people to do the work. If his investments did well, he reinvested the money and made more money. I've mentioned that Rich Dad was generous with his money.

He was also generous with his free time. He spent hour after hour with his son and me explaining exactly what he was doing in business and investing.

This is a major difference between the left side and the right side of the CASHFLOW Quadrant: The right side gives you time. And time is freedom—freedom to make more money, to give it away, and to be with your loved ones. The path to freedom is open to you. You can be a worker bee, buzzing around till the end of your days, barely noticing those around you, or you can be a free spirit, with plenty of time to seize the day and tend to your family. Freedom is yours for the taking.

Getting STARTED

"There is gold everywhere. Most people aren't trained to see it."

By now you're getting the gist of Rich Dad's thinking—and no doubt you're anxious to get started. Getting started requires two actions. First, you have to decide what your general financial goal is. Do you want to be secure? Comfortable? Or rich? The answer to this question is important because it will determine which quadrant you stay in or enter, and how you go about making money inside that quadrant. Second, you have to become financially literate so that you learn to think like the rich.

SECURE, COMFORTABLE, OR RICH?

What is your financial goal? To be secure, comfortable, or rich? Bear in mind that a goal is different from a wish. You may wish to be rich, but that doesn't mean you've ever taken any practical steps to make it come true. If you've ever earned enough money to put some aside, like most people, you've probably invested it with an eye toward security, since you can't imagine yourself ever getting rich.

TAKE NOTE

A goal is different from a wish. You may wish to be rich, but that doesn't mean you've ever taken any practical steps to make this wish come true.

Be honest with yourself. If you had to list the three choices in order of priority—as goals rather than just wishes—you'd probably put security at the top of the list, comfort in the middle, and wealth at the bottom. Like most people, you probably want, if you don't already have, a job with a steady paycheck and with good health and retirement benefits. Next you'd like a house, a car, and enough money for extras like vacations. Then, of course, you'd like to be rich, but that's only something that will happen if you "get lucky." Or so you think.

"Most people dream of becoming rich, but it isn't their first choice," Rich Dad said. That's because the effort and uncertainty of becoming rich disturb them, and they seek refuge in the easier goals of security or comfort. People who make security and comfort their first and second choices are often seeking a single hot investment tip, a simple, risk-free way of getting rich quick. Some people do get rich on one lucky investment, but all too frequently the money they amass is later lost.

EXAMINE YOUR LONG-TERM GOALS

If you're really serious about achieving financial freedom—about moving from the left to the right side of the *CASHFLOW Quadrant and* staying there—it's time to examine closely how you order your long-term goals. Knowing what you value most will save you many agonizing decisions and sleepless nights later. A good way of getting started is to write down what you perceive as the pros and cons for each possible goal:

FINANCIAL GOAL	PROS	CONS
Secure		
Comfortable		
Rich		

Depending on how the pros weigh against the cons, you may actually find yourself re-ordering your goals. This can be a priceless exercise, for it suggests possibilities that you might not have previously imagined.

RICH DAD'S TIP

▲

"Nothing is more tragic than to see people who have sold themselves short on what's possible for their lives. Take the time to discover possibilities, and the lesson will be priceless."

"Nothing is more tragic than to see people who have sold themselves short on what's possible for their lives," Rich Dad taught me. They try to live frugally, scrimping and saving, and they think they're being financially smart. In truth, they're limiting themselves. Most people spend their lives imprisoned by financial ignorance. It shows up in their faces and in their attitudes as they get older. They begin to look like wild lions trapped in their cages, pacing back and forth while they mull over what happened to the life they once knew.

DRAFT FINANCIAL PLANS FOR EACH GOAL

How can you escape this fate? Start by drafting a series of personalized financial plans—one for security, another for comfort, and a third for rich. Carefully written plans will give you a clearer idea of the possibilities ahead. You might be motivated to move beyond mere security and on to comfort, which would expand your horizons, or even on to becoming rich, which would give you unlimited horizons.

At this early stage of the Rich Dad program, of course, you may not be financially literate enough to draw up detailed plans. That's okay. The purpose of this exercise isn't to map out your route to financial freedom—you'll be doing that in Section 3—but rather to get a general idea of possibilities that you might not otherwise entertain. If you have a financial advisor, he or she can help you with a rough outline for your plans. Here's what you do:

- Write up a plan for lifetime financial security. What does security mean to you personally? The absence of sleepless nights? Being in a better mood more of the time? And what do you need to do to achieve your vision of security? If you've decided your first priority is to be rich, this step might seem mechanical or boring. When you plan for security, you're planning for a world of not enough. One of the points of this step is to motivate you to reach beyond a goal that will only curb your potential.

- Next, write up a financial plan for lifetime comfort. What does comfort mean to you? A big house and two cars? A house, a vacation cottage, and three cars? How can you go about achieving your level of comfort? Obviously, this plan will be a little more aggressive than the first one. And it will be less boring because when you plan for a world of enough, there are more choices open to you. Your challenge will be to choose.
- Finally, write up a financial plan for becoming rich. This will be your most aggressive plan and your most exciting, for now you're anticipating a world of more than enough. You'll be faced with a myriad of choices, for although you may not be aware of it yet, opportunities to make money are all around you. As with the previous plan, your challenge will be coping with the abundance of possibilities. You don't want to wander through life like a child in a candy store, so distracted by choice that you never make one. Think this plan through carefully and thoroughly.

The point of the exercise is to show you that you have choices, more than you may have ever imagined—and that you need to make decisions about those choices. Too many people go from job to job or business to business without getting where they want to be financially. They wander through life without a plan, and all the while their most precious asset, time, is dwindling away. This doesn't have to happen to you.

LEARN TO THINK LIKE THE RICH

Acquiring wealth is rarely easy. It certainly wasn't easy for me, or for the many hundreds of rich people I've met in my career as a business owner, investor, and teacher. One thing that is easy, however, is learning to think like the rich so that you can identify great financial opportunities.

FEAR: I can't set a goal to get rich. People only get rich through luck.

FACT: Getting rich is more a matter of determination than of luck. Great financial opportunities lie all around you. If you learn to seize those opportunities, you're more likely to amass money than if you play the lottery.

FREEDOM: By making a plan to get rich, you're taking the first real step in that direction.

You may believe that money is the root of all evil. You've probably been taught to work for money rather than to have money work for you—and not to worry about your financial future because some company or the government will take care of you when your working days are over.

If your plan is to be rich, then it's time to wean yourself from such risky thinking. What follows are nine points that I learned through the years that can help you get started. As you proceed through this work/study program, you'll start thinking like the rich and no doubt develop ideas of your own.

POINT 1: IDENTIFY THE DEEP-SEATED REASONS YOU WANT TO BE RICH

Most people say yes when asked if they would like to be rich or financially free. But then reality sets in. The Yellow Brick Road seems too long, with too many dangers along the way. It's easier to work for money and then just hand the excess to a broker, they think.

TAKE NOTE

To stay on the road to riches, you must have deep-seated reasons compelling you forward.

To stay on the road to riches, you must have some deep-seated reasons compelling you forward. When people ask me why I wanted to be rich, I recite the list of deep "wants" and "don't wants" that drove me on. I didn't want to work all my life, for example. I didn't want what Poor Dad aspired for, which was job security and a house in the suburbs. I wanted to be free to travel the world and live the lifestyle I loved. I wanted control over my time and my life.

Can you identify your own reasons for wanting to be rich?

DON'T WANT	WANT
1 ______	1 ______
2 ______	2 ______
3 ______	3 ______
4 ______	4 ______
5 ______	5 ______

Are your reasons deep-seated enough that you'll be able to endure the risks of the road ahead?

POINT 2: CHOOSE DAILY TO BE RICH

Most people choose not to be rich. For 90 percent of the population, being rich is too much of a hassle. "I'm not interested in money," they say, or "I'll never be rich," or "I don't have to worry, I'm still young."

Indeed, people who think that making money is too much of a hassle never will make it. They're sealing their own fate by robbing themselves of their two most precious assets: time, and a mind open to learning.

Each day you choose what to do with your time, and each day you choose what information you put in your head. You can watch TV all day, play golf, read decorating magazines—or take a course on financial planning. I've talked about the importance of financial literacy. The issue to ponder here is the amount of time it takes to become literate. What you do with your time *now* will shape what you do with your time when your working days are over. When you retire, will you be pursuing your interests—or sitting at home fretting over medical bills that Medicare hasn't covered?

POINT 3: SELECT YOUR FRIENDS CAREFULLY

The power of association is strong, so select your friends carefully. I'm not suggesting that you select them for their financial statements. I have friends who've taken the vow of poverty as well as friends who earn millions every year. I learn from them all. What I'm saying is that you don't want to spend too much time around financially frightened people—the Chicken Littles of the world. They'll always tell you the sky's going to fall. If you really want to be rich, cultivate friendships with successful people, ones who seek out and talk about opportunity. These are the people who will become your mentors and who will help you meet your financial goals.

RICH DAD'S TIP

▲

"Who you spend your time with is your future."

POINT 4: FIND FINANCIAL HEROES TO EMULATE

When it comes to investing, too many people make it sound hard. Instead of listening to the naysayers, find heroes who make it look easy and listen to their stories.

Emulating heroes is learning at its best. When I was a kid playing baseball, I was full of admiration for Willie Mays, Hank Aaron, and Yogi Berra. They were my heroes and I learned everything I could about them, their stats and their style of playing, which improved my own game even if it didn't catapult me to the major leagues. And over the years I developed new heroes. Today I learn everything I can about people like Donald Trump, Warren Buffett, Peter Lynch, George Soros, and Jim Rogers. I know their "stats" through and through, that is, their successes and their style of investing. For example, I follow what Warren Buffett invests in and read about his point of view on the market, and I follow Donald Trump's business deals, trying to discover how he negotiates and puts them together.

When I first started negotiating real estate deals, I subconsciously acted with the bravado of Trump. When I was analyzing a trend in the stock market, I would recall *Beating the Street* by Peter Lynch and look at the trend as if through his eyes. If you find heroes to emulate, you'll tap into a tremendous reservoir of power that will help give you strength.

Look over your life so far. Think of the activities and subjects that have most inspired you. Were there any personal heroes who sparked these interests and kept them alive? What lessons did you learn from them?

PERSONAL HERO	LESSONS LEARNED

If you're as committed to financial freedom now as you were to your passions of the past, then seek heroes who will help light the way.

POINT 5: PAY YOUR ADVISORS WELL

People are often eager to tell me they're using discount brokers for all their investments. I don't understand that. Why would people want to put their investments into the hands of anyone but the best?

Rich Dad believed in paying professionals well. That's because the services of top-notch professionals made him money. Sure, professionals will charge you for their services. But if they're smart and competent, the more money they make, the more money you'll make.

When you're considering advisors to accompany you on your journey toward financial freedom, be they brokers, real estate agents, lawyers, tax planners, or others, choose people who have experience and your best interests at heart. They may wind up being your best assets. When you meet difficulties in implementing your plan, they'll be there to protect and assist you.

POINT 6: MASTER ONE FORMULA AND THEN GO ON TO THE NEXT

TAKE NOTE

In today's fast-changing world, it's not so much what you learn that counts, but how fast you learn it.

To make bread, the baker follows a recipe. The same is true for making money.

As I've said, most people follow one basic formula for making money: Get a job and a steady paycheck. As you've probably guessed by now, however, there are other, much more lucrative formulas out there, if you're willing to make the effort to find and study them.

When I was in my twenties, I took a weekend class on how to buy real estate foreclosures. I learned a formula, which was the easy part. The hard part, of course, was having the discipline to study the formula and implement what I'd learned. It helped to recite my deep-seated reasons for wanting to get rich. They became the mantra that kept me focused, and over the next three years I spent my spare time mastering the formula for buying foreclosures. Then I put what I'd learned into practice. It earned me several million dollars.

Today, I've gone on to master other formulas. Each one I've applied has reaped a profit. In today's fast-changing world, it's not so much what you learn that counts, but how fast you learn it.

POINT 7: PAY YOURSELF FIRST

To get rich you must take control of your finances, and that requires discipline. What's the sense of making money and investing it only to lose it? By discipline, I mean you have to learn how to pay yourself first—*even before you pay your bills.* Why? Because when you pay everyone else first, there is often nothing left for you.

I'm not saying you should pay yourself first so you can run out and spend your money on "ego" toys like a new car, a new outfit, or a cruise. Paying yourself first means using the money for investments in the B or I quadrant. Don't you want your money to start earning you more money? Then go ahead: Pay yourself first, invest the money, and let your creditors' yelling spur you to find new ways to expand your income.

Don't get me wrong. I'm not suggesting that you avoid paying your bills. You should just know that it's not financially intelligent to cave in to creditor pressure and dip into your investments in order to pay them. How can you pay yourself first without getting into a credit rut? First, keep your personal expenses low. Don't buy yourself toys until the habit of paying yourself first has built up enough assets for you to afford them. Second, when you come up short, don't dip into your investments to pay off your creditors. Look at the pressure they're applying as a source of inspiration; it will force your financial genius to come up with new ways of making money. When your genius pulls through, then pay your bills. As you start to build assets, you'll see that the income from your assets will allow you to pay for your personal expenses and you will have expanded your means so you can live the lifestyle you desire.

FEAR: I can't pay myself first—that would ruin my credit.

FACT: If you're disciplined, you can pay yourself first without ruining your credit. The trick is to keep your personal expenses low. If you're under pressure from creditors, the pressure will actually inspire you to come up with new ways of making money.

FREEDOM: Start paying yourself first today, and you'll get into a lifelong habit of building assets.

POINT 8: GET SOMETHING FOR FREE

When you make an investment, you should first ask how long your money will be tied up. Second, you should ask what you can expect in the way of return on investment.

Here's an example of how return on investment can work: Several years ago I found a small condominium a few blocks from my home that was in foreclosure. The bank wanted $60,000 for it. I submitted a bid for $50,000 in cash, which the bank quickly accepted. Most investors would say, weren't you tying up a lot of cash? Wouldn't you have been better off getting a loan? Not in this case. My investment company now uses the condominium as a $2,500-a-month vacation rental during the winter, when the "snowbirds" come to Arizona. During the off-season, the unit rents for a $1,000 a month. I had my money back in about three years. Now I own this asset, which pumps money out for me, month in and month out.

With stock investing, I've also often gotten a good return on investment. When my broker feels that a company is set to make a move that will add value to its stock, he'll call and recommend that I buy a sizable amount of that stock. I'll park my money there for a week to a month while the stock price rises, then I'll pull the initial amount out and stop worrying about the fluctuations of the market because my seed money is back and ready to buy another asset. So my money goes in and then it comes out, and I own an asset that was technically free.

On every one of your investments, whether it's a rental condo, a stock, or something else, you should end up with something for free. That's financial intelligence.

TAKE NOTE

With every one of your investments, whether it's a paper security or a tangible asset, you should get something for free.

POINT 9: DON'T BUY LUXURIES WITH CREDIT

In our culture of consumer temptation and easy credit, too many people borrow money rather than create it to buy the luxuries they desire. Borrowing is easier in the short term but harder in the long term. If you've fallen into the habit of buying on credit, you're not alone. But just because so many other people engage in this practice doesn't mean you should. The earlier you train yourself to be a master of money, the better.

Before you ever buy luxuries, use what money you have to make more money. Let's say 100 people were given $10,000 at the start of the year. Here's my opinion of what those 100 people would do with their money by the end of the year:

- Eighty would have nothing left. In fact, many would have created debt by making down payments on luxury items such as sports cars and home entertainment systems.
- Sixteen would have increased that $10,000 by 5 to 10 percent.
- Four would have increased it to $20,000 or more.

Which group would you be in? If it's either of the first two, then read on, and don't forget this point: Use the desire to consume not to buy, but rather to inspire your financial genius to invest. Later, when you've built enough assets, you can use the income from those assets to buy the luxuries you crave. In this way, instead of being a slave to money, you'll be the master of it.

YOUR SUPERMENTOR

It is my hope that in the preceding pages I've managed to jump-start your thinking about financial matters. Much has been said of mentors. In the next two sections Rich Dad is going to serve as your guide while you learn the fundamentals of financial literacy and then act on what you've learned.

RICH DAD'S TIP

▲

"Borrowing is easier in the short term but harder in the long term. Don't buy luxuries until you've built the assets to afford them."

Introduction

You start without any money. All you have is hope and a dream of attaining great wealth. While many people dream such a dream, few achieve it. But you could if you make that choice. You're about to see the investment world from the inside out. You're about to learn to invest—*really* invest, in a way that most people who are looking from the outside in never do.

Like Rich Dad, you're choosing a path for your life. In Section 1, you learned ways to change your attitude toward finances, asking the questions: Who am I? What are my financial goals? Am I ready to choose to be rich? The rest of this work/study program is designed to give you the knowledge and skills you'll need to move toward financial freedom. As you build your knowledge and financial plan from the base up, you'll be working at your own pace, without anyone pressuring you to study or to make decisions that only you can make.

RICH DAD'S TIP

▲

"If you want to be rich, you need to be financially literate."

MAKE THE DECISION TO BE RICH

When my wife Kim and I were homeless for almost three weeks in 1985, we could easily have found jobs as employees, but we had made a choice. We chose to be rich—rich but homeless. That sounds like opposites.

We chose to reside on the right side of the CASHFLOW Quadrant. Our plan was financial freedom, and we knew it was only to be found through the B and I side of the quadrant. To become Bs, we knew we had to become financially literate and to build businesses so we could become investors.

A DIFFERENT WAY OF THINKING

We knew that to become rich, we needed to think like the rich. In Section 1 you learned some of the differences between the attitudes of the middle class and the rich:

Middle Class

- Job security is key.
- Owning a home is my goal.
- Saving money is the best I can do.
- The rich are greedy.

Rich

- Building a business is key.
- Owning an apartment building is my goal.
- Investing money is the best I can do.
- The rich are generous.

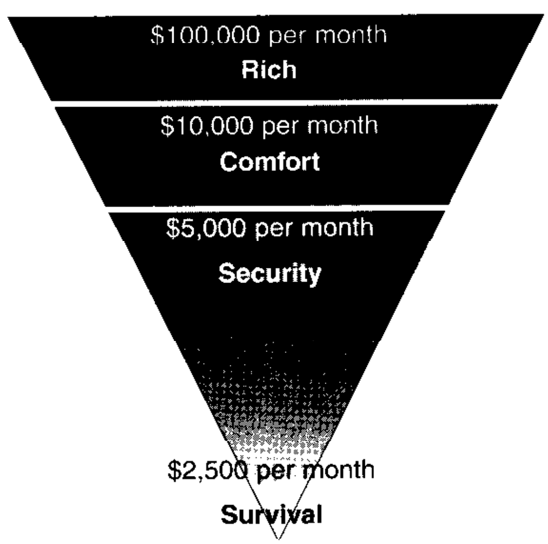
We knew that building a business was not the easy path, but we also knew that we could do it. We chose to build an education company. That company eventually generated the funds that allowed us to invest in real estate. It was the passive income generated from our real estate that allowed us to become financially free. Today we are building CASHFLOW Technologies, Inc., with our partner Sharon Lechter. Funds from the success of CASHFLOW Technologies are allowing us to invest in more real estate, other businesses, and the Foundation for Financial Literacy. Giving back should be an important part of any financial plan to be rich.

CHOOSE YOUR OWN REALITY

Kim and I had to choose our personal financial plan together. It's important that you and your spouse or partner unite in developing your financial plan. If one of you wants financial security and the other wants financial freedom, you may be in for a very bumpy ride. Kim and I were united in our desire for financial freedom. We chose to build a business together.

Kim and I chose to reach financial freedom so I could retire by the age of forty-five. It took a little longer, but when I was forty-seven and Kim was thirty-seven, we were financially free.

Our reality, however, may not be your reality. I believe that everyone should have a financial plan for security and comfort first, and then to be rich. To bring reality to each of these plans, let's examine the following diagram, The Financial Plan Builder:

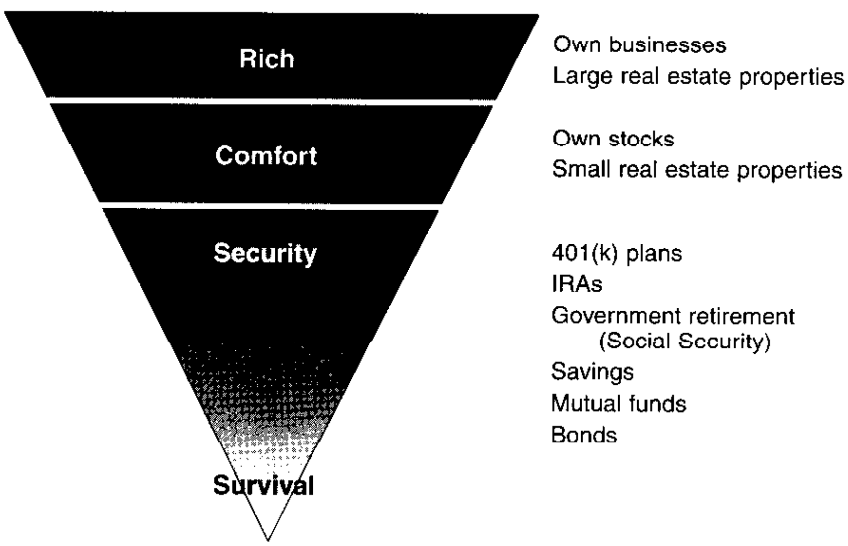


If your plan is to be rich, your reality, or goal, needs to be an income in excess of $100,000 per month, or $1,200,000 per year. This represents your money working for you, not you working for money. If this is outside your reality, then concentrate on a financial plan for security, first, up to $5,000 per month, or $60,000 per year. Income under $2,500 is survival level and therefore not included in the secure financial plan. Rich Dad would consider it baseline (or redline).

Bear in mind that your reality doesn't have to keep you imprisoned. This is good news. As you start on your own path to financial freedom, your reality will change. Your financial plan should change as your reality changes. The important word here is *start*.

DIFFERENT PLANS, DIFFERENT INVESTMENTS

Just as there are different financial plans, there are different investments for each type of plan. Many people believe I am against investing in 401(k) plans. I am not. They are important vehicles for a security-oriented financial plan, being one of the few tax-deductible or -deferred vehicles still available to employees. Today my personal financial plan includes a 401(k) plan. It also includes mutual funds.



LEARN WHAT THE RICH KNOW

I was fortunate to have Rich Dad as my mentor from a young age. He taught me much, but I am still learning today. When Kim and I decided to build a business, we had to build up our financial literacy first. You'll have to do the same if you choose to be rich.

In Section 2, "Learn What the Rich Know: The Five Pillars of Financial Literacy," you'll learn the same basics of financial literacy that I learned from Rich Dad, everything from large economic concepts such as supply and demand to the fundamentals of filling out a financial statement. You'll learn the ABCs of accounting, taxes, and investing, and you'll discover what systems make a business sound. In short, this easy-to-read section will give you what you need to know if you're really serious about achieving financial freedom. The information has encyclopedic breadth and depth, and you'll want to refer to it time and again. Indeed, what follows, in addition to being part of a personalized work/study course, is an invaluable reference tool.

The written material in this section primarily focuses on what you need to know to be secure and to be comfortable. The accompanying audio portion complements this information by focusing on what it takes to be rich. You will hear not only from me and Kim, but also from my co-author and business partner, Sharon Lechter, and from six members of my own team, Rich Dad's Advisors. The audio will give you deeper insights into the financial plans of the rich as I discuss different aspects of financial literacy with each of these advisors. The conversation is lively, the information invaluable. I know you'll be inspired.

You've made the choice to develop your own financial plan. Now it's time to acquire the knowledge that will help you achieve your plan. Turn the page and get ready to learn!

A Primer on ECONOMICS

"The poor and the middle class turn cash into trash, or liabilities. Meanwhile, the upper class buys things like stocks, real estate, and businesses, turning cash into assets."

Time is money. Understanding this maxim can mean the difference between reaching and not reaching your financial goals. Even small amounts of money saved consistently over time can add up to considerable wealth, which is good news if you have more time than money. Unfortunately, most people have too little of both. What can you do if you're no longer young—or if you're not rich? Learn, learn, learn. In this chapter you'll begin your apprenticeship by absorbing the fundamentals of economics.

TIME IS MONEY

Time is money—it's one of the most fundamental of economic concepts, otherwise known as the *discounted present value of money.* The idea is simple: You're better off receiving $100 today than tomorrow, for if you receive it now you can start earning interest right way. There's one little problem, however: Time can erode the value of your money. This process is called inflation. The $100 you spend today will buy more goods and services than it will later. Some people remember when a ticket to the movies was just a dollar and a gallon of gasoline was only fifty cents. Inflation is linked to *supply and demand:* how many goods and services are available at any given time and how much consumers are willing to pay for them.

TAKE NOTE

If you start saving young, it's easy to be rich. There's a staggering difference between the assets of a person who starts saving consistently at age twenty and those of a person who starts saving at age thirty.

These are some of the basic principles of economics, the science of observing how people behave with respect to money, goods, and services. Why should you care about economics? Because you're one of those people. What you do or don't do with your money matters, and not only to you. Other people have saving and spending habits similar to yours. Together these habits form a system of collective behavior. Sometimes the collective behavior stimulates the economy, in which case you might benefit; at other times the collective behavior causes the economy to stagnate, in which case you might suffer—but maybe not.

HOW ECONOMICS AFFECTS YOU

Once you see how economics works on a larger scale, you'll appreciate how it affects your everyday life. The more you understand about this subject and how money works, the better you'll be at handling your own money. Once you're financially literate, you'll understand that the economy runs in cycles and that over time a slow economy will once again pick up steam. Such knowledge will strengthen your resolve to stick to any plan you've made. More important, it will enable you to spot opportunities and take advantage of them, even in the worst of times. At its core, the Rich Dad philosophy is about how not to suffer during the booms and busts of economic fortune. It's about how to seize opportunities and create wealth for yourself even in times of economic stagnation, when others go begging for jobs.

WHY MONEY?

TAKE NOTE

Time is money—and you have to seize the day.

Economies took shape when people started trading things they had for things they wanted. Imagine a group of our ancestors who possessed a surplus store of animal skins but not enough nuts to last them through the winter. They could trade with another group who had plenty of nuts but no skins. While this process, known as *bartering,* worked well enough, it had some real limitations. What if a group couldn't find animal skins when the chill winds of winter began blowing? And how many nuts equaled a skin anyway? Timing and worth—these were two critical problems, and to solve them money was invented.

Money, or *currency,* is anything used as a means of exchange. Instead of paying for skins with nuts, people began paying with money. And when they sold their nuts, they were paid with money. Money meant that buying and selling didn't have to happen at the same time. With money, people could buy and sell when they wanted or needed to, not just when the opportunity presented itself. As soon as money made its debut, so did the concept of value. Everything bought and sold had a value or price affixed to it.

FROM COMMODITY TO FIAT CURRENCY

As early as 2500 B.C., precious metals such as silver and gold were circulating as money. Very soon after silver and gold coins appeared, they went through the process of *devaluation.* In Roman times, people took up the practice of clipping coins, that is, they would shave off part of a coin before handing it to a seller. Over time, coins not only shed weight but also lost value. To combat clipping, the Roman authorities ordered that coins be minted with tiny grooved edges. Coins that had been tampered with could thus immediately be spotted. Grooves were an ingenious idea but, as it turned out, not a real solution to the problem of devaluation, which has never stopped plaguing economies.

Money circulated not just within countries but also between them. Until fairly recently, the relative value of various currencies was measured against silver and gold, hence terms such as *pound sterling* and *gold standard.* Money made of precious metals was *commodity currency.* The first "paper" money was issued in 1282 by the Chinese emperor Kublai Khan, who stamped his seal on strips of mulberry bark.

In 1862 the U.S. government issued paper money, or *scrip.* The bills were called *greenbacks* because the backs were printed with green ink. Technically, scrip was commodity currency, because it could be exchanged for silver or gold. Individual banks using scrip, however, couldn't always meet customer demand for hard currency, or *specie.* Sometimes a dollar bill would be exchanged for only a fraction of its value in gold. In the early twentieth century, the United States put into effect a full gold standard, providing for full convertibility of currency into gold coin; dollars could also be exchanged for silver. But then in 1971 the United States went off the gold standard and abandoned silver exchange. No longer could the dollar be exchanged for something tangible. It had no intrinsic value.

Money that has no intrinsic value and can't be redeemed for a precious metal is called *fiat currency.* Fiat currency is backed by nothing but the stability of the government that issues it and the confidence of that government's citizenry.

DID YOU KNOW?

In ancient Rome soldiers were often paid with sacks of salt. The Latin word for salt is sal, the root of the word salary.

A HOUSE OF CARDS

Fiat currency is not an instrument of equity, but an instrument of debt. Every unit of currency, instead of being backed by gold or silver as it once was, is now an IOU guaranteed to be paid by the taxpayers of the issuing country. As long as the public has confidence in the taxpayers' ability to work and pay for this IOU called money, everything's fine. But if that confidence suddenly disappears, the economy can collapse like a house of cards.

RICH DAD'S TIP

▲

"An economic system built on fiat currency is a house of cards."

The house of cards has collapsed many times throughout history. Take the era of the Weimar Republic, when the German mark became utterly worthless. As one apocryphal story has it, an elderly woman was pushing a wheelbarrow full of marks to the store to buy a loaf of bread. When she turned her back, someone stole the wheelbarrow and left the money behind.

Fiat currency is only as good as the people's confidence in the government backing it. Today, much of the global economy is based on debt backed by confidence. As long as everybody keeps holding hands and no one breaks ranks, everything will be fine. Wait a minute—fine? Couldn't that be shorthand for Feeling Insecure, Neurotic, and Emotional?

THE FED

In 1913 Congress established a central banking network called the Federal Reserve System, or simply, the Fed. The Fed, although the central bank of the United States, is not really one bank. It consists of twelve regional banks, so that no one region of the country can unfairly gain an economic advantage. The Fed is run by a seven-member team called the Board of Governors, whose main job is to control the *money supply*, or the amount of cash circulating through the economy. The Fed has to keep enough money circulating so that the economy expands, but not too quickly. Too much money in circulation drives down its value, leading to inflation, while too little money results in consumers having less to spend, leading to recession. The Fed controls the money supply, and thus keeps the economy relatively balanced, by buying and selling securities, printing money, and establishing interest rates.

HOW THE FED KEEPS TRACK OF OUR MONEY SUPPLY

If you take a look in your wallet, empty out your piggy bank, rummage for change between the sofa cushions, and count up everything in your checking and savings accounts, the amount you come up with is your own personal money supply. That's what the Fed periodically does—tally the country's money supply. Without such a count, it can't know for sure how much money is in circulation and whether the economy needs more.

The Fed has a system for keeping track and it works like this: *M1 money*, or narrow money, is money that people can spend immediately, such as cash and checking account balances. *M2 money*, or broad money, is M1 money plus any money that can't be spent immediately but can be converted easily into cash, such as money in savings and certificates of deposit. *M3 money* is M1 and M2 money plus the assets and liabilities of financial institutions that can't be easily converted into cash. Together, the three Ms are known as the *monetary aggregates*. They're reported in billions of dollars in the *Wall Street Journal*, where bankers, economists, and investors of all stripes can check on them every two weeks.

DID YOU KNOW?

The term dollar comes from a silver coin minted in sixteenth-century Bohemia, where it was called the Joachimsthaler. The unit of currency was called the daalder in Holland, the daler in Scandinavia, and the dollar in England.

THE MONEY SUPPLY

The Fed's main customer is the U.S. Treasury. The Fed collects tax payments for the Treasury (the Fed is the bank that receives the money that is withheld from your paycheck if you're employed). It pays the government's bills, for example, sending out Social Security checks and making interest payments on treasury bills, notes, and bonds. And it oversees the operations of the nation's commercial banks.

But the main job of the Fed is to establish U.S. economic policy. Every six weeks a special committee of the Fed, the Open Market Committee, meets to review the state of the economy, then tells the Federal Reserve Bank of New York whether to increase or decrease the money supply. To slow down a rapidly expanding economy that has too much money in circulation, the Fed sells the securities it owns, removing from the market some cash that would otherwise be available for lending. In this way, the Fed slows borrowing, forces interest rates up, and cools the overheated economy.

If there isn't enough money in circulation, the Fed puts it back on the market by buying securities and, if necessary, ordering the U.S. Mint to print more money for the purchases. Depending on economic conditions, the Fed might put into circulation anywhere from $1 million to $4 million in a given month, causing a ripple effect throughout the economy as more money is made available for banks to lend out.

THE RIPPLE EFFECT

The Fed requires all banks to set aside a portion of their deposits, usually 10 percent, to meet any unexpected demands for cash by customers. But the remaining 90 percent can be lent. A brokerage firm that sells securities in exchange for cash received from the Fed deposits that cash in a bank. The bank sets aside 10 percent in accordance with the banking rules and loans out the remaining 90 percent. Customers who borrow from that bank to make purchases such as real estate give the cash to sellers, who in turn deposit the money in their banks. Those banks each set aside 10 percent of their deposits and loan out the remaining 90 percent to customers. The ripple effect involves more and more banks and customers, causing the amount of money in circulation to multiply.

INTEREST RATES

Another tool the Fed has at its disposal when it wants to change the direction of the economy is the interest rate it charges banks. This in turn determines what banks will charge their customers. An *interest rate* is nothing more than the price of a loan. It's expressed as a percentage per year of the amount loaned. For instance, if you borrow $100 at 10 percent interest for one year, you'll owe $110 at the end of the year. The cost of the borrowed money is $10.

Banks, like people, borrow money. They borrow money from the Fed or from each other, depending on their particular needs and which lender offers more attractive terms. The interest rate banks are charged when they borrow from the Fed is called the *discount rate.* The rate they're charged when they borrow from each other is called the *federal funds rate.* When the Fed increases the discount rate, banks borrow less and have less cash to lend their customers. When the Fed lowers the rate, banks are encouraged to borrow more freely, from both the Fed and each other, which makes more cash available for banking customers to borrow and at more attractive rates.

INTEREST RATES, INVESTING TRENDS, AND YOU

The way the Fed handles money affects the economy, which in turn may affect the way you invest. The money the Fed collects in the form of taxes enables the government to pay for such things as maintaining the highway system. When the Fed doesn't collect enough money to meet the government's obligations, which is often the case, the government borrows by selling U.S. Treasury securities. When buyers purchase securities, there is less money circulating in the economy. The money supply becomes scarcer, which drives up interest rates. In short, the more the government borrows, the higher interest rates go.

A change in interest rates affects the financial markets and, ultimately, the decisions investors make. When interest rates are high, yields on bonds go up and investors buy more bonds; when interest rates are low, it's cheaper for businesses to borrow money for growth, and when businesses are growing, investors flock to stocks.

Once you learn the Rich Dad program, you may find yourself bucking these investing trends. For instance, when interest rates are high and other investors are fleeing stocks, you might be buying stocks at bargain prices, positioning your money for growth.

Banks don't lend to their customers at a single rate of interest. Their best customers—usually their biggest, for example, a large corporation that needs money to expand its operations—are charged the more favorable rate, known as the *prime rate,* since the risk to the bank in lending is lower. Their individual customers—say, people who want to buy houses—are usually charged a higher rate, calculated by adding a few points to the prime.

THE BUSINESS CYCLE

History is an important teacher, and history teaches us that there have always been, and there will always be, booms and busts in the economy. Essentially, whenever you invest, you're investing in business. And business goes through a cycle. Inflation (expansion) and recession (contraction) are the recurring phases of the cycle, measured by certain economic indicators such as the gross domestic product and the unemployment rate. If you know where the country is in the business cycle, whether it's expanding or contracting, you'll be better able to determine how the businesses you've invested in are performing.

INFLATION

By 1990 the value of the dollar had eroded to the point where it was worth many times less than in 1790. *Inflation* is the increase in prices over time that causes the purchasing power of money to decline. Inflation is an unavoidable fact of economic life.

RICH DAD'S TIP

▲

"Those who work the hardest and are paid the least suffer the most from the constant erosion of money's value. Since money has an ever-declining value, a financially wise person must constantly seek ways to create value and produce more and more money."

One way economists keep tabs on inflation is by a measurement called the *gross domestic product* (GDP). The GDP is the total value of all goods and services produced in the United States in a given period. Whenever prices rise owing to increased costs associated with production but production itself stays the same, inflation occurs.

Small price increases are considered normal for a growing economy. Employees may receive slight increases in salary to match inflation, so that purchasing power remains roughly the same and rising prices aren't all that noticeable. But salaries don't always keep pace with inflation, and over time, when it takes more money to buy the same amount, purchasing power is reduced.

WHO WINS, WHO LOSES?

Any financial plan you put in place for yourself should take inflation into account. Inflation mostly hurts those living on fixed incomes, such as Social Security payments or pensions. It's also detrimental to those whose savings are tied to fixed interest rates, such as savings accounts or bank certificates of deposit, unless of course the fixed interest earnings exceed the inflation rate.

But inflation isn't always bad. High inflation usually favors those who owe money. Each year that a debtor makes payments on a fixed loan, he or she is repaying it with dollars that have declined in value since the previous year. Sometimes inflation can even help create wealth, especially when investments increase in value faster than the inflation rate, as can happen, for example, in real estate.

TAKE NOTE

The law of supply and demand, one of the fundamental economic principles, is really quite simple. When demand exceeds supply, prices rise, but when supply exceeds demand, prices fall.

HOW DOES THE BUSINESS CYCLE WORK?

The supply of goods and services available and the demand for those goods and services—known as *supply and demand*—help indicate what part of the business cycle the country is in, that is, its general economic health. Simply put, supply describes the behavior of sellers, while demand describes the behavior of buyers. Over time the economy expands and contracts in accordance with the behavior of buyers and sellers. You've probably heard of the *law of supply and demand.* It's really quite simple: When demand exceeds supply, prices rise, but when supply exceeds demand, prices fall. This law shapes the business cycle.

So how does the business cycle work? Let's say more people want to buy cars than there are cars available. Sellers increase prices, because demand is greater than supply and some people will pay more to get what they want. Once prices go up, people—including those working in automobile factories—will demand higher wages so they can buy cars. As a result of wage increases, production costs will rise and so will selling prices. Eventually, when prices are more

THE RULE OF 72 REWRITTEN

Economists have a formula called the Rule of 72. The Rule of 72 can tell you how long it will take not only for the money you're saving to double, but also for prices to double—a valuable guide when assessing the possible impact of inflation on your investments. Here's how it works: To figure out how many years it will take for an investment to double, divide 72 by the rate of return you're earning. Let's say you have $500 earning 6 percent interest. Your money will double to $1,000 in twelve years, because 72 divided by 6 equals 12. To calculate roughly how long it will take for prices to double, divide 72 by the annual inflation rate. Let's say inflation is currently 3 percent. Then prices may double in twenty-four years because 72 divided by 3 equals 24.

But the Rule of 72 doesn't fit the Rich Dad program because it is based on opinions, or assumptions. It assumes that the economy will always be increasing. The Rich Dad program encourages you to learn, through financial literacy, how to increase your wealth in a down as well as in an up market. Rich Dad's program will show your money doubling much faster than in twelve years, because you'll be earning a much higher rate of return than 6 percent. Thus you'll be beating inflation by a significantly wider margin.

than most people can afford, they'll stop buying. At this point, fewer cars will be needed, and automobile factories will lay off workers. Since unemployed people buy less of everything, the economy will slow down or go into recession. Now the manufacturers, desperate to sell their inventory, will offer cars at reduced prices, sometimes even at a loss, to get enough cash to meet their expenses. Seeing reduced prices, people will once more be enticed to buy cars, which will stimulate production. Factory workers will be employed again and will have more money to spend at the local grocery store, toy store, and movie theater. Those businesses will prosper too. The economy will enter the expansion part of the cycle.

TICKLE ME ELMO

During Christmas season 1996, something happened that well illustrates the law of supply and demand. A toy company advertised the imminent arrival in stores of a doll based on the Sesame Street character Elmo. Children all over the United States put Tickle Me Elmo at the top of their Christmas lists. For some reason or another, however, the supply of Elmos was woefully inadequate. As demand skyrocketed, panic set in and desperate parents scoured store shelves. By then, Tickle Me Elmo was worth its weight in gold. The result? Scalpers made a small fortune.

TAKE NOTE

Three consecutive rises in the index of leading economic indicators signal that the economy is growing. Three consecutive drops signal a downturn.

MEASURING THE ECONOMY'S VITAL SIGNS

Because the health of the economy directly affects the value of investments, economists have devised a number of different measurements to gauge it. Here are the main ones, which you'll hear reported on the nightly news and in your newspaper:

- ***The Index of Leading Economic Indicators.*** This is the measurement perhaps most widely watched by economists. Issued monthly by the Conference Board, a business research group, the index is based on ten different economic factors, among them the jobless rate, the number of new houses under construction, the M2 money supply, the number of new factory orders for consumer goods, and the prices of certain stocks. The index allows economists to assess the current state of the economy and to predict, for example, when there might be higher inflation, an upswing in productivity, higher unemployment, or a recession.

- ***The Gross Domestic Product.*** As you've learned, this is a total measure of the goods and services produced in any given period, usually a year, in the United States. The GDP, measured by surveying several thousand different goods and services, is a sort of national balance sheet. It reports on production, distribution, use, and export. The GDP is adjusted for inflation and for seasonal factors such as increased consumer spending before the winter holidays.

- ***The Consumer Price Index (CPI).*** Also known as the cost-of-living index, the CPI looks at the economy from your point of view. Every month the U.S. Bureau of Labor Statistics records the prices of 80,000 different goods and services typically used by Americans. Among the prices tracked are those for housing, food, clothing, transportation, health care, education, and recreation. The most widely used indicator of inflation, the CPI is the basis for calculating increases in such things as Social Security payments.

INFORMATION IS POWER

How do the fundamentals of economics affect your financial future? The answer will gradually emerge in the chapters that follow. Little by little, you're learning the language of financial literacy. Like any language, it can't be learned overnight; you have to be patient and keep your mind open.

RICH DAD'S TIP

▲

"There will always be market booms and busts. The trick, in a bust, is to buy instead of sell. Don't panic, profit!"

It's time, however, to let you in on a secret. You've just read about the economic cycle. Let's say the economy goes into a nosedive. An economic depression is emotional depression. People lose money and they get depressed. But if you're armed with financial knowledge, you increase your chances of riding out a depression. Indeed, you might even make money in a downturn. Here's the secret: Sophisticated investors make more money in times of bust. They keep their emotions neutral and enter the market when everyone else is fleeing it in panic. The financially intelligent buy when others are selling. Great opportunities are seen not with your eyes, but with your mind.

Fortunately for you, this is the dawn of the age of information. As we saw in Section 1, for the first time in history the 90/10 rule—10 percent of the investors make 90 percent of the money—need not apply. Information isn't restricted the way land and resources were in the age of the feudal lords or the robber barons. It is now possible for more and more people to gain access to the world of wealth through information. That's because information is power. Do you want to be one of the informed? More important, do you want to put your knowledge to work? Then have patience and read on. There's still plenty to learn about accounting, taxes, and investing.

FEAR: No matter how sound my investments, a depression will wipe them out.

FACT: If you talk to experienced investors and other experts, read and listen to financial news, keep your mind open, and follow the Rich Dad program, you'll be equipped to make sound investments even in a down market.

FREEDOM: Information will free you from the boom-and-bust cycle and help you profit in a down as well as an up market.

The Basics of ACCOUNTING

"It's not the numbers, but what the numbers are telling you. It's not the words, but the story the words are telling you."

Every household, no matter how large or small, is its own business. Like a business, a household has assets, liabilities, income, and expenses. And like a business, every household has various financial statements that explain the relationship among them.

Assets and liabilities, income and expenses—you may not be fully aware of them, but they do indeed exist. The details of your financial situation are expressed in hard numbers, such as the amount of money you owe a credit card company or the amount you have in a savings account. By taking a cold, hard look at the numbers and learning what they mean, you'll be better positioned in Section 3 to assess your financial position and identify where changes can be made. Numbers are like words—learn to read them and you'll grasp the story. Learn to read and analyze them, and you'll be able to change the plot to your liking.

RICH DAD'S TIP

▲

"My banker has never asked me for my report card. He's only asked me for my financial statement. Your financial statement is your report card for life."

GUIDE TO ASSETS AND LIABILITIES, INCOME AND EXPENSES

Assets, liabilities, income, expenses. Wait a minute, you say. Isn't income an asset? Aren't expenses liabilities? Why does the terminology have to be so confusing? In truth, there's a very practical reason for separating income from assets and expenses from liabilities. There's also a very practical reason for considering assets together with liabilities, and income together with expenses. That reason is cash flow. If you have a clear picture of your assets/liabilities on the one hand and your income/expenses on the other, ultimately you'll be able to manage and increase your cash flow.

ASSETS AND LIABILITIES

An asset puts money in your pocket, whereas a liability takes money out of it. That seems simple enough. Yet many people have trouble making the distinction. Poring over their financial statements, they get tangled up in the numbers and can't tell what is making them money and what isn't.

RICH DAD'S TIP

▲

"Assets put money in your pocket. Liabilities take money from your pocket."

ASSETS

To repeat, a financial asset is something that puts money, or income, in your pocket. Assets include:

- Cash
- Bank accounts
- Stocks
- Bonds
- Mutual funds
- Retirement funds
- Debts owed to you
- Net value of businesses you own
- Net value of income-producing real estate you own

As you can see, debts owed to you are assets, known as *receivables*. If you sell a piece of property, the amount of money the buyer owes you is a receivable. Assets also include the net value of any businesses and real estate you own. The *fair market value* of a business or a piece of real estate is the amount of money you could fairly expect to receive if you sold it. But remember, you must deduct (and pay off) any money you owe on it, such as a mortgage.

It's important to keep in mind that Rich Dad wouldn't consider your personal property an asset. Why? Because it doesn't produce income. Your home, car, furniture, clothes, and collectibles might be things of financial or even sentimental value, but they are not financial assets unless and until they are sold for a profit. Some, in fact, might even be liabilities. Your banker or your accountant would encourage you to list these as assets in order to give you a stronger financial statement. Is the value of this personal property really what you could expect to receive if you had to sell it quickly? Since personal property produces no income, in this book it is treated as a doodad, not an asset. The financial statement you'll learn to prepare is the financial statement of a sophisticated investor.

LIABILITIES

A liability takes money out of your pocket. Liabilities include:

- Credit card balances due
- Mortgages
- Car loans
- School loans
- Personal loans
- Taxes

The typical amount you pay on each of these liabilities is considered your expense related to that liability. The term expense here refers to the total payment, including principal payment and related interest. Expense is calculated as it relates to total cash flow, not technical accounting principals.

RICH DAD'S TIP

▲

"The reason most people suffer financially is because they purchase liabilities but list them under the asset column."

As mentioned, Rich Dad would treat your home as a liability, the financially prudent approach. A lot of money goes toward the maintenance of your home in the form of mortgage and insurance payments, property taxes, utility bills, and checks paid to plumbers and other contractors. These are all expenses related to your home. It's misleading to think of your home an asset, for who would own it if you stopped making mortgage payments? Many people purchase homes with the expectation that they'll increase in value, but there is no guarantee of this, and some homes actually decrease in value. Only when a home is sold for a profit can it be considered an asset.

RICH DAD'S TIP

▲

"Every time you owe someone money, you become an employee of their money. If you take out a thirty-year loan, you've become a thirty-year employee."

Debt is a liability because it is money owed to someone else. Credit card debt is a classic example of a liability. When you use a credit card, you're taking a loan from the bank or company that issued the card. With that loan come interest payments. You generally do not pay interest for the first credit card cycle (usually a month), but any amount not completely paid off after that first cycle is subject to interest. If you carry a balance on your credit card, then all future charges are also subject to interest; there is no more first-cycle grace period. Furthermore, many credit card companies charge an annual fee for use of the card. Credit cards easily seduce the unwary into debt. Because no money exchanges hands, it may seem as if something is being purchased for nothing.

TAKE NOTE

It can be financially smart to carry good debt; it is never financially smart to carry bad debt.

But debt isn't always a negative thing. There is bad debt and there is good debt. Bad debt is money borrowed to purchase doodads such as clothes, cars, or electronic equipment. You cannot expect to get a financial return from something purchased with bad debt. Good debt is debt that allows you to purchase assets. An example is money borrowed to purchase rental real estate. The tenant's payments are used to pay off the loan and generate cash flow. It can be financially smart to carry good debt; it is never financially smart to carry bad debt.

INCOME AND EXPENSES

Understanding the dynamics of income and expenses is critical to cash flow management. People who cannot control their cash flow work for others; people who can control their cash flow work for themselves or have others work for them.

INCOME

Income is money that goes into your pocket. Income sources are:

- Wages or salary
- Tips
- Interest on investments
- Dividends
- Rent from real estate
- Distributions from businesses/limited partnerships
- Royalties
- Capital gains

There are three basic types of income: earned, passive, and portfolio. *Earned income*, which is taxed at a higher rate than other forms of income, is the salary or wage you are paid by an employer for doing a job. Earned income also includes tips and self-employment wages. This is the form of income that keeps many people on the left side of the CASHFLOW Quadrant. A young person who heeds advice to "get a good job" may end up stuck in the E quadrant.

The least-taxed form of income is passive income. *Passive income* is money generated by a business or real estate property. Business or real estate owners aren't actively involved in generating passive income; the money they have invested in assets is working for them. *Portfolio income* is a type of passive income; it is income derived from a collection of paper assets such as dividends, stocks, bonds, mutual funds, or royalties from patents and license agreements. Portfolio income also includes interest earned from a savings account, an outstanding loan, or some other source.

The difference between earned income and passive or portfolio income is this: If you have to show up for a job you have earned income; if you can sit back and let your assets work for you, you have passive or portfolio income.

RICH DAD'S TIP

"You want to learn how to convert earned income into passive or portfolio income."

EXPENSES

An expense is the opposite of income; it is money leaving your pocket. In Rich Dad's program your expenses are all your payments, that is, your total cash outflow, each month. An accountant would include only the interest portion of your mortgage payment as an expense, not the principal portion. This program, however, is more concerned about your total cash flow. Later you will account for total cash in and total cash out.

In Rich Dad's program, then, expenses include:

- Taxes
- Credit card payments
- Home mortgage payments
- Car loan payments
- Utility payments
- Grocery bills
- Travel and entertainment
- All other personal expenses

Income pays expenses, and if you don't have enough income you may have to incur additional debt to pay your expenses.

A doodad is an unnecessary and sometimes unexpected expense or item you purchase that does *not* put money in your pocket. It may be a pleasure boat, a dream vacation, a new pair of sunglasses, or a meal you ate in a restaurant when a snowstorm kept you from driving home. Doodads can slowly and inexorably deplete your income—or serve as incentives to make more. For example, if you're determined to take a dream vacation but equally determined not to put it on your credit card, you may figure out a way to purchase a new asset that will generate the cash flow to pay for your holiday. After you pay for your vacation, you will still have the additional cash flow generated by the asset. People in the B quadrant quickly learn the value of buying assets because it earns them the ability to pay for doodads. Certain personal expenses that relate to your business can become business expenses and thus tax deductions. For instance, if you subscribe to an Internet service and you use that service to communicate with clients, you can deduct that expense. Unlike personal expenses, business expenses are paid with pre-tax dollars. Of course, the expense must have a valid business purpose.

RICH DAD'S TIP

▲

"Income is money in; expense is money out."

BALANCE SHEETS AND INCOME STATEMENTS

There are many different types of statements reflecting the state of your finances. The two most important are the balance sheet and the income statement. Understanding these two documents and their relationship to each other is the master key to financial freedom.

THE BALANCE SHEET

The balance sheet is self-explanatory: It balances the value of your assets against the value of your liabilities. One half of the balance sheet lists assets, the other half liabilities and your net worth:

Assets	Liabilities

The balance sheet indicates how much money you have and how much money you owe, and the difference between the two at a point in time.

From the balance sheet you can determine your personal equity or *net worth*, which is the difference between the value of your total assets and your total liabilities:

net worth = assets – liabilities

In other words, your net worth is how many assets you have left over after paying off all your liabilities (bills and loans), or the shortfall thereof. It is how much you are worth on the day the balance sheet is drawn up. In the example of the fictional Max described later in this section, as well as in the examples given later in Section 3, Rich Dad's version of net worth is calculated along with a banker's version of net worth. The difference between the two is the value of a person's doodads.

RICH DAD'S TIP

▲

"People who are not aware of the power of a financial statement often have the least money and the biggest financial problems."

THE INCOME STATEMENT

The income statement, also called a profit and loss statement, measures income and expenses. One section of the statement lists all income—either earned, passive, or portfolio—while the other section lists all expenses.

Income
Expense

RICH DAD'S TIP

▲

"Most people fail to realize that in life, it's not how much money you make, but how much money you keep."

Unlike the balance sheet, which is a snapshot of net worth at a particular point in time, the income statement catalogs income and expenses over a period of time. Preparing an income statement on a regular basis, such as every few months, is a good way to measure financial progress.

Income statements and balance sheets have a symbiotic relationship. For example, the income statement helps in determining whether a balance sheet entry should be listed as an asset or a doodad.

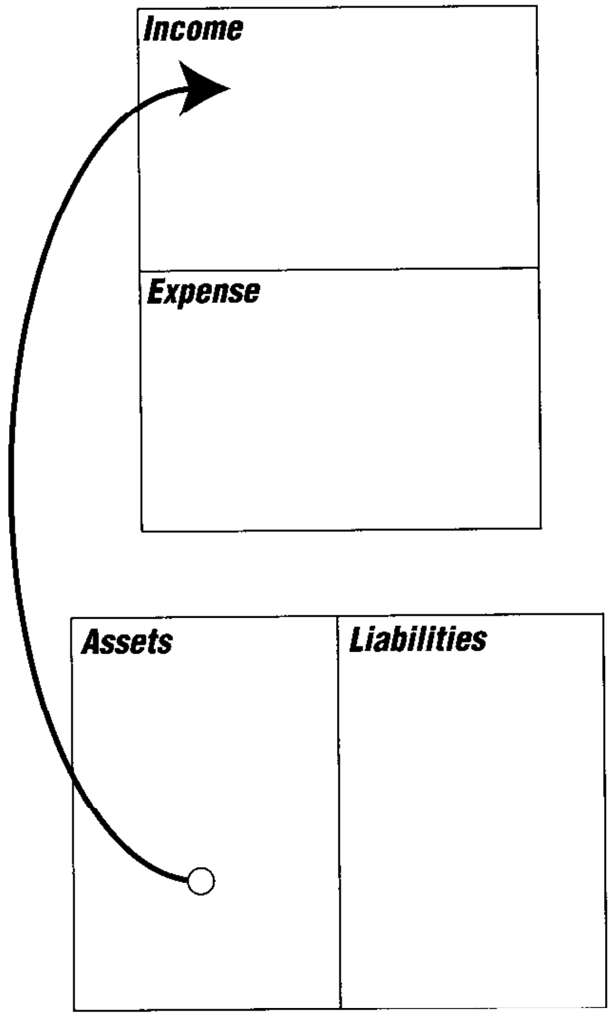
The income statement starts with gross income and ends with net income. *Gross income* is money earned through a job or from a business or investment. *Net income*, for our purposes, is that portion of gross income pocketed after all expenses have been deducted from it:

net income = gross income – expenses

CASH FLOW

Cash flow refers to the stream of cash coming in as income and going out as expenses. Cash flow links balance sheets and income statements, for better or worse. How cash is flowing determines a person's degree of financial freedom.

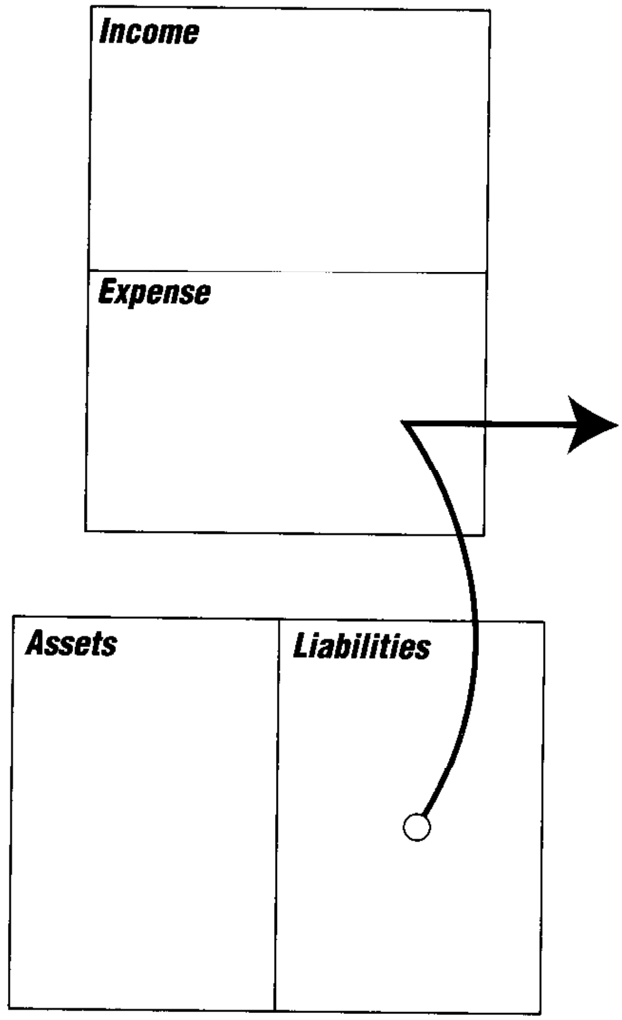
The cash flow of an asset travels from the assets column of the balance sheet to the income section of the income statement:



RICH DAD'S TIP

"People who lack control of their cash flow make people who are in control of their cash flow rich."

The cash flow of a liability goes from the liability column of the balance sheet to the expense section of the income statement, and then out.



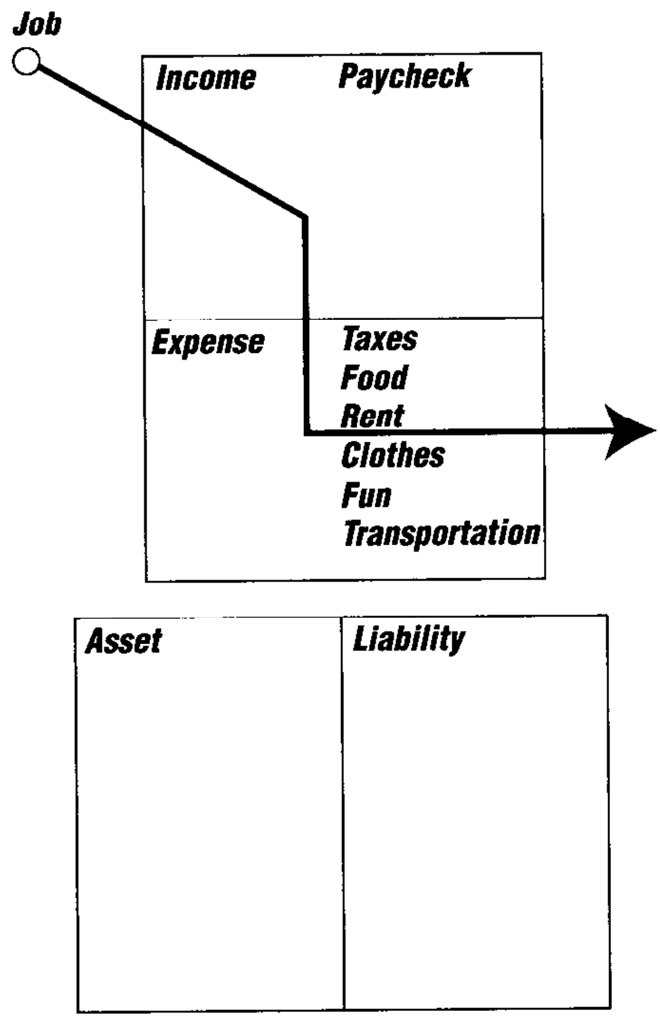
When preparing a balance sheet, if you have trouble determining whether something is an asset or a liability, it's helpful to sketch the cash flow for that item using these diagrams as models.

RICH DAD'S TIP

▲

"Rich people acquire assets. Middle class people acquire liabilities that they think are assets."

The typical cash flow pattern of a poor person can be simplified as follows:



All income is used to pay expenses; he or she owns no assets.

TAKE NOTE

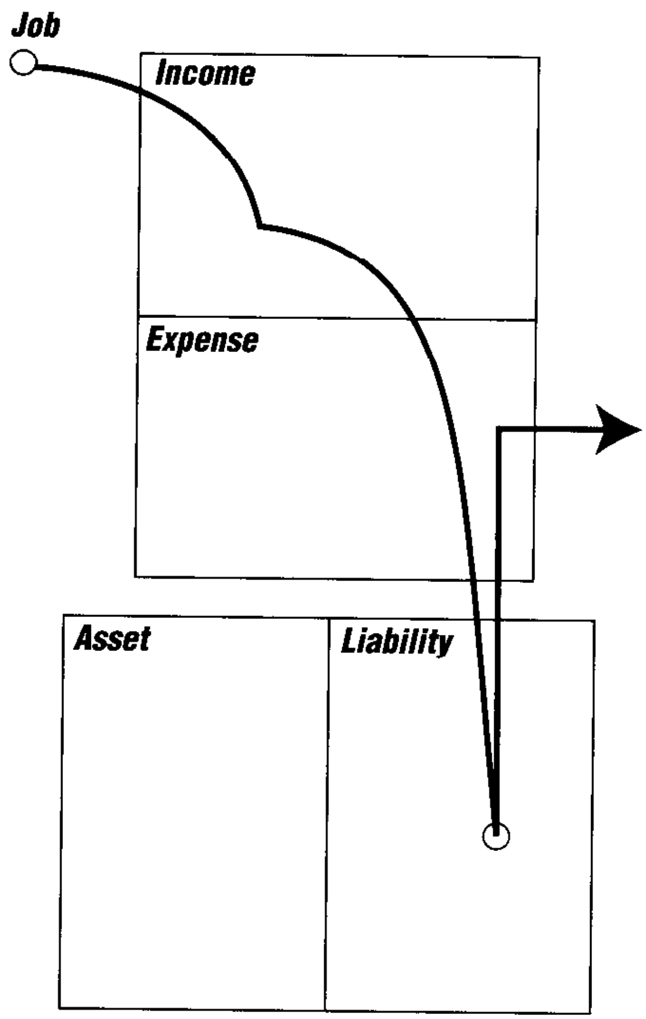
In Rich Dad's philosophy, your personal property is not an asset because it doesn't put money in your pocket.

RICH DAD'S TIP

▲

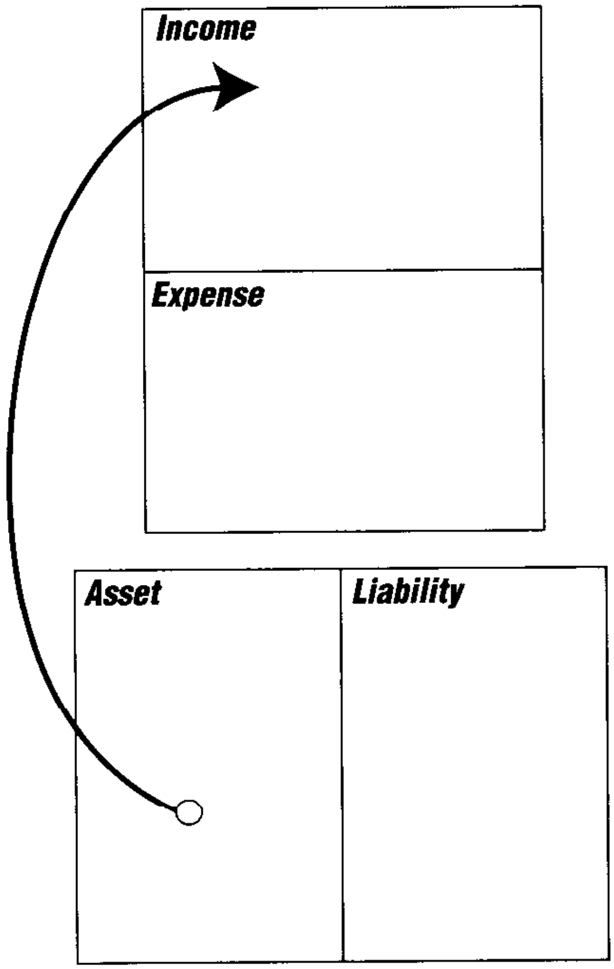
"If something is a liability, make sure you call it a liability and watch it closely."

The basic cash flow pattern of a middle class person is:



In this case, income is used to pay expenses instead of buying assets. The middle class person often buys liabilities he or she thinks are assets, such as a new car or a bigger house, and therefore the total amount of debt keeps increasing.

The simplified cash flow pattern of a rich person moves in the opposite direction:



It's true that the rich have expenses, but their income covers their expenses and they continue buying more assets, which generate more and more income. Hence the saying, "The rich get richer and the poor get poorer."

ENVISIONING CASH FLOW: THE FINANCIAL STATEMENT

Worksheet

"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

Name ____________________ Date ____________

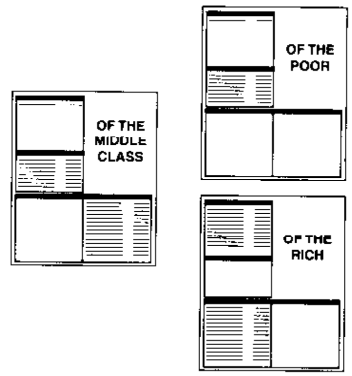
INCOME

Earned Income	
Job and Self-Employment	$
Passive Income	
Real Estate (Net)	$
Business (Net)	$
Passive Income Total	**$**
Portfolio Income	
Interest	$
Dividends	$
Royalties	$
Portfolio Income Total	**$**
TOTAL INCOME *(Earned + Passive + Portfolio)*	**$**

EXPENSES

Taxes	$
Credit Card Payments	$
	$
Home Mortgage (Rent)	$
Car Payments	$
Food and Clothing	$
Other Payments	$
TOTAL EXPENSES	**$**
NET MONTHLY CASH FLOW *(Total Income less Total Expenses)*	**$**

Cash Flow Patterns



What story do your numbers tell?

ASSETS

Bank Accounts	$
Stocks	$
Bonds	$
Receivables	$
Real Estate *(Fair Market Value less Mortgage)*	$
Business Value (Net)	$
ASSETS SUBTOTAL	**$**
DOODADS	
Home	$
Car(s)	$
Other	$
DOODADS TOTAL	**$**
TOTAL ASSETS per Banker *(Assets Subtotal + Doodads)*	**$**
TOTAL ASSETS per Rich Dad *(Assets Subtotal only, do not add Doodads)*	**$**

LIABILITIES

Credit Cards	$
Car Loans	$
School and Personal Loans	$
Home Mortgage Loan	$
Other Debt	$
TOTAL LIABILITIES	**$**
NET WORTH per Banker *(Total Assets per Banker less Total Liabilities)*	**$**
NET WORTH per Rich Dad *(Total Assets per Rich Dad less Total Liabilities)*	**$**

A handy way to envision cash flow is to combine the income statement and the balance sheet in a single financial statement. Later on in Section 3 you'll be filling out and analyzing your own financial statement. For now, it's enough just to see what a blank statement looks like.

The financial statement is a critical element of the Rich Dad program, for it shows you how cash is flowing and therefore determines your degree of financial freedom. In your youth you got a report card for school. Your financial statement is your report card for life.

To give you an idea of how a financial statement works, let's consider the situation of a fictional person. We'll call him Max E. Max is twenty-seven years old and starting to worry about his financial future. He has a bachelor of science degree in biology, but after completing it he ran out of money and went to work as a technician in a biotech firm. The only way Max can advance in his field is to go back to school and get an advanced degree. Unfortunately, he's discovered that biology isn't his passion after all. Max is at a crossroads. Before deciding what direction to follow, he decides to assess his financial situation by filling out a financial statement. Max is about to get his report card for life—at least, his life as it currently stands.

Max's salary is $36,000 a year, or $3,000 a month. His net pay after withholding of $790 for taxes is $2,210, but that hasn't been covering his expenses. If he reduces his withholding to receive $2,610 a month, it will still only give him $100 a month after all his bills are paid. His employer offers a 401(k) plan that would match every dollar Max saved with fifty cents. But he can't participate in the plan because he needs every dime to live on.

Determined to find out where he's going wrong, Max gathers all his records and puts together a blank financial statement. One Saturday morning he sits down and figures out how much he's spending. Here are his monthly expenses:

Taxes	$ 790
Apartment rent (utilities included)	$ 650
School loan of $50,000 (including interest)	$ 400
Car loan of $25,000 (100% financed)	$ 510
Car insurance	$ 100
Gas	$ 50
Food	$ 400
Clothing	$ 150
Credit card	$ 150
Miscellaneous living expenses	$ 100

Max fills out the expenses column of his financial statement, then logs in the income, assets, and liabilities columns. The result is on the following page.

Once his financial statement is filled out, Max can see at a glance that he has the cash flow pattern of the poor: all income sucked up by expenses, and no assets. Indeed, his dismal report card shows a net worth of minus $85,000 in Rich Dad's book. (A banker would tell Max he has a net worth of minus $63,000, but that's because the banker would encourage him to list his doodads as assets. Max's car is a doodad but not, according to Rich Dad, an asset. Technically, doodads are only assets when they're sold for a profit—highly unlikely in the case of a car.)

Needless to say, Max is in a tight box with very little room to maneuver. Now that the shadowy details of his financial situation are expressed in clear numbers, he begins to ask himself some unsettling questions. What if his car breaks down? What if he has a medical emergency? What happens at the end of the year when he has to pay the taxes that haven't been withheld? Even more unsettling, what if he loses his job?

Even before filling out a financial statement of your own, you probably have some vague idea of where you stand in relation to Max. Is there anything about your financial situation that reminds you of his? Take heart. Under the Rich Dad program, there's hope for you. Now that you have the basics of household accounting under your belt, it's time to read on and learn the other fundamentals of financial literacy. In the end, literacy will equip you to analyze your financial statement and determine your own unique path to financial freedom.

Worksheet

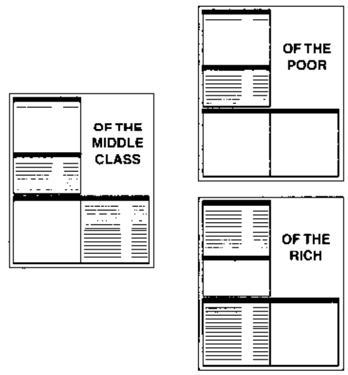
"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

Name Max E. Date

INCOME	
Earned Income	
Job and Self-Employment	$ 3,000
Passive Income	
Real Estate (Net)	$
Business (Net)	$
Passive Income Total	$
Portfolio Income	
Interest	$
Dividends	$
Royalties	$
Portfolio Income Total	$
TOTAL INCOME (Earned + Passive + Portfolio)	$ 3,000

EXPENSES	
Taxes	$ 790
Credit Card Payments	$ 150
	$
Home Mortgage (Rent)	$ 650
Car Payments	$ 510
Food and Clothing	$ 550
Other Payments	$ 650
TOTAL EXPENSES	$ 3,300
NET MONTHLY CASH FLOW (Total Income less Total Expenses)	$ -300

Cash Flow Patterns



What story do your numbers tell?

What cash flow pattern does Max have?

ASSETS	
Bank Accounts	$
Stocks	$
Bonds	$
Receivables	$
Real Estate (Fair Market Value less Mortgage)	$
Business Value (Net)	$
ASSETS SUBTOTAL	$
DOODADS	
Home	$
Car(s)	$ 20,000
Other	$ 2,000
DOODADS TOTAL	$ 22,000
TOTAL ASSETS per Banker (Assets Subtotal + Doodads)	$ 22,000
TOTAL ASSETS per Rich Dad (Assets Subtotal only, do not add Doodads)	$ - 0 -

LIABILITIES	
Credit Cards	$ 10,000
Car Loans	$ 25,000
School and Personal Loans	$ 50,000
Home Mortgage Loan	$
Other Debt	$
TOTAL LIABILITIES	$ 85,000
NET WORTH per Banker (Total Assets per Banker less Total Liabilities)	$ -63,000
NET WORTH per Rich Dad (Total Assets per Rich Dad less Total Liabilities)	$ -85,000

The Fundamentals of TAXES

"In this world nothing can be said to be certain, except death and taxes."

— Benjamin Franklin

Nobody likes taxes. Ever since the Boston Tea Party in 1773, when colonists dumped British tea into Boston Harbor rather than paying the tax on it, Americans have been seeking ways to avoid giving their hard-earned money to the government. Their efforts have been in vain. Today the Internal Revenue Service is a fact of life, and we all have to pay taxes. But there's no reason you have to hand over more than your fair share. If you take the time to learn some of the basics of tax law, you'll reduce your burden and keep more of your money. By becoming financially literate, you'll learn what the rich already know: While you can't beat the IRS, you can turn it to your advantage.

Income Tax: A Pocket History

Personal income tax is a relatively new phenomenon in American life. It wasn't until 1863 that the federal government even began collecting income tax, to fund the war effort, and nine years later the tax was repealed. For the next forty-one years the government funded most of its activities by levying duties on imported goods such as wool and shoes. The system of duties, however, prevented the United States from gaining a competitive edge in world trade. Thus in 1913 Congress reduced duties on imported goods and, to make up for the loss in revenue, ratified the 16th Amendment to the Constitution legalizing personal income tax.

During World War II, paycheck withholding was introduced. Under this system, taxes were taken out of a person's paycheck each payday instead of annually, giving the government enough ready cash to cover the cost of the war. To reduce government borrowing, the tax rate was also raised, in some cases to a whopping 94 percent of personal income. Since then rates have settled back down, but not—as the tax wars of the last few decades suggest—to everyone's satisfaction.

"That the institution of the income tax will tend to silence all boasting about wealth may ... be regarded as one blessing associated with it; we know at present of no others."

—*The New York Times* in 1913, the year income tax was introduced

"This is too difficult for a mathematician. It takes a philosopher."

—Albert Einstein, on preparing his income tax return

BECOMING TAX LITERATE

The U.S. tax system is *progressive*, meaning people earning more money pay tax at a higher rate than people earning less. If only it were that simple ... The present Byzantine tax code may have your money passing through more than one tax bracket before your final tax bill is calculated. The rate you pay depends on many factors, not just your income but whether you're married or single, how many children you have, and so forth. So complicated is the tax system that some lawmakers in Washington have repeatedly called for a *straightforward* proportional tax, that is, a tax that takes the same percentage of each person's income. It is often called the *flat tax.*

Instead of overhauling the tax code, Congress is forever tinkering with it, changing this and adding that. The result resembles a house built without blueprints. Doors give way to walls, and staircases lead nowhere. Many laws are written to favor investors, others are not. It's important to know the laws, and it can be very expensive if you don't.

For instance, in 1986 Congress passed the Tax Reform Act, which eliminated the tax break for real estate investors whose expenses on rental properties exceeded the rents they collected. When the law changed and the government stopped subsidizing people for losing money, some people went bankrupt and the stock market took a steep dive. It's never a good idea to invest in something just to avoid paying taxes or in something that's losing money. The idea is to make money, not lose it. The 1997 Taxpayer Relief Act introduced a whole new set of rules, and it contained some good news for some. For example, now if you're married and you sell your house, you can avoid paying capital gains tax on profits up to $500,000. The law is always changing, and the best way to reduce your tax burden is to keep abreast of developments. How? By watching the financial news on television, reading the financial section of your newspaper, or consulting your tax attorney or accountant.

TYPES OF BUSINESS ENTITIES

Most people earn money, pay taxes through withholding, and spend what little is left over. The rich do it differently. They earn money, spend it, and *then* pay taxes. The government gets less that way, and it's legal.

EMPLOYEES OF CORPORATIONS:

Earn → pay taxes → spend

THE RICH WHO HAVE CORPORATIONS:

Earn → spend → pay taxes

What is the secret of the rich? They take advantage of the tax loopholes that allow individuals to choose different entities for their businesses. Loopholes, though they may have a negative connotation for some, are intended to help businesses grow and prosper. The tax law allows a corporation, for example, to earn, spend everything it can on legitimate business expenses, and then be taxed only on what remains. How can you get in on this secret? First by learning what business entities are available to you and what the advantages and disadvantages are of each. These entities include the sole proprietorship, the partnership, the corporation, and the limited-liability company, which is a hybrid partnership/corporation.

In the Rich Dad program, it is important that you be aware of the various entity choices and their primary attributes. Consult your legal and tax advisors about what entity may be most appropriate for you and your intended business, whether it is real estate, a purchased business, or a start-up.

RICH DAD'S TIP

▲

"You can't beat the IRS. Concentrate instead on earning as much as you can, knowing that you can reduce, but not eliminate, your tax burden."

FEAR: My hard-earned profits will disappear in the black hole of the IRS.

FACT: There are business entities available that may help counteract your tax burden. By consulting with your tax and legal advisors, you can structure your business in such a way as to maximize your tax deductions.

FREEDOM: If you structure your business properly, you can protect more of your profits.

"It's a game. We (tax lawyers) teach the rich how to play it so they can stay rich—and the IRS keeps changing the rules so we can keep getting rich teaching them."

—John Grisham

SOLE PROPRIETORSHIP

This is the oldest and simplest form of business. The owner and the business are one and the same, enjoying all the benefits but assuming all the debts and tax responsibilities. Only one person is required to form a sole proprietorship, and since there is legally no difference between the owner and the business, all income generated by the business is regarded as personal income. The owner reports all business income and losses on a personal tax return (Schedule C) and is allowed to deduct business expenses. The owner is also personally liable for the business and can be sued by an unhappy customer or unpaid creditor. If business assets cannot satisfy such a claim, the owner's house, car, and other personal assets are vulnerable.

Sole Proprietorship

Pros

- Owner in complete control
- Flexible decision making
- Business expenses deductible
- Owner earns all profits
- Easy and inexpensive to set up

Cons

- Owner completely liable for debts and suits
- Business terminates with owner's death
- Tax rate may be higher than other entities'

PARTNERSHIP

A partnership is two or more people co-owning a business for profit. The partners agree to establish and run the business, sharing in profits, assuming responsibility for all losses and liabilities, and paying all taxes, which are paid at the individual rate. There are two types of partnerships: general and limited.

In a *general partnership*, the partners have full rights to control all the day-to-day affairs of the business. They also share all the liability for the partnership's debts or obligations. If the partnership's assets are insufficient to meet its obligations to creditors, or if a third party is damaged or injured, then each partner's personal assets can be taken to satisfy the debt.

DID YOU KNOW?

Just to pay all federal, state, and local taxes for the year 1996, taxpayers in the average American household had to work from January 1 through May 7.

Partnership

Pros

- Combined assets and expertise
- Flexible decision making
- Partners, not partnership, taxed at the individual level
- Business expenses deductible
- Ease of formation

Cons

- Partnership terminates on death or withdrawal of any partner
- Partners totally liable
- Each partner can enter into other business agreements, so control is difficult
- Each partner is individually liable for agreements made by any partner

A limited partnership has both general partners, who run the daily business and make all the decisions, and limited or silent partners, who generally put up the money in hopes of profit. Limited partners have limited financial liability, meaning that if a creditor or an injured party sues, limited partners can't be held responsible for any more than the amount they originally invested. When it comes to taxes, general partners and limited partners are treated the same way. Any profits from the business go directly to them, that is, they are "passed through" to all the partners, who report their share of the partnership net income on their individual tax returns.

Limited Partnership

Pros	Cons
• Limited partners are not personally liable for the partnership's debts and obligations	• Transfer of interest usually requires general partner approval
• Partnership does not dissolve with death of limited partner	• Complete and separate paperwork filings
• Number of partners/owners unlimited	• Limited partners have little, if any, control over daily operations

RICH DAD'S TIP

"Utilizing the corporation is one of the secrets of the rich: Own nothing, but control everything."

CORPORATION

Most people think of a corporation as a business in a big building with lots of employees. A corporation is really nothing more than a way of doing business. It is a legal entity regarded as separate from the owner, one that offers distinct tax advantages as well as liability protection from creditors and others who might sue. The owner controls the corporation and is a shareholder, possibly the only shareholder. As owner and shareholder, the owner is the boss.

The owner controls what happens in the corporation, but because the corporation is a separate entity, the owner doesn't own any of the corporation's assets and therefore doesn't have to assume any of the corporation's debts. The corporation owns its own assets and pays its own debts. This is one of the secrets of the rich: Own nothing, but control everything. This was Rich Dad's favorite form of entity in which to build businesses.

There are two types of corporations: C and S. The *C corporation*, named for Subchapter C of the federal tax code, is also known as a regular corporation. It offers all the legal protection just mentioned but is taxed as a separate entity. In general, income tax rates for a corporation are lower than rates for individuals. After the C corporation deducts business expenses from its income, tax is paid on the corporation's profits. The owner/shareholder in turn pays tax on any money received from the corporation, usually in the form of a salary or bonus, and the corporation can deduct these payments as expenses on its tax return. However, when a corporation pays a dividend to its shareholders, the dividends are taxable to the shareholders but not deductible by the corporation. This is often called *double taxation,* that is, tax is paid on the income by the corporation when it earns the money, and tax is paid again by the shareholder when the corporation pays a dividend with that same money.

But there's a way around double taxation, and the rich use it all the time. When the C corporation deducts legitimate business expenses and pays out profits in the form of compensation to its shareholders, there may be no taxable income left. In that case, the corporation doesn't have enough income left to pay dividends. Shareholders must report any compensation (deducted on the corporation's return) on their individual tax returns, but they have no dividend income to report. Taxation occurs once, not twice. Note: The shareholders must be performing duties for the compensation they are receiving, and compensation should be reasonable, not excessive.

Another advantage of the C corporation is in the area of fringe benefits. The C corporation usually gets a deduction for fringe benefits, and the employee does not recognize taxable income. Many of the fringe benefits available to the C corporation are not available to, or are restricted in, an S corporation, partnership, or LLC. For example, a C corporation can make contributions towards life, accident, health, or other insurance deductibles and offer tax-free benefits under a medical-expense reimbursement plan.

C Corporation

Pros

- Liability limited in case of lawsuit
- Shareholders risk only their investment
- Corporation can survive the death of owner, officer, or shareholder
- Easy to sell small portions of stock to raise capital
- Tax rate may be lower
- Corporation can elect different year-ends than shareholders—helpful for tax planning
- Corporation can provide certain benefits not available to other entities

Cons

- Double taxation occurs when dividends are paid to shareholders
- Corporations must comply with recordkeeping and other government regulations
- State laws can limit operating flexibility

Also named from a chapter in the tax code, *S corporations* offer the same legal protection as C corporations but don't pay corporate taxes. Instead, shareholders report the company's income and losses on their individual tax returns. The tax may be higher at the individual level than it would have been at the C corporate level, but because the S corporation itself pays no taxes, the income is only taxed once, not twice as it can be with the C corporation.

Let's say your business isn't yet profitable and you're earning money from another source, such as a part-time job. The money from this other source is taxable, but if you have an S corporation, you can reduce the amount of your total tax by deducting your S corporation operating loss from income being earned from other sources. Reducing the amount of taxable income in this way may add up to significant tax savings.

S Corporation

Pros	Cons
• No double taxation • Changing from C to S and from S to C is possible	• Company must be registered as a domestic corporation • Corporation can issue only one class of stock • Limited number of shareholders can own stock • Limitations on who qualifies for shareholder status

LIMITED-LIABILITY COMPANY (LLC)

This relatively new type of business is a cross between a C corporation and a partnership. An LLC gives its shareholders, or members, all the legal protection that a corporation offers, but an LLC may elect how it is to be taxed, whether as a corporation or as a partnership. This is called the "check the box" election. If the LLC elects to be taxed as a partnership, it means that profits earned by the LLC are passed through to the members, who report them on their individual tax returns.

If the legal protection and the tax setup are the same for both an LLC and an S corporation, how is an LLC different? In an S corporation, there are certain laws restricting the number of shareholders and also the type of stock that can be issued. With an LLC, none of that applies. Thus an LLC has more flexibility than an S corporation. But there's a downside. Because LLCs are relatively new, there is no solid history of legal test cases, and laws governing LLCs vary from state to state. Some states have "bulletproof" laws, meaning that if you establish an LLC and follow all the rules, you'll automatically be given favorable tax status. In other states you may follow all the rules but not gain favorable tax status. It's best to check with a legal expert before forming an LLC.

Limited-Liability Company

Pros

- Owners or members have management authority
- Allows an unlimited number of shareholders
- Can elect to have income or loss pass through to members' returns
- Liability protection of a corporation with no responsibility for debts

Cons

- More expensive to open than a partnership
- Rules may vary by state
- Must have consent of members to transfer interest to another person

THE SECRET OF THE RICH

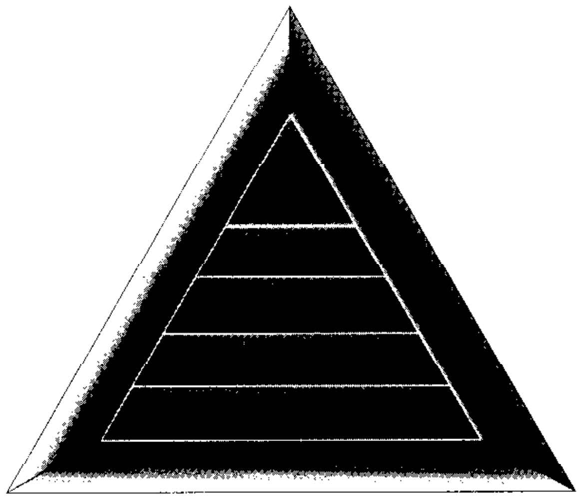
Now that you know something about corporations, you have more insight into the secret of the rich. This secret has been around ever since the days of sailing ships, when the rich created the corporation as a vehicle to limit their risk. The rich would put their money into a corporation to finance a voyage. If the ship was lost the crew lost their lives, but the loss to the rich would be limited to the money they invested for that particular voyage. Corporations can protect assets and serve as vehicles for the creation of new assets. If you understand that basic secret, then you're ready to master the art of building the B-I triangle.

The B-I TRIANGLE

"There are many people with great ideas but few people with great fortunes. The B-I triangle has the power to turn ordinary ideas into great fortunes."

Pillar 4:
The B-I Triangle

Anyone can start a company, yet how many can start a company that survives and thrives? Anyone can purchase real estate, yet how many know how to analyze a property or how to structure the purchase to take advantage of the tax savings available for real estate? The key to business success in either business development or real estate lies in the so-called business-investor triangle, or B-I triangle.



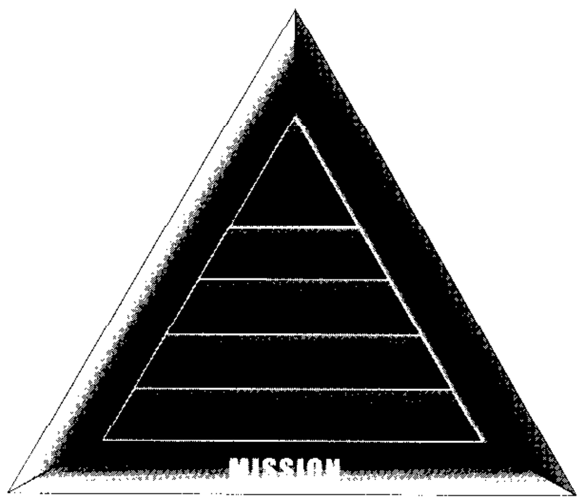
Take away any one side of a triangle, and what do you have? An unstable angle. Take away any one side of the B-I triangle and what do you have? A company doomed to failure. There are three sides to the B-I triangle: mission, teamwork, and leadership. Each side is critical to the stability and long-term success of the business.

THE MISSION

At the base of the triangle is its most important component: the mission. As the world market becomes ever more glutted with products and competition becomes increasingly fierce, the businesses that thrive will be those that use their mission as their beacon.

RICH DAD'S TIP

"Just to make money is not a strong enough mission. The mission of a business should be to fill the customer's need."



What does mission mean? In truth, it is an intangible concept that, in the hands of a devoted entrepreneur, can take on spiritual overtones. The best way to define mission is by example. Henry Ford's mission—one he fulfilled with messianic fervor—was to make the automobile available to the masses. Hence his mission statement, "Democratize the automobile." It was Ford's ability to maintain his focus on this mission that helped fuel his financial success. Or consider the case of Johnson & Johnson. Back in 1890, the brothers Johnson invented a first-aid kit for railroad workers who were getting cut up as they laid tracks across the United States. For over a century the company has remained true to its original mission, and today the name Johnson & Johnson remains synonymous with on-site first aid.

In the case of both Ford and Johnson & Johnson, the mission came first, not the lure of profits. Too many would-be business owners are driven by the desire for profit alone. Unfortunately, money alone won't provide the entrepreneur with sufficient stamina to weather the storms his or her young company will inevitably face. A glaring example is the owner who becomes an instant millionaire by taking the company public through an initial public offering (IPO)—then watches as the company falls apart. The problem with the profit-only mission is that it doesn't take into account customer need. After all, without customers there can be no profits. The mission of a business should be to meet customer need by providing a product or service. If customers are well satisfied, then profits will follow.

A mission that serves customers first, and serves them well, will:

- Keep the entrepreneurial flame alive
- Serve as a beacon in the early years
- Eventually reap profits
- Keep your business focused

RICH DAD'S TIP

"If the mission is clear and strong, the business will weather the trials every business goes through during its first ten years. When a business gets big and it forgets its mission ... the business begins to die."

THE CUSTOMER AS MISSION

The story of Levi Strauss suggests the importance of defining a mission with customers—rather than profits—in mind. During the Gold Rush, Strauss, a 20-year-old Bavarian immigrant, boarded a ship for San Francisco with hopes of selling dry goods to prospectors. Included in his stock was a roll of rough canvas for tents and wagon covers. When Strauss landed on the West Coast he met a prospector.

"You should be selling pants," said the prospector, dubiously eyeing the roll of canvas.

"Why pants?" asked the would-be merchant.

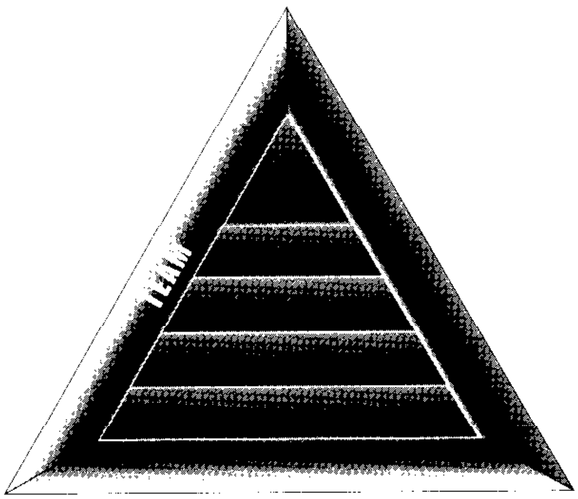
"Because pants aren't worth a damn up in the diggins," came the reply.

So Strauss took the roll of canvas to a tailor and had him sew it into pants for his new acquaintance, giving birth to Levi's. Because of Strauss's primary commitment to customer satisfaction, eventually the profits rolled in and today his casual denim pants are worn the world over.

Your mission may be obvious if you're building a business to provide a specific product or service. If your business is to own real estate, you still have a mission. It may be to build assets for your family, or it may be to provide housing to your tenants. If you stay focused on your mission and pay attention to your customers' or tenants' needs, you'll fulfill your mission.

THE TEAM

The second side of the B-I triangle is the team. In school, students are taught to take tests as individuals, and they bring home individual report cards. But in business people are measured by their ability to perform teamwork. If there is no teamwork—if every person is an island—then the business will fail.



RICH DAD'S REMINDER

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"Business is a team sport."

A team is not a group of people with the same skills. Employees and small-business owners often make less money than they would like because they try to do things on their own. When they grow frustrated with the powers that be, they form a union. A business team, however, is not like a union. It is a collection of specialists—accountants, bankers, attorneys, insurance agents and so forth—with *differing* skills. In a team, the whole is greater than the sum of its parts. With a solid team in place the owner or investor gets the broadest education possible. And that's exactly what an entrepreneur needs, an expansive view of the world, not a single, specialized skill.

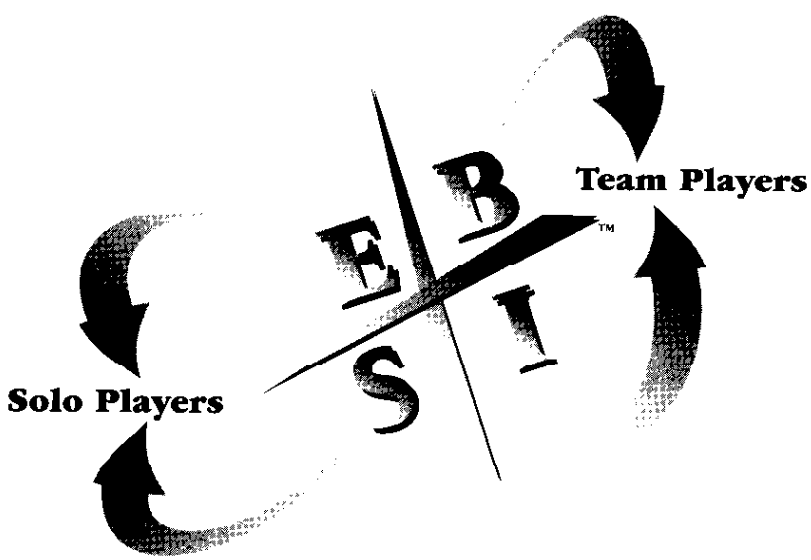
When first starting out, the business owner should dream of having a team of specialists, not a car or a plane. Sam Walton, founder of the phenomenally successful chain Wal-Mart, saw this in the early generation of discount retailers: "Most of these ... guys were very egotistical people who loved to drive big Cadillacs and fly around in their jets and vacation on their yachts." Not surprisingly, most of them

TEAMWORK REAPS PROFITS

In the old days employees were considered "workers." By the 1980s a shift in attitude—and language—had taken place in the halls of corporate America. More and more, successful companies began to treat their people as part of a team. At McDonald's employees became known as "crew members," at the Walt Disney Company, they were now "hosts," and at J. C. Penney, "associates." These companies weren't just paying lip service to the concept of teamwork—they gave it life, and corporate profits responded.

went out of business. Go for the team, not the Cadillac. Depending on your company's cash flow, specialists can be either paid members of the team or part of an unpaid—but committed—advisory board. Ideally, of course, the team works only for your business, not a host of others. With a team in place, you can make informed decisions and avoid the pitfalls into which many a hapless young company falls.

How can you afford a team? Consider the CASHFLOW Quadrant of employee, self-employed or small-business owner, business owner, and investor:



Those in the E and S quadrants tend to be solo players and want to do things on their own. If they do happen to pay for specialist advice, it may be after much hesitation and out of their own sweat and blood. Those in the B and I quadrants, however, do not hesitate to hire professionals because the entire B-I triangle is paying for their services. Those in the B and I quadrants have shed the common notion that building a business is risky. To these team players, it is riskier *not* to build a business. If your business is real estate, your team will include legal and tax advisors as well as a real estate agent or broker and an insurance agent. You may also want a property manager on your team.

Of course, specialists are just one of several groups that make up the larger business team. A successful team-driven business depends on investors, owners, employees, and specialists.

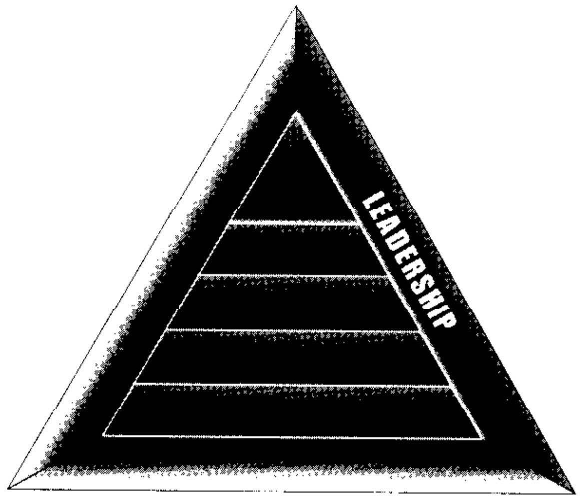
The investors fund the company. The owners work with the employees to make the business grow and bring a return on the original investment. The employees serve as an extension of the owners and represent the business to customers. And all the while, the specialists help the owners keep the business moving in the right direction.

LEADERSHIP

To keep the company focused on the mission, and the company's different personnel working as a team, you need leadership—the third and final side of the B-I triangle.

RICH DAD'S TIP

"A leader's job is to bring out the best in people, not to be the best person."



Though leaders come in all different shapes and sizes, they have certain intangible qualities in common. A true leader is part:

- Visionary
- Cheerleader
- Pit boss
- Listener

As visionary, the leader conceives the mission and keeps all eyes focused on it. As cheerleader, he or she heralds the successes of the team as it strives to fulfill the mission. And as pit boss, this person makes the tough calls regarding issues that distract the team from its mission. The leader is able to take decisive action while focusing and inspiring the troops.

True leaders aren't born, they're made. They have the ability to listen, and by listening, they gain invaluable feedback from the team. Feedback helps them correct what they're doing wrong and hone their leadership skills. It stands to reason that leaders are humble—

they know their advisors have much to teach. And leaders, as any successful military commander knows, trust their team. The person who thinks he or she is the smartest person on the team isn't a true leader; this person has no faith in the others and has never bothered to develop leadership skills. It is the person willing to listen and learn who has the makings of a great leader.

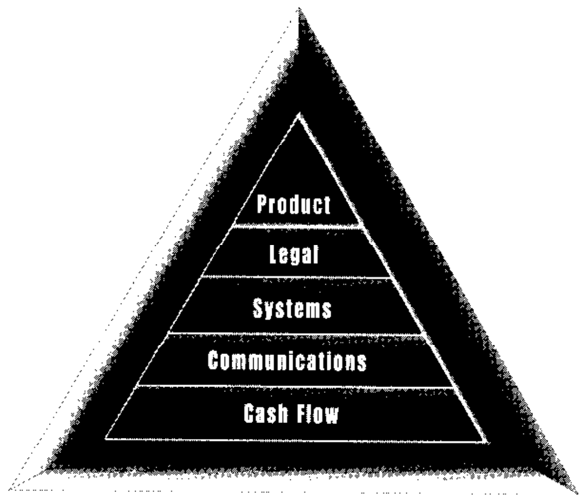
David Ogilvy, prescient founder of the advertising agency Ogilvy & Mather, went to great lengths to avoid holing himself up in an ivory tower. Knowing the importance of remaining visible, he walked the halls and visited his people. "A chairman who never wanders about his agency becomes a hermit, out of touch with his staff." Ogilvy met with success not because he was a born leader endowed with exceptional charisma, but because he strove to listen and learn. Not surprisingly, what motivated him to continue honing his leadership skills wasn't the thirst for profits but a deep-seated commitment to his company's mission of unparalleled client service.

"To force good ideas to bubble up within [your organization], you must listen to what your associates are trying to tell you."

—Sam Walton,
founder of Wal-Mart

INSIDE THE B-I TRIANGLE

With the right mission, team, and leader, you'll establish a stable triangle for your business. But there's more to business than just the framework. Prudent management is the ongoing activity that fulfills the promise of mission, team, and leader. Think of the B-I triangle as having within its framework five management tiers, thus:



CASH FLOW MANAGEMENT

Cash flow management, the bottommost tier, is also the most fundamental to business success. Cash flow management means financial literacy—the ability to read and make sense of financial statements. Many small-business owners go under because they can't tell the difference between profit and cash flow. Profit may be phantom cash flow. Actual cash flow is to a business what blood is to the human body. Nothing affects a company more dramatically than not being able to make payroll one Friday.

COMMUNICATIONS MANAGEMENT

Communications management is the next tier up. Much communication is devoted to activities external to the company, such as raising capital, sales, marketing, customer service, and public relations. Most entrepreneurs spend too little time improving their external communication skills. This can be risky, not least because communication is essential to raising capital, the life of any business. Internal communication is also important—sharing the company's successes with the entire team, staying in touch with advisors, and having regular meetings with employees. Investors, advisors, and employees can get away with speaking the language of their specialized areas, but the entrepreneur—leader of the flagship—must speak the language of all.

RICH DAD'S TIP

"All great leaders are great public speakers."

THE FINE ART OF COMMUNICATION

Almost any successful business has a leader who knows how to communicate with everyone on the team—investors, advisors, and employees. What sort of communication will inspire different team members to unite and fulfill the company's mission? Detailed policy reports tend not to work. What has proven effective is the age-old language of the common person: uplifting anecdotes, homely but inspiring metaphors, and legends about company heroes. Leaders at Frito-Lay are known to tell service stories, leaders at Johnson & Johnson, quality stories, and leaders at 3M, innovation stories. These people speak the language of the common folk, for this is the language that opens ears and hearts. Through stories, the leader motivates the team to fulfill the mission.

SYSTEMS MANAGEMENT

Systems management is the third tier up. A business is a web of interlocking systems. For it to grow, a general director must be in charge of making sure all systems operate with maximum efficiency. The director is like a pilot in the cockpit reading gauges from all the plane's systems; if one gauge indicates a malfunction, emergency procedures must be implemented to prevent the plane from going down. The pilot isn't part of the system—he or she is merely managing it. Most S quadrant businesses are weak because the director *is* the system. In a B-quadrant business, the director supervises multiple systems without becoming a part of any.

Systems managed in a typical B-quadrant business include:

- Product development
- Office operations
- Manufacturing and inventory
- Order processing
- Billing and accounts receivable
- Customer service
- Accounts payable
- Marketing
- Human resources
- General accounting
- General corporate
- Physical space
- Computer systems

LEGAL MANAGEMENT

Legal management, one tier from the top of the triangle, is too often neglected. Legal fees may seem expensive at first, but it is much more expensive to lose the rights to your property or to get embroiled in litigation down the road. The young Armand Hammer well understood this. He and his father bought out a partner in their pharmaceutical manufacturing business and renamed it Allied Drug and Chemical Company. As soon as sales started skyrocketing, the partner resurfaced, claimed that he'd been swindled, and brought a million-dollar suit against the Hammers. So Armand went to the famed commercial trial lawyer Max Steuer. He paid Steuer a thousand dollars simply to write a letter showing the ex-partner that he intended to fight. It worked. The man, scared stiff, backed down—and saved the Hammers many thousands of dollars in potential legal fees later on.

Lots of businesses go under because they fail to protect their intellectual property. Never underestimate the power of patents, trademarks, copyrights and contracts. Bill Gates became the richest man in the world by buying an operating system, protecting his purchase, and selling it to IBM. Aristotle Onassis became a shipping magnate with a simple legal document—a contract from a large manufacturing company guaranteeing him exclusive rights to transport its cargo all over the world. A single legal document can be the seed of a worldwide business.

Here are some areas of the law where attorneys can prevent problems:

- Contracts
- Intellectual property
- General corporate
- Shareholders
- Labor
- Consumers
- Securities and debt

PRODUCT MANAGEMENT

Finally, on the very top tier, rests product management. Product is at the top because it embodies the business's mission, and because success in selling product depends on all the tiers below. The product can be a tangible item like a hamburger or an intangible idea such as consulting services. Whatever it is, in one sense the product should be viewed as the least important part of the business. Take away the rest of the B-I triangle and the product has no value. Most of us can cook a better hamburger than McDonald's, but few of us can build a better business system than McDonald's.

After reviewing each level of the B-I triangle, consider how each also relates to the business of owning and investing in real estate. Whether you own a hotdog stand or a multinational business, whether you own one property or many, all the elements of the B-I triangle must be present and working in harmony for your business endeavor to succeed.

SOLVING THE B-I TRIANGLE RIDDLE

The difference between people in the E and S quadrants and people in the B and I quadrants is that the E and S side tend to be too hands on. They stay busy in their busyness and never build anything. You don't have to become imprisoned in busyness.

Once you master the art of building B-I triangles, you will find that the less you work, the more money you make. The key lies in putting together systems that can function without you. You will also discover that it doesn't take money to make money. If you develop your ideas and build B-I triangles around them, investors will come to you. Once you learn these lessons, you will have solved the B-I triangle riddle.

The ABCs of INVESTING

"Investing is a plan, not a product or procedure."

Most people will tell you they have a financial plan. What they really mean is they have a "retirement package" with a pension fund, life and health insurance policies, mutual funds, and the like. The typical plan is nothing more than a collection of financial products purchased without a clear idea of the total picture.

Investing requires a true plan. Where are you and where do you want to go? Do you just want to be secure? Comfortable? Or rich? Are you set up to retire early, or are you living like a financial yo-yo? These are the sorts of questions you need to answer in order to choose your investments wisely.

▲ **RICH DAD'S MILLION-DOLLAR QUESTION**

Do you want to be: • Secure? • Comfortable? • Or rich?

It's difficult to build a jigsaw puzzle without seeing the cover of the box. Likewise, it's difficult to invest wisely without a fiscal picture in mind. The most successful investors are the ones who can envision a picture—and who build rather than buy the pieces.

How do you build your own jigsaw? First, you choose an image by envisioning your future. Will you retire at age forty-five or remain self-employed until eighty? Live in a mansion on the coast or in a small condo in the city? Spend your twilight years in a long-term care facility or tended to by a private nurse? Do you want to have too little money or too much money? Once the image is clear, you'll have to achieve financial literacy to create it. If you do not know how to make money, what type of income is tax favored or tax penalized, when to sell or when to sit tight, your plan is sure to fall apart. With the proper education and experience, however, you can break your plan down into investment vehicles, such as income-producing property, business franchises, and stock portfolios that will optimize your chances of financial well-being.

No two financial plans are alike, for dreams and comfort levels are different. Some people love camping in the wild, others can't sleep without a roof over their heads. In general, though, people hope to be either secure, comfortable, or rich. The lifestyle you strive for determines what type of investing you'll pursue. If your plan is to be rich, you must also have a plan to be secure and comfortable.

RICH DAD'S TIP

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"Financial intelligence is the ability to convert cash or labor into assets that provide cash flow."

TYPES OF INVESTORS

Investors, like investing plans, are not created equal. Average investors buy packaged securities such as mutual funds, treasury bills, or real-estate-investment trusts. Professional investors are more aggressive—they create investment opportunities or get in on the ground floor of new offerings, build businesses and marketing networks, assemble groups of financiers to fund deals too large for them to undertake alone, and pick the companies with the most promise for initial public offerings of stock. There are five different types of professional investor:

1 The accredited investor
2 The qualified investor
3 The sophisticated investor
4 The inside investor
5 The ultimate investor

The accredited investor. As defined by the Securities and Exchange Commission, this individual investor earns at least $200,000 in annual income ($300,000 for a couple) and/or has a net worth of $1 million. An accredited investor has access to many lucrative investments that, because of their risk may be legally off-limits to people of lesser income. Although usually financially educated, accredited investors are not necessarily fully literate. They may be content with security and comfort rather than wealth, and may rely on advisors to develop and implement their financial plans.

The qualified investor. This investor is well versed in either fundamental or technical investing. Fundamental investing requires the ability to assess a company's potential by reviewing financial statements, tracking the industry the company represents, and calculating how changes in interest rates and the economy as a whole could affect profitability. The fundamental investor uses financial ratios, which you'll learn all about later, to assess the strength of a company he or she is considering as an investment. Technical investing is different—it is based on knowledge of the sales history of a company's stock, the mood of the market in general, and techniques such as short selling and options. Unlike a fundamental investor, a technical investor (often a stock trader) does not necessarily look for well-run, profitable corporations. If people are rushing to invest in a certain type of industry, say dot-com companies, the technical investor may jump on the bandwagon, regardless of whether these companies are showing earnings, let alone profits. Technical investing is thus more speculative than fundamental, but it can yield greater rewards. Regardless of investment style, qualified investors know how to make, or at least preserve, money in an up or down market.

TECHNICAL INVESTING TECHNIQUES

Short selling is borrowing shares from a broker and immediately selling them, prior to an anticipated drop in the stock's price. Should the price in fact go down, the investor can purchase replacement shares at a lower cost and pocket the difference. If the price goes up, however, the investor suffers a loss.

Margin buying is borrowing money from a brokerage firm to buy securities. By law, up to 50 percent of the cost can be leveraged. If the stock's value goes up, the investor enjoys a higher percentage of return on his or her share of the investment. If the value drops, the investor risks losing the cash outlay as well as incurring debt, for the loan must be repaid.

An option is the right to buy (call) or sell (put) a stock at a specified price within a stipulated period. Investors call when they think the price of a security will rise, put when they think it will fall. Options allow investors to make money on the market without actually owning or selling stock.

A stop-loss order instructs a broker to sell a security automatically if it falls to a certain price.

The technical investor is typically an S in the CASHFLOW Quadrant because he or she will usually operate alone in evaluating stocks, either through examining fundamentals or using technical analysis in evaluating potential investments.

The sophisticated investor. The goal of this investor is to build wealth by developing a foundation of assets that can generate high cash returns with minimum payment of taxes. Armed with the three Es—

education, experience, and excess cash—the sophisticated investor takes advantage of tax, corporate, and securities laws to protect capital and maximize earnings. When operating from the B quadrant, the investor can choose the best structure or entity through which to create assets. This entity provides some degree of control over the investment and also serves as a firewall between personal and business finances in the event of a lawsuit.

Sophisticated investors exercise control over the timing of taxes and the character of their income. They know, for example, to defer paying taxes on capital gains from real estate by rolling over profits to more expensive property. They look at economic downturn as an opportunity to pay bargain basement prices for quality securities, and they create deals instead of simply waiting for the right one to come along.

Sophisticated investors take risks but abhor gambling, hate losing but are not afraid to, are financially intelligent yet rely on experts to teach them more, own little in their names yet command great wealth. Although they become partners in real-estate ventures and large shareholders in corporations, they lack one essential strength: management control over their assets.

The inside investor. Building or owning a profitable business is the primary goal of this investor. Whether as an officer of a corporation or owner of a majority of its shares of stock, the inside investor exercises some degree of management control. By running business systems from the inside, he or she learns how to analyze them from the outside and thereby becomes a sophisticated investor as well. Although inside investors have financial intelligence, they do not necessarily have financial resources and thus may not meet the definition of an accredited investor. If inside investors mind their own business and succeed, however, they can become not only accredited investors but ultimate investors as well.

The ultimate investor. The goal of the ultimate investor is to own a business that is so successful that shares are sold to the public. Making an initial public offering (IPO) is expensive and full of risks, yet it allows business owners to cash in on the equity they have built up in the company, while also raising money to pay down debt and fund expansions. The ultimate investor is one who has mastered every rule and enjoys playing the game for its own sake.

GUIDE TO INVESTMENTS

Unless they choose to turn their money over to professional managers, all levels of investors must be financially literate if they're going to preserve their earnings and accumulate assets.They must be able to comprehend a corporate financial statement or stock-offering prospectus. They must know when to hire professionals for expert advice and second opinions. And they must be able to discriminate between good debt and bad debt. Remember, good debt is debt that someone else pays for you. An example is buying an apartment building. You borrow the money from a bank, but your tenants pay the debt service. Bad debt is debt you acquire with hard-earned, after-tax wages, like a credit card loan for a new pleasure boat.

To preserve earnings and accumulate assets, the investor has to be literate in the language of investment. An investment is a financial transaction designed to generate passive or portfolio income. Some investments, like blue-chip mutual funds or treasury bonds, offer modest gains with little or no risk of principal, although a major downturn in the market can severely affect the principal value of blue-chip stocks. Other investments, such as commodities or stock in emerging companies, are speculative, with the potential for enormous gains or total loss of capital. Investments can be assets or liabilities.

One thing investments are not: savings. When you save a dollar, you keep it safe and liquid; when you invest a dollar, you assume a certain degree of risk in expectation that the money will grow. Whether you access savings by cracking open a piggy bank or making a withdrawal at an ATM machine, you have immediate access to cash—but remember, once it's spent, it's gone. Everyone needs a rainy-day reserve. The rule of thumb is to have enough to cover three to six months of living expenses in case of emergency. Keep more than that liquid, however, and your cash could run through your fingers. That's because savings accounts return such low interest that taxes and inflation erode the money's purchasing power.

RICH DAD'S TIP

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"The rich don't work hard for money. They have their money work hard for them."

WAYS TO SAVE

While savings are not an avenue toward wealth, they are a way of earning low interest on liquid assets. *Passbook* or *statement savings accounts* pay low interest and give you immediate access to cash, with no limit on withdrawals. *NOW accounts* are checking accounts that pay interest, provided you maintain a set minimum balance. *Money market deposit accounts* pay slightly more interest than savings or NOW accounts but limit your withdrawals to a few a month. *Certificates of deposit* pay more interest and guarantee preservation of principal, yet funds are obligated for specified terms, and penalties are charged for early withdrawal.

A true investor does not become attached to any one investment option but uses different vehicles to assemble a financial plan. In general, investments come in one of three forms: paper securities, such as stocks and bonds; tangible objects, such as gold and real estate; and business ventures, such as franchises or start-up companies.

PAPER SECURITIES

BONDS

When a government agency or private corporation needs to raise money, it offers or issues a bond. An investment banker determines how much money the agency or corporation needs, what the interest rate on the loan will be, and when the loan will be repaid. A bond pays interest over a fixed period. An investor who buys a bond intending to hold it to maturity need not worry about fluctuations in the interest rate. However, for those who want to sell before maturity, current interest rates are crucial. In the bond market, lower interest rates in the marketplace raise bond prices, and higher rates lower them. Thus as interest rates go up and down, a fixed-rate bond becomes either more or less valuable.

THE BOND MARKET

Unlike stocks, which are traded through organized stock exchanges, bonds are traded in the over-the-counter (OTC) market. The OTC is not a place; it is a market of dealers who do business over the phone or by computer. All U.S. government, municipal, and most corporate bonds are traded over the counter. In addition, U.S. government securities may be purchased by investors directly from the U.S. Treasury through Federal Reserve banks located throughout the country.

Types of bonds. There are many kinds of bonds, including the following:

- ***U.S. treasuries.*** By purchasing a treasury, an investor lends money to the U.S. government for a specified amount of time in exchange for interest payments. Because treasuries have the backing of Uncle Sam, they are among the safest investments available. *Treasury bills,* or T-bills, are issued in thousand-dollar increments and mature within three, six, or twelve months. An investor receives an up-front interest payment called the discount, which runs around 5 percent, lower or higher depending on the economic climate. When the bill matures, the principal can be returned or reinvested for another discount. *Treasury notes* mature in two, five, or ten years, and require a minimum investment of between $1,000 and $5,000. *Treasury bonds* mature in ten to thirty years and require a minimum investment of $1,000. Both notes and bonds pay interest semi-annually.
- ***Savings bonds.*** These U.S. government bonds are issued in denominations ranging from $50 to $10,000. Sold at a discount price, they are redeemed at face value at maturity.
- ***Municipal bonds.*** These are issued by state and local governments. You pay no federal income tax on the interest earned, and no state or local income tax if the bond is issued by the state in which you live. Municipal bonds tend to pay less interest than taxable bonds. While the interest payment may

RICH DAD'S TIP

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"Good debt is debt that someone else pays for you. Bad debt is debt you acquire with your hard-earned money."

remain steady, the price of the bond may rise and fall with changes in the markets.

- ***Corporate bonds.*** These are issued by companies that need to borrow money. The minimum investment in corporate bonds is $1,000. The interest is taxable, so to induce investors, rates are typically higher than for municipal bonds. Here, too, the interest rate may remain steady, but the price of the bond may rise and fall with changes in the markets. Corporate bonds may be riskier than government bonds because businesses can go bankrupt.
- ***High-yield (junk) bonds.*** These are issued by corporations without solid sales and earnings records, or with a dubious credit rating. The chance that the investor will not be repaid is higher with a junk bond because of the issuer's instability. To attract investors, the issuer offers a relatively high interest rate. The price of a junk bond is more likely to fluctuate than that of any other type of bond.

Bond ratings. A bond rating is a method of evaluating the possibility of default by a bond issuer. Bonds are graded periodically by analysts at companies that do evaluations, such as Standard and Poor's Ratings Services and Moody's Investors Service. U.S. government bonds are not rated, because there is very little chance that the U.S. government will default on a bond.

Pros and cons of investing in bonds. Many bonds, especially government bonds, represent a safe, secure investment—the very sort of investment that people on the left side of the CASHFLOW Quadrant seek for their hard-earned dollars. If held for more than twelve months, profits on sales are capital gains and taxed at a maximum of 20 percent. Municipal bonds are exempt from federal taxes, though they may be subject to local and state taxes. U.S. Treasury income is taxed by the federal government but is free from local and state taxes.

With the tax advantages, why wouldn't people on the right side of the quadrant rush to the bond market? For one, changes in the tax law could affect the investor's tax liability.

Furthermore, over time, inflation can cause the fixed-rate interest payment as well as the principal to erode. Then there's the reality of

WHAT THE RATINGS MEAN

S&P	MOODY'S	TRANSLATION
AAA	Aaa	Highest possible rating with lowest degree of risk; high confidence in issuer's capacity to pay interest and principal
AA	Aa	Very high rating, but slightly higher degree of long-term risk
A	A	High-medium-grade rating with high capacity to repay debt; some vulnerability to changing economic conditions
BBB	Baa	Lowest investment-grade rating; adequate ability to pay interest and principal, but lacks protection against changing economic conditions
BB	Ba	Speculative elements; medium security but not much protection
B	B	Speculative; lacks positive attributes of higher-grade bonds; small guarantee that interest and principal will be paid on time
CCC	Caa	Poor quality; in default or close to default
CC	Ca	Highly speculative and in default
C	C	Very poor quality; no interest
D	Not rated	In default; principal and interest unpaid

interest rate fluctuation: When interest rates rise, it makes the fixed interest rate of a bond worth less. And of course not all bonds are as safe as Uncle Sam's U.S. government bonds. With junk bonds and other high-risk securities, there is always the danger that the issuer might default on repayment.

Individuals on the right side of the quadrant often invest in bonds as part of their overall plan for security and comfort. Tax-free bonds can be very attractive vehicles for the rich when they see the market about to change. They often "park" their funds in tax-free bond funds until they see the opportunity to move back into the market (generally when everyone else is exiting).

STOCKS

A stock is a share of ownership in a company. When a private business needs money to operate, develop new products, or expand, its management may decide to issue stock for individual public investors to buy. This could be called a private placement or going public. A company goes public in an *initial public offering* (IPO). How many shares a company issues depends on the amount of capital

RICH DAD'S TIP

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"An investor's most important tool is information. Without good, solid information, stock investing becomes just guesswork."

needed; what shares should sell for, given current market prices; and the cost of paying experts to prepare, or underwrite, the offering. As part of an IPO, a *prospectus* or financial profile of the company is published to promote interest.

Once stock has been sold, the price of each share will rise or fall depending on the performance of the company, supply and demand, general market fluctuations, and broad economic trends. When this happens, the company does not directly gain or lose money, but the trend of a stock's price will affect investor interest in future offerings. If the value rises to $100 or more per share, a stock may split, for example, the number of shares could double while the price of each is halved. This makes the stock more affordable to new investors and allows room for additional growth.

HOW STOCKS ARE TRADED

Trading in the stock market occurs in stock exchanges, where registered brokers publicly buy and sell individual stocks and bonds. Among the exchanges operating in the United States are the American Stock Exchange, the New York Stock Exchange, NASDAQ (National Association of Securities Dealers Automated Quotation System), and various regional exchanges. Except for NASDAQ, which is a telecommunications system, all are actual marketplaces where trading occurs, and all are regulated by the SEC. There are also exchanges in major cities throughout the world, such as London and Tokyo.

Types of stock. All stock can be categorized as common or preferred. Preferred stock is given preference over common stock if a company liquidates its assets. Income to shareholders is based on fixed dividends and redemption dates rather than corporate earnings. Convertible preferred stock gives the owner the option to convert preferred into common stock.

Common stock is the choice of most investors. Owners are entitled to vote on the selection of directors and other important corporate concerns. If a company is forced to liquidate, owners also have a right to a share in the assets after all debts and prior claims have been satisfied. Here are just a few of the categories of stock:

- ***Blue chip.*** Stocks of large companies with established records of profitability and dividend payment. Blue chips tend to be more expensive than other stocks, but their value is also considered more stable.
- ***Small cap.*** Stocks of smaller companies. "Cap" refers to capitalization, which is the price of a share multiplied by the total number of shares on the market. While these stocks may fluctuate significantly in the short term, over the long term small caps as a whole have outperformed every other type of stock.
- ***Growth.*** Stocks of companies with earnings that have risen faster than average. These companies tend to reinvest profits in the business to maintain a competitive edge. Investors hope that, over the long term, prices will rise as the company grows. In the short term, though, price swings can be more dramatic than with stocks that pay dividends.
- ***Income.*** Stocks that pay fairly reliable quarterly dividends. Utilities, such as power companies, are the most commonly held income stocks. Income stocks tend to be relatively stable because of the high level of income they produce, yet a more competitive climate or overall market decline can cause drops in prices.
- ***Speculative.*** Stocks in companies that have no proven track record or dividend history. Often called penny stocks, they sell for $5 or less and come with a high risk.
- ***Foreign.*** The price of foreign stock, which is affected by all the market concerns that drive the prices of domestic stock, is also vulnerable to currency exchange rates, political turmoil, different laws and regulatory oversights, and any number of other issues arising in individual countries.

Pros and cons of investing in stocks. Should you invest in stocks? Unless you possess the skills of a qualified investor and understand either technical or fundamental methods of analysis, you should exercise caution. As a minority outside stockholder you have no control over the management of the company in which you own

RICH DAD'S REMINDER

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"As an outside stockholder, you have no control over the management of the company in which you own stock."

HOW TO ANALYZE STOCKS

The SEC reports, *prospectus* or financial statement of a company provides a window on its health and profitability, so investors should carefully review this document. *Stock indexes* are economic indicators of overall stock market performance. By tracking the price changes of a specific selection of securities, an index provides a benchmark for investors to evaluate the performance of an individual stock. The Dow Jones Industrial Average, for example, tracks the stock prices of thirty companies that it considers to be the bedrock of American business. In addition to the Dow Jones Industrial Average, the most widely used indexes are Standard & Poor's Composite Index (the S&P 500) and the NASDAQ Composite. *Stock brokers* are trained to evaluate the financial history of a company and make an informed "guesstimate" of how an individual stock will perform in any given market. For investors who are uncomfortable selecting stocks themselves, a reputable broker can be a great advisor.

RICH DAD'S TIP

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"It is not possible to predict the market, but it is important that we be prepared for whichever direction it decides to go."

stock. Historically, the market has proven to be a sound vehicle for long-term investment, but highlight long term (the buy-and-hold strategy). When you invest in a stock, your money is tied up in that stock and only provides cash flow if the company pays dividends. On a positive note, stocks may be less likely than savings or bonds to decline in purchasing power, and they can be bought and sold quickly, at prices easily determined. Moreover, for a stock with no dividends, taxes on gains can be deferred until the stock is sold. When gain is recognized on a sale or other disposition of stock held by an individual for over twelve months, it is taxed at the favorable capital gains rate of 20 percent.

For the average investor, knowing which stocks to buy is a fine art, one that few people master. It takes an enormous amount of time and knowledge, to outguess the market. Every time investors buy stock they invite the risk that it will not perform as expected. To top off these disadvantages, brokerage fees for trading shares can be expensive, and accurate records of every transaction must be kept for the IRS.

MUTUAL FUNDS

A mutual fund is a portfolio of securities purchased by a professional manager with the pooled resources of many private investors. Each mutual fund share represents a partial share of every stock or bond in the portfolio. By joining financial forces, investors with limited funds are able to benefit from the knowledge of experts, diversify their holdings, and gain from lower prices and fees that come from buying in quantity. Certain funds are required to buy back shares whenever owners want to sell. As with stocks, the redemption price depends on the value of the securities in the portfolio at any given point in time.

In addition to the cost of mutual fund shares, investors also have to pay fees. Load funds are sold mostly through brokers, who charge a commission when the fund is either bought (front-end load) or sold (back-end load). No-load funds are sold directly to the public at no additional charge. Both load and no-load funds charge management fees of anywhere from 1 to 5 percent, and some include marketing fees. All together, fees can add up to a significant reduction in capital gains.

Types of mutual funds. Two fundamental types of mutual fund are closed end and open end. Closed-end funds issue a fixed number of shares, which trade on exchanges like stocks. The price of

MUTUAL FUND OBJECTIVES

Mutual funds aim to make money in one of two basic ways. When a fund manager sells stocks or bonds for more than the purchase price, a profit, or *capital gain*, is recorded. The money is distributed to shareholders, sometimes as a check but most often as additional shares. Unless the fund is a tax-deferred account, taxes are owed the year the gain is realized.

Some investors, such as retirees, want to receive regular cash payments. Mutual funds designed to generate *income* invest in bonds or companies that pay high dividends, which are shares in corporate profits. Cash distributions from the mutual fund are taxable, unless it is a tax-sheltered account.

RICH DAD'S REMINDER

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"For the average investor, stocks are no easy road to riches."

shares depends not only on the value of the assets held, but also on the demand for the shares themselves. Shares in open-end funds are bought directly from the fund and trade according to customer demand.

Here are some of the most common types of funds:

- ***Balanced funds.*** These are a conglomeration of stocks and bonds, usually in a set proportion. They are suitable for investors who are willing to accept modest growth in exchange for stability.
- ***Equity income funds.*** These invest in the stocks (equities) of well established companies that pay dividends. The safest of the stock funds, they are an alternative to bond funds for those who want steady income.
- ***Income funds.*** These have the same goal as equity income funds, but they rely on more than just stock dividends to attain it. For example, they may deliver interest on bonds and treasuries.
- ***Growth funds.*** These invest in fairly established companies whose stocks offer long-term growth of equity rather than income, for all dividends are reinvested. There can be a fine line between "growth" and "aggressive growth" funds, the latter of which seek maximum capital gains by investing in new but promising companies or down-on-their-luck firms that may rebound.
- ***Index funds.*** Index funds invest in the same securities tracked by stock indexes such as Dow Jones and Standard & Poor's, the logic being that few managers can beat their performance. These funds usually have lower management fees.
- ***International equity funds.*** These invest primarily in foreign securities.
- ***Bond funds.*** These are primarily for generating income and offer little or no long-term growth. They are relatively stable, with price fluctuations based mainly on changes in interest rates, and may include corporate bonds, U.S. government and municipal bonds, and mortgage-backed bonds issued by the Government National Mortgage Association (Ginnie Mae).
- ***Sector funds.*** Also called single-industry funds, these invest in specific market sectors such as health care, energy, or telecommunications. They tend to be riskier than average because there is nothing to buffer them from a downward trend in their particular sector.

RICH DAD'S TIP

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"Investing is a plan, not a product or procedure."

HOW TO ANALYZE MUTUAL FUNDS

First and foremost, a mutual fund should meet an investor's financial goal. If someone is risk-averse or retired and looking for steady income, a fund in the precious metals sector is probably a poor choice, no matter how well it performs. And an investor who wants growth may not want the added risk of investing in foreign companies.

Within any chosen category of fund, investors should compare fund performances over the short and long term, as well as in up and down markets. Volatility rankings measure the variations in a fund's total return over the last five years relative to those of similar funds. The wider the swings, the more volatile—or risky—the fund is considered, on a scale of one to ten (most volatile). Rankings can be obtained from investment periodicals and data collection services such as Standard & Poor's Micropal.

A fund's loads and management and marketing fees should also be carefully assessed in light of both fund performance and investor objective. While the general wisdom is to find a fund with low fees, the intelligent investor must look at the bigger picture. There are load funds that consistently outperform the indexes, and there are funds delivering high returns that more than offset their high management expenses.

A lot of important information about a fund can be found in its prospectus. By law, all mutual funds must provide customers with a document that outlines the fund's objectives, procedures for buying and selling shares, loads and fees, and annual operating expenses. As a rule, bond funds should have total operating costs of no more than 1 percent of assets; stock funds, 1.5 percent. Numerous publications and web sites such as Morningstar's also rate funds on a regular basis.

Pros and cons of investing in mutual funds. Mutual funds are often attractive to people who are so preoccupied with their work on the left side of the CASHFLOW Quadrant that they have no time to oversee their investments. Fund managers have the expertise that people stuck in the E and S quadrants lack, and depending on its degree of diversification, a fund's collective stocks may buffer investors from the sharp losses often incurred by individual stocks. Shares, moreover, are liquid and can be purchased for relatively little money.

But mutual funds are not always ideal investments. Because funds are overseen by managers who have more knowledge and experience than investors, investors can be lulled into complacency and neglect to track the performance of their fund. Like stocks and bonds, funds can experience dramatic drops in value, particularly during a general market decline. In a good market, the very buffers that protect against loss can also limit gains. In a down market, investors can actually find themselves with taxable capital gains even though the value of their holding has dropped dramatically. This occurs when the fund is forced to sell its holdings (with built-in capital gains) to meet the demands of selling shareholders. Furthermore, loads, management fees, and marketing fees can be sizeable.

RETIREMENT PLANS AND ACCOUNTS

Retirement plans are built by regular contributions paid by a company, an employee, or both. The contributions are deposited in a company-sponsored plan or individual account, which accumulates earnings through investments. When the employee reaches retirement age, benefits are paid in regular installments or a lump-sum distribution. All retirement funds offer the advantage of tax-

WHAT IS VESTING?

Vest means to grant possession or control of something. While you are always in control of money that you contribute to a pension fund, your employer's deposit is another matter. You are fully vested, or entitled to all of the company's contributions no matter what, after a maximum of either five or seven years of service, depending on the schedule your employer adopts.

deferred earnings; some even shelter earnings or income. They differ, though, as to the limit of contributions, who can contribute, the age when benefits begin, the number of years it takes to be vested, the fees charged, and portability.

Types of retirement plans and accounts. Traditionally, employers rewarded years of loyal service by providing employees with a guaranteed pension for life. So-called *defined-benefit plans* were fully funded by the company, with the level of benefit determined by the employee's salary and years of service at the time of retirement. Defined-benefit contributions were free money that the employer planted and grew for employees.

Not surprisingly, defined-benefit plans are rapidly disappearing in favor of various types of employee-contribution plans, including the following:

- ***Defined-contribution plans.*** These define the amount of contribution an employee can make to a retirement fund, usually as a percentage of salary. Although the plans are company sponsored, employers do not have to contribute. Benefits depend on how much has been deposited and how well the investments have done. Earnings are not taxed until withdrawn. A 401(k) is an example of a defined-contribution plan.
- ***Individual retirement accounts (IRAs).*** An IRA allows the investor who either has no retirement plan at work or falls below a certain salary level to make annual contributions to a tax-favored account. Money cannot be withdrawn until age 59½, but there are exceptions to the rule. IRA funds can be invested in any number of vehicles, including money-market accounts, certificates of deposit, individual stocks and bonds, mutual funds, and government-issued coins. In addition to traditional IRAs, there are ROTH IRAs (unlike the former, not tax deductible) and for the self-employed, SEP and SIMPLE IRAs.
- ***Keogh plans.*** Keoghs cover small business owners and the self-employed. They are similar to IRAs but allow more pre-tax earnings to be invested in a tax-deferred account.

Pros and cons of retirement plans and accounts. Determining which plans are best for you is a personal decision. Much depends on whether you are an employee, self-employed, or living off passive

RETIREMENT PLANS FOR SMALL BUSINESS OWNERS AND THE SELF-EMPLOYED

SEP-IRA. The self-employed can contribute as much as 15 percent of their net earnings each year, up to an IRS-defined ceiling of $170,000 in income.

SIMPLE IRA. This allows the self-employed up to $6,000 in annual contributions, as well as an "employer" match for themselves of 3 percent of income (not to exceed $6,000). There is no income ceiling or percentage basis as with a SEP.

Defined-benefit Keogh. Older, highly compensated workers can define their own benefit—within a limit set by the IRS—and contribute unlimited amounts of pre-tax earned income to achieve it. But if assets throw off too much income, everything in excess of the limit is taxed at much higher rates.

Defined-contribution Keogh. This limits the amount self-employed workers can contribute, while offering a choice of investment strategies. With a profit-sharing Keogh, 15 percent of net income can be deposited, up to the $170,000 income ceiling, and participation is not mandatory. With money-purchase Keoghs, participation is mandatory. These allow the self-employed to earmark a larger portion of net income—up to 25 percent or $30,000—and to invest that amount annually.

RICH DAD'S REMINDER

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"Retirement plans are savings plans more than investing plans."

income, whether you are just beginning your career or nearing retirement, whether your income is high or low, and whether you want to retire early or work forever.

An employer-sponsored retirement plan is one of the few tax-savings opportunities available to employees. The greatest advantage of retirement plans is this: The more you contribute to yourself, the less you contribute to the government in the form of taxes. Furthermore, if you have an employer who matches your investment, every dollar you contribute automatically earns a 100 percent return. But you have to weigh these advantages against a plan's pre-defined retirement age of 55, 59, or 70, which dictates when you can withdraw your funds.

ANNUITIES

Annuities are contracts that guarantee a steady income in retirement. They are purchased with a lump-sum payment or a series of payments, usually to a life insurance company, which invests the money. Although contributions are not tax deductible, as with IRAs and 401(k)s, annuities allow greater flexibility in establishing the starting date and duration of distributions.

Types of annuities. The investor must decide between annuities with fixed or variable returns, and must choose how and when benefits are paid. Here are the possibilities:

- ***Fixed annuities.*** These earn interest at rates established by the annuity company. The rates are comparable to those for savings accounts or treasuries. Fixed annuities are not good hedges against inflation, let alone vehicles for growth.
- ***Variable annuities.*** These offer a number of different securities to invest in—primarily mutual funds—and thus have earnings in league with stock indexes.
- ***Immediate annuities.*** These begin distributions within a year of a lump-sum payment. For those who have ready cash from an inheritance or the sale of a property, an immediate annuity guarantees income for life without the responsibility of managing investments. Immediate annuities are usually fixed.
- ***Deferred annuities.*** These begin distributions at a future date specified by the owner. They can be either fixed or variable—most are the latter—and offer the same benefits as immediate annuities.

Pros and cons of investing in an annuity. The great attraction of annuities is that they guarantee investors income for life and remove the headaches associated with investment management. Unlike IRAs annuities do not limit contributions, contributions can come from sources other than just wages, and distributions can be delayed at the owner's discretion.

The tax advantages of annuities, however, are minimal. Contributions are not tax deductible, and distributions are taxed. Only the earnings are tax deferred. Furthermore, when the annuitant dies, assets are subject to income and estate taxes. Last but not least, variable-annuity fees are high, as are penalty fees for premature withdrawal.

Should you invest in stocks, mutual funds, and annuities? It depends. If your investment plan is to be secure and/or comfortable, these investment vehicles should be components of your overall plan. But if your investment plan is to be rich, these vehicles should only be used to realize the secure and/or comfortable portion of your plan. If your plan is to be rich, you also need to consider investing in tangible things such as real estate, and you need to consider building businesses.

INVESTING IN REAL ESTATE

With real estate, investors move to the right side of the CASHFLOW Quadrant, positioning themselves to realize gains that people stuck on the left side can only dream of. A real-estate investment is a building or property other than a family home that generates income through rent or resale. The price of the investment and the earnings are driven by supply and demand. Real estate is an investment with "curb appeal." Investors who want to see more than a print-out of their holding can drive by the property or building, vacation in it (with certain limitations), or work from it. Because real estate is tangible, investing in it requires expertise in a number of areas not pertinent to paper securities. Real estate also requires ongoing contributions of time and money. Investors must shop around for the best financing or refinancing terms, buy liability and property insurance, set up entities for tax and management purposes, install security systems and maintain buildings to code, screen and evict tenants, and possibly hire professional personnel to assume management responsibilities.

As with other securities, often the best time to buy real estate is when the seller doesn't want it—in other words, when the market is depressed or a bank is unloading property in foreclosure. Investors can scout deals themselves, but most rely on the services of a top-notch realtor or broker. As a building's income-and-expense statement may not always be accurate, an investor should be able to evaluate it cautiously, using knowledge of the current market to determine if the cash flow is realistic.

FUNDING FOR THE REAL ESTATE VENTURE

Once a property is identified and a price negotiated, funding can be secured through a mortgage broker, a savings and loan association, a bank, or even the seller. When shopping for a loan, an investor must carefully assess various long-term interest rates, up-front interest charges (called *points*), processing fees, and the duration of the loan to determine which mix offers the best deal. In general, lenders require a higher down payment (20 to 25 percent) and charge higher interest rates for investment property than for owner-occupied homes. Sophisticated investors find ways around these drawbacks. They assemble partners and get colleagues to put up the cash, or they find lenders who will accept less down. Sophisticated investors understand good debt. Their tenants pay for the debt service of their real estate assets.

Types of real estate investment. There are three basic ways to invest in real estate: buy a property, buy shares in a real estate investment trust, or invest in a mutual fund focused on the real estate sector.

- ***Property.*** An investor can choose from four different types of property: residential (single- and multi-family homes, condominiums, townhouses, and apartment buildings), industrial (manufacturing plants, storage units, warehouses, industrial parks, and research-and-development parks), commercial (hotels, offices, and retail- or wholesale-sales space), and undeveloped land. When choosing one of these investment vehicles, the investor should be knowledgeable about the local real-estate market, general economic forecasts, and tax realities. For example, raw land might need nothing more than an improvement in grading, but it is also the most speculative investment and cannot be depreciated for tax purposes. A recession can reduce the demand for every type of property except apartments. In general, commercial property is more difficult to manage than residential, for new business tenants may require costly improvements. However, these expenses can be deducted from pre-tax income, so the tax savings may be significant.

- ***Real-estate investment trusts (REITs).*** REITs are business entities that invest in income-producing real estate. For a fee, the trust managers provide a broad range of services from locating and buying properties to contracting with tenants. Shares in REITs, traded on the major stock exchanges, are easy to buy and sell. They can also be purchased through tax-deferred retirement accounts. REITs are good for investors who want headache-free real estate.
- ***Real estate mutual funds.*** These are funds that invest in different REITs, thus providing the investor with real estate diversification.

How to analyze a real estate investment. A sophisticated real estate investor knows how to find diamonds in the rough. The bleak remains of an urban gas station can become a trendy restaurant with the right facelift and zoning variance. For investors who are still learning the tricks of the trade, however, it is best to look not for possible diamonds but for solid real estate investments—those that don't cost too much and that can be easily rented or resold.

MONOPOLY FOR THE REAL ESTATE MAGNATE OF TOMORROW

The formula for winning at real-estate investing is the same as for winning at Monopoly: Buy four green houses, then trade them for a red hotel. Beginning investors should start small while they acquire education and experience. Later, they will have the financial intelligence and assets to trade up to more lucrative investments.

Determining a property's market value is best done by obtaining a professional appraisal or by comparing the asking price with the recent selling prices, called comparables, of similar properties. If the comparables are much higher, the investment is either a great deal or a lemon—a building whose location or condition is a problem. If comps are much lower, the property is either overpriced or has marketing advantages and cachet that place it in a league of its own. Secure investments tend to hover in the middle range of the pricing chart.

A good real estate investment also generates positive cash flow, that is, a good cash-on-cash return. Cash-on-cash return can be expressed as net cash flow divided by cash invested in the property.:

$$\text{cash-on-cash return} = \frac{\text{positive net cash flow}}{\text{total cash requirement}}$$

For example, a $100,000 down payment on a building that generates $20,000 in annual income after mortgage and expenses are paid yields a cash-on-cash return of 20 percent ($20,000 divided by $100,000). In general, the cash-on-cash return should be comparable to the returns of other good investments, preferably 10 percent or more. The lower the return, the riskier the investment. A more detailed explanation of this calculation is covered in Section Three.

Pros and cons of investing in real estate. An informed real estate purchase is a classic investment from the right side of the CASHFLOW Quadrant. For a relatively small amount of money, the real estate investor may well gain substantial returns. If you have $10,000 you can choose to buy $10,000 of stock, or you can choose to use the $10,000 as a down payment for a $100,000 rental property. In the first case you have a $10,000 asset, and in the second you have an asset of $100,000, albeit offset by a $90,000 liability (mortgage). Which one do you think will appreciate faster, $10,000 or $100,000?

RICH DAD'S REMINDER

▲

"Your banker might loan you money to buy a piece of rental real estate, but he won't lend you money to buy stock."

The person who buys rental property is gaining a source of ongoing passive income as well as a hedge against inflation, since rents can be raised. Rental losses, including phantom losses from depreciation, may be deductible as long as certain conditions are met. Earnings from the appreciation of property are tax deferred, and capital gains can be rolled over into a "like kind" investment.

Like any investment, however, a real estate purchase must be carefully considered before it is made. Real estate is not liquid, and there are many built-in risks. These include loss of income from tenant turnover and a low occupancy rate, the costs of property maintenance and management, increases in annual property taxes, heavy losses inflicted by natural disasters, and payment of taxes on capital gains if profit is not rolled over within six months.

Most real estate investors hire professional property managers to minimize their day-to-day involvement with the enterprise. The best plan is to start small and carefully review possible real estate purchases, working with a realtor in the community, looking at many properties, and analyzing each for its cash flow potential. This is the way to gain intimate knowledge of a community. But remember, unless the would-be landlord ultimately takes action, he or she will never gain riches through real estate.

RICH DAD'S REMINDER

▲

"The S-business owner owns a job, the B-business owner owns a system."

INVESTING IN BUSINESSES

Investing in businesses, like investing in real estate, is an activity on the right side of the CASHFLOW Quadrant. Owning or buying a business creates tax advantages that employees do not have, for operating costs can be deducted from pre-tax income, thus lowering the business's taxable income. By contrast, employees have income taxes withheld from their paychecks before they have the opportunity to invest. Businesses can generate positive cash flow, be taken public with an IPO, or sold.

Many small business owners believe they have a B business when what they really have is an S business. What's the difference? The B-business owner owns a system, while the S-business owner owns a job. If an owner can leave a business for a year and come back to a stronger and more profitable operation, he or she is a B-business owner.

The advantages of business ownership do not come easily. B and I quadrant types face great risks and responsibilities. Not only their money and livelihoods but also other people's are usually at stake. And starting or owning a business requires a strong mission, a good team, and leadership. The business owner/investor needs far more than good ideas; he or she also needs sales, accounting, and team-building skills, for the viability of the enterprise depends more on leadership and operating systems than on the product or service being sold. Those who master the art of solving business problems and creating business systems gain an advantage over investors who remain outside the enterprise. In the process of building a money-making business, insiders learn to better analyze the businesses of others—an important skill when it comes time to make additional investment decisions.

Types of businesses. There are several vehicles for owning or operating a business for income and profit. They differ in the amount of investment and sweat equity required.

- ***Franchising.*** When a corporation sells a franchise, it typically grants the buyer the exclusive right to sell its goods or services in a specified area. In exchange for a fee and usually a share of the profits, the company or franchisor provides the buyer or franchisee with its product or service, the use of its name, a business system, and sometimes training as well as advertising and marketing services. McDonald's and KFC are examples of franchises. Franchises are tailor-made for people who don't want to build a business from the ground up or who want hands-on training in all aspects of operating an enterprise before starting their own. The initial investment can be steep—leaders of the pack charge a million dollars or more for rights—but banks more readily fund franchises than small start-up businesses, because the former have proven track records.
- ***Network marketing.*** Also called direct-distribution systems, network marketing companies provide the investor or distributor with proven business systems. As with a franchise, the distributor buys the rights to distribute an existing product line but for a much lower fee, often around $200. Because network marketing relies on techniques such as personal demonstrations, Internet marketing, and sometimes direct mail or telemarketing rather than the usual retail sales outlets, overhead costs are much lower than in the retail trade. This saves the distributor large fees and the headaches of managing a storefront operation. In fact, distributors can work from home, using company software systems to process sales. The best network marketing companies offer not only quality products but also long-term educational programs that hone leadership, salesmanship and communication skills, helping gung-ho investors build a strong enough revenue base to generate passive income.
- ***Buying a business.*** Businesses are always coming on the market. For the investor who is financially literate, buying a pre-existing business that has positive cash flow, sound operating systems, and good name recognition can save

the time and worry associated with starting a business from scratch.

- ***Starting a business.*** For those who have the drive and the start-up capital, or the connections to raise it, developing a business can be the ultimate investing experience. A business can take any number of forms offering different levels of investor/owner control and varying potential for gain. A sole proprietorship, for example, carries the highest risk and is seldom used by the professional investor. More than any other investment, starting a business requires an expert team of advisors.

How to analyze a business investment. To evaluate whether to buy, or buy into, a business, an investor must learn how to calculate the economic indicators below or hire an expert to do so, for they are windows into the financial strength or weakness of a firm. Even the investor who never makes it into the B quadrant can use these indicators to assess companies being considered for a portfolio of paper securities.

- ***Gross margin percentage.*** This indicates the percentage of sales left after deducting the cost of goods sold—in other words, how much income remains to cover fixed costs (overhead) and to return cash to the owner/investor. Companies with low overhead can remain profitable with low gross margin percentages, but in general, the higher the percentage, the better for a company's financial health.

$$\text{gross margin percentage} = \frac{\text{sales} - \text{cost of goods sold}}{\text{sales}}$$

- ***Net operating margin percentage.*** This reflects the net profitability of a business before taxes and interest on debt are deducted. The higher the net operating margin, the stronger the company.

$$\text{net operating margin percentage} = \frac{\text{earnings before interest and taxes}}{\text{sales}}$$

- ***Operating leverage.*** This tells whether a business has enough revenue to pay fixed costs. "Contribution" is the same as gross margin, which is sales minus cost of goods sold. The higher the operating leverage the better.

$$\text{operating leverage} = \frac{\text{contribution}}{\text{fixed costs}}$$

- ***Financial leverage.*** Together with operating leverage, this figure helps determine the total risk a company carries. "Total capital employed" is the amount of interest-bearing debt added to the owner's equity as a shareholder.

$$\text{financial leverage} = \frac{\text{total capital employed (debt + equity)}}{\text{shareholders' equity}}$$

- ***Total leverage.*** This is the company's level of risk and indicates what effect a given change will have on equity owners. If you are the business owner, and therefore on the inside, your company's total leverage is at least partly under your control.

total leverage = operating leverage x financial leverage

- ***Debt-to-equity ratio.*** This measures the portion of the business financed by outsiders and the portion financed by insiders. Most companies maintain a ratio of one-to-one or less.

$$\text{debt-to-equity ratio} = \frac{\text{total liabilities (outsiders)}}{\text{total equity (insiders)}}$$

- ***Quick or current ratios.*** This indicates whether the company has enough liquid assets to pay its liabilities in the coming year. If a ratio is less than one-to-one, the company could be in trouble. Two-to-one is a rule of thumb for a healthy company.

$$\text{quick ratio} = \frac{\text{liquid assets}}{\text{current liabilities}} \qquad \text{current ratio} = \frac{\text{current assets}}{\text{current liabilities}}$$

- ***Return on equity.*** Perhaps the most important ratio, this indicates the return a company is making on a shareholder's investment. Investors should compare the figure to the return on other options, such as stocks, to determine if the business is their best investment vehicle.

$$\text{return on equity} = \frac{\text{net income}}{\text{average shareholder's equity}}$$

As a rule of thumb, the wise investor uses the above ratios to evaluate a minimum of three years of performance for a company. The overall direction of the numbers should be considered in conjunction with industry trends. Even a sound company can be a poor investment if its product or service is becoming outmoded. The more you know from these ratios, about the company, its management, and its products and related industry, the more informed you will be for a potential investment in the related company. As Rich Dad said, "Business is a team sport." Consult your advisors and go over these calculations with them when you are considering an investment. If you try to analyze them on your own, you are still operating from the left side of the Quadrant. Your advisors may know additional information about the company or its industry. The more you know, and the more advice you receive from your advisors, the better prepared you will be for making an investment decision.

INVESTOR SAFETY NETS

Since ideally investors are their own best assets, they should insure not only their holdings but also themselves. Investors should explore the basic ways of protecting themselves and their assets.

Types of insurance. Disability and death have sent more than one business and financial empire crashing down. Here are some types of insurance that could buffer the fall:

- ***Health.*** In this country, medical bills are the leading cause of personal bankruptcy. No one can anticipate a major illness or surgery, yet the wise investor plans for it.
- ***Disability.*** This replaces wages lost when someone becomes too disabled to work. Anyone who relies on earned income to meet expenses should have coverage of at least 60 to 70 percent of monthly pay. Unlike workman's compensation, disability insurance covers a person on and off the job.
- ***Life.*** There are three basic forms of life insurance. *Term* is bought for a set period, from one to thirty years, and renewed periodically. It is the most affordable insurance for those starting out, yet it has no cash value and premiums increase at the end of each term, so it can get costly. *Whole-life* insurance charges a fixed premium for guaranteed lifetime protection and a death benefit. It builds cash value, which the insured can borrow against, and usually pays dividends, which are used to pay premiums or buy extra insurance. *Variable universal life* is part life insurance, part investment vehicle. Policyholders, rather than insurance managers, choose the size and frequency of premiums as well as the mutual funds in which they are invested. With this control the investor assumes some risk: If premiums are too low and investments do poorly, the death benefit may be reduced.

RICH DAD'S REMINDER

▲

"Disability and death have sent more than one business and financial empire crashing down. Insurance buffers the fall."

HOW HEALTHY IS YOUR CARRIER?

The following agencies rate the ability of insurance carriers to pay customer claims. Stay clear of any provider that is not in excellent health.

A.M. Best Company	ambest.com (908) 439-2200
Duff & Phelps Credit Rating Company	dcrco.com (312) 368-3198
Moody's Investor Services	moodys.com (212) 553-0377
Standard & Poor's	standardandpoors.com (212) 438-2000

THE CHOICE IS YOURS

Now that you have learned the various ways to invest, grow, and protect your money, you're ready to begin putting together the pieces of your financial plan. Whether you invest to be secure, comfortable, or rich, you should have a plan. Financial literacy is vitally important in the information age, a time of lightning-quick change, fewer guarantees, and more opportunities. Will you take advantage of the opportunities? The power is in your hands. It's up to you to decide whether you'll be an average, an accredited, a qualified, a sophisticated, an inside, or an ultimate investor—whether you won't have enough money or you'll have too much. To make money, you have to seek opportunity rather than security. Which will it be?

RICH DAD'S TIP

▲

"There are two kinds of money problems, not enough money and too much money. Which one do you want?"

Introduction

In Sections 1 and 2, you began the process of choosing to be rich. You learned to change your way of thinking and expand your mind, opening up a new and exciting path of opportunity. You also learned the basics of financial literacy. Knowledge builds confidence, and now you're armed with a lot more of both. Here in Section 3 you'll be applying what you've learned to build your new life. You'll be doing what the rich do.

What follows is Rich Dad's hands-on, step-by-step program designed to help set you free. You'll begin with a general assessment, filling out your own personal financial statement to determine where you are. After completing this checkup, you'll set new and exciting goals for yourself and tend to your bottom line, getting out of debt and cutting costs. Once you take control of your cash flow, you'll be ready to use your mind and your money to invest in the future. Whatever you decide to do—become a savvy investor, open your own business, or use the businesses you own as the ultimate investment vehicles—by the time you've completed this section, you will have left the rat race behind, or at least be well prepared to take that giant step toward freedom.

As you work through these pages, you may find it helpful to refer back to lessons learned in Sections 1 and 2. Apply information covered earlier to the material here. Take notes in the margins of your binder, highlighting pointers that are especially relevant to your situation. As you did in the last section, go at your own pace. And most important, don't give up. Whenever fear or doubt blocks your path, circle around these obstacles and continue on. You'll find that with every step you take, your confidence grows along with your assets. Remember, the reward is not only the freedom that money buys but also the confidence you gain in yourself—for they are really one and the same.

You've made the choice to seek financial freedom. You've begun the financial education that will help you on your path. Now turn the page, and start creating your own financial plan.

Determine

WHERE YOU ARE

"If people knew how
a financial statement worked,
they would be more
in control of their money."

By now you're probably asking, Where do I begin? Naturally, you're eager to start putting into practice what you learned in Section 2. You may also be a little intimidated. Know this: You're not alone. Anyone who's ever dared dream of financial freedom and then taken the steps to achieve it has felt the same way at first. Don't lose heart. If the rich can do it, then with determination and a sound plan, you can too.

To reach your financial goal, the first thing you must do is figure out where you are. For if you don't know where you are, you can't expect to get where you want to go. Knowing where you are means taking an honest inventory of your financial situation—filling out a financial statement—and taking a good hard look at the results. This may sound difficult, and maybe even a bit scary, but it's a simple process, and if you make up your mind to do it, you'll be amazed at what you can learn about yourself.

PREPARING A FINANCIAL STATEMENT

RICH DAD'S TIP

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"A financial statement is your personal story told in numbers."

Numbers are like words. Put them together and they tell a story. When you fill out your financial statement, the story the numbers tell will be about you—about where you've been, where you are right now, and how to get where you want to go. The exercise that follows is not intended to make you feel guilty for having mishandled your money in the past. It's not about things you can't change. It's about charting a course for your future.

Later in this chapter, you'll gather and organize all your financial records as a prelude to setting new goals and creating a strategy to reach them. At this point, however, you're just filling in enough information to determine the monthly flow of cash into your life and the monthly flow of cash out of your life. (As was mentioned in Section 2 and as you'll soon see, Rich Dad's program of tracking cash flow doesn't necessarily agree with formal accounting principles.) To track your flow, you'll need to record all your income and assets and all your expenses and liabilities using Worksheet #1, the blank financial statement you encountered in Section 2. We've included another copy here, and you'll probably want to make a number of photocopies. This is the tool you'll use to record the details of your financial story. You'll be filling out this sheet gradually, as you go through the process of gathering your records. The sections below will walk you through this process.

INCOME AND ASSETS

You'll recall that income can be earned, passive, or portfolio. You work for earned income. Assets that you own generate passive and portfolio income. In your banker's version of a financial statement, assets also include doodads. In Rich Dad's version, assets don't include doodads.

EARNED INCOME

Earned income is what you earn when you work for your money. It's income you're paid for doing a job as an employee, or income you receive as a self-employed person.

Job income. Job, or employee income, is reported by your employer at the end of each year on a W-2 form.

Start with your paycheck. Determine whether you're paid weekly, biweekly, twice a month, or monthly. Fill in your monthly gross income. *Gross income* is the amount received before any deductions are made for taxes or other purposes. *Net income* is the actual amount of your paycheck after all deductions. For your purposes here, assume a four-week month. Then calculate your monthly income in one of the following ways, and enter the figure on your financial statement next to "Job and Self-Employment" (if you're self-employed, continue reading):

Weekly __________ x 4 = __________

Bi-weekly or twice monthly __________ x 2 = __________

"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

Name ______________________________ Date ____________

INCOME

Earned Income

Job and Self-Employment $ ________

Passive Income

Real Estate (Net) $ ________

Business (Net) $ ________

Passive Income Total $ ________

Portfolio Income

Interest $ ________

Dividends $ ________

Royalties $ ________

Portfolio Income Total $ ________

TOTAL INCOME $ ________
(Earned + Passive + Portfolio)

EXPENSES

Taxes $ ________

Credit Card Payments $ ________

$ ________

Home Mortgage (Rent) $ ________

Car Payments $ ________

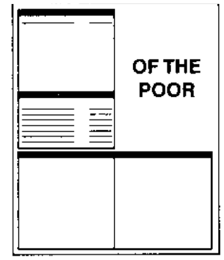
Food and Clothing $ ________

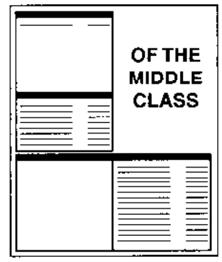
Other Payments $ ________

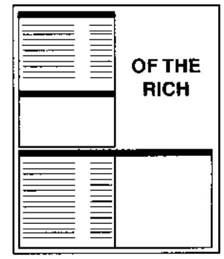
TOTAL EXPENSES $ ________

NET MONTHLY CASH FLOW $ ________
(Total Income less Total Expenses)

Cash Flow Patterns







What story do your numbers tell?

____

____

____

____

____

____

ASSETS

Bank Accounts $ ________

Stocks $ ________

Bonds $ ________

Receivables $ ________

Real Estate $ ________
(Fair Market Value less Mortgage)

Business Value (Net) $ ________

ASSETS SUBTOTAL $ ________

DOODADS

Home $ ________

Car(s) $ ________

Other $ ________

DOODADS TOTAL $ ________

TOTAL ASSETS per Banker $ ________
(Assets Subtotal + Doodads)

TOTAL ASSETS per Rich Dad $ ________
(Assets Subtotal only, do not add Doodads)

LIABILITIES

Credit Cards $ ________

Car Loans $ ________

School and Personal Loans $ ________

Home Mortgage Loan $ ________

Other Debt $ ________

TOTAL LIABILITIES $ ________

NET WORTH per Banker $ ________
(Total Assets per Banker less Total Liabilities)

NET WORTH per Rich Dad $ ________
(Total Assets per Rich Dad less Total Liabilities)

Monthly __________ x 1 = __________

Annually __________ ÷ 12 = __________

Self-employment income. Self-employment income is the income you make working for yourself, whether as a sole proprietor or in a partnership, corporation, or limited-liability company. Remember, this is income you receive only when *you* work—it is not income you receive from your business working for you, which would belong under "Business (Net)" *(see below).*

To calculate your total earned income, look at the receipts for bills you've submitted to customers or clients over the past month. Is this a typical month for your business? If not, it may be better to add up four months' worth of receipts, then divide by four (or better yet, add up a whole year's worth and divide by 12). By giving you an average of your monthly receipts, this will more accurately reflect the income you record on your financial statement. Log in the monthly average next to "Job and Self-Employment" on your financial statement.

PASSIVE INCOME AND ASSETS

Passive income is income you've earned from any asset you own, such as a real estate investment or a business. For your personal financial statement, you need to review each real estate investment property and/or business separately. As laid out below, you'll be calculating all income received from each asset, deducting all expenses related to each, then adding together net income (or net loss) for all real estate assets or all business assets and entering the total in the appropriate section of your financial statement.

Real estate. What you earn from a rental property is real estate income, and you'll see this listed on your financial statement in the Income section as "Real Estate (Net)." Net means the income you have left over once total expenses for the property are deducted. To determine your net income from a single rental property, fill out the information below. If you own more than one rental property, do the exercise for each property you own, and total all the net income figures.

Worksheet: Determining Cash Flow from Real Estate

Cash requirements	
Down payment	$________
Closing costs	$________
Holding cost	$________
Fix-up costs prior to rental	$________
Total cash requirement	$________
Gross income	
Rental income	$________
Other (parking fees, laundry, etc.)	$________
Subtotal	$________
Vacancy and bad debt allowance	- ________
Total gross income	$________
Expenses	
Maintenance	$________
Repairs	$________
Utilities	$________
Landscaping	$________
Management fees	$________
Advertising	$________
Legal and accounting	$________
Insurance	$________
Property taxes	$________
Debt service (mortgage + interest)	$________
Other	$ ________
Total expenses	$________

Gross income	$________
Expenses	– ________
Before-tax cash flow	$________

Enter the before-tax cash flow next to "Real Estate (Net)."

As mentioned above, real estate—that is, the property itself—can also be an asset. When determining the value of your real estate for the Assets section of your financial statement, you'll need to be honest with yourself and enter a fair market value for the property, that is, the amount for which you could sell it today. Fill in the information below for each property you own to ascertain the current value of your asset.

Fair market value of property	$__________
Current balance of mortgage	– __________
Net value of property	$__________

Enter the net value of the property next to "Real Estate" in the Assets section. If you have more than one property, total the separate values and enter that figure.

Business. Business income is the income you receive from businesses in which you own an interest, whether they are partnerships, limited partnerships, corporations, or LLCs. This is *not* the self-employment income you listed under "Earned Income"; this is income you receive from your business working for you. You'll see this as "Business (Net)" in the Income section of your financial statement. Again, net refers to the income you receive once all expenses have been deducted. To calculate your business income, fill out the information below, repeating the formula for each business you own.

Income

Sales		$__________
Other		$__________
	Total income	$_________ A

Expenses

Cost of goods sold		$__________
Administrative costs		$__________
Taxes paid by business		$__________
Other		$__________
	Total expenses	$_________ B

Total income A – total expenses B =
Net business income $__________

Enter net business income next to "Business (Net)" in the Income section. If you have more than one business, add the net income figures and enter the total.

A business can also be an asset. When determining the value of your business (or an investment you've made in a business) for the Assets section of your financial statement, you'll have to ask yourself, in all truth, how much the business could be sold for today. To determine the value of your business asset, fill out the information below, repeating the exercise for each business you own or are invested in.

Current value of business (how much could you sell it for today)?	$ __________
Current balance of mortgage or liability related to business	– __________
Net business value	$ __________

It's possible that your net business value is a negative amount. Record the value, whether positive or negative, next to "Business Value (Net)" in the Assets section.

PORTFOLIO INCOME

Portfolio income consists of interest and dividends derived from investments such as paper securities and royalties from products or services you create. There is a recordkeeping sheet on page XXX [TK]. Use this to make sure you include all your income and accounts here.

Interest and dividends. Interest and dividends are income you earn on investments as reported at year's end on IRS form 1099. To determine your total interest and dividends, look at the statements you've gathered for all accounts, for example, from brokers, mutual funds, companies in which you own stock, and banks. Review your tax returns from the past three years to make sure you've included all accounts, and make sure you add any statements of receivables, that is, money that people owe you. Then for each account, list the monthly income or average monthly income, whether in the form of interest or dividends.

Account or financial source ________________________

Interest (or average monthly interest) $ __________

Account or financial source ________________________

Dividends (or average monthly dividends) $ __________

Add together all monthly interest figures and log in that total next to "Interest" in the Income section of your financial statement. Then total all dividend figures and enter that number right below, next to "Dividends." Later in this chapter, starting on page 18, you'll be gathering together your financial records. In reviewing these, including your 1099s, you'll see references to capital gains income. This income occurs when you sell assets at a gain or a loss, or an underlying security (for example, a mutual fund) sells assets at a gain or loss. Capital gains is *not* recurring income and therefore shouldn't be included on your financial statement.

Now move to the Assets section of your financial statement. List the current (month's end) balance for each bank account you have, for example, checking, savings, and money market funds.

Bank account ________________

Month's end balance $ ________

Add together all the bank account balances. Next to "Bank Accounts," record the total. For each stock or mutual fund you own, list the market value at month's end.

Stock or mutual fund ________________

Month's end market value $ ________

Add together all the stock and mutual fund values, then enter the total next to "Stocks." For each type of bond you own, record the month's end market value.

Bond ________________

Month's end market value $ ________

Add together all bond values, then enter the total next to "Bonds."

Now move down to "Receivables" in the Assets section. A receivable is money owed to you, usually in the form of an IOU or a note receivable. There may be an amortization schedule that identifies the value of the note at any given time. For each receivable, record the most accurate balance of the amount owed to you.

Receivable ________________

Balance of amount owed $__________

Total all your receivable balances, then enter the number next to "Receivables" in the Asset section.

Royalties. The IRS classifies royalties as portfolio income. Royalties are any income earned from intellectual property you've created or you own. The income is usually generated from the sale or license of patents, copyrights, tapes, books, CDs, or oil and gas properties. For each type of royalty-producing property you own, fill out the following:

Royalty-producing property ________________

Average monthly royalty $ ________

Record the royalty amount, or the total of all royalties, in the Income section next to "Royalties."

Having filled out your entire Income section, you can enter your total income on the appropriate line there. You've also filled out the first half of your Assets section. Subtotal your assets and enter the number on the appropriate line.

DOODADS

This brings you to "Doodads," in the Assets section of your financial statement. As you well know by now, doodads are things you once probably thought of as assets. According to Rich Dad, because doodads take money from your pocket they aren't true assets. Below, record the current value of each doodad you own, that is, the value if you were able to sell it today.

Home	$__________
Personal car(s)	$__________
Jewelry	$__________
Furniture	$__________
Sports equipment	$__________
Other personal belongings	$__________

TAKE NOTE

A banker's idea of your total assets includes doodads; Rich Dad's version excludes them.

DO

WHAT THE RICH DO

Enter the value of your home and of your car on the appropriate lines in the Assets section. Add together the values of all other doodads and enter the total next to "Other" in the same section. Now you can total all your doodads. (Later, you'll record the mortgage or debt related to each doodad in the Liabilities section.)

Now that you have your assets subtotal and your doodads total, you can figure out your total assets. Note that there are separate versions for total assets, a banker version and a Rich Dad version. This is a reflection of the different approach bankers and Rich Dad take toward doodads. To calculate the banker version of total assets, add your assets subtotal and your doodads total and enter the figure on the appropriate line. To calculate Rich Dad's version, enter only your assets subtotal next to "Total Assets per Rich Dad."

RICH DAD'S REMINDER

▲

"For each liability you have, such as a car loan or a mortgage, you're an employee of the institution or person lending you the money."

EXPENSES AND LIABILITIES

You'll recall that expenses are not the same as liabilities. The typical monthly amount you pay on a liability is your expense related to that liability. Expenses include monthly payments you make for things such as utilities and food. (Keep in mind that the term expense, for our purposes, includes principal payment along with interest.) Hence you'll be filling out separate Expenses and Liabilities sections.

Review several months' worth of all your bills, including bills for credit cards and for doodads like your car and home. If you're employed, review the deductions on your paycheck; if you're self-employed, estimate how much you pay for such things as taxes and insurance. Whatever your situation, select the month that represents your typical expenses. Basically what you'll be doing, as you read on, is recording each monthly expense in the Expenses section of your financial sheet, and recording the related balance due in the Liabilities section.

TAXES (AND OTHER PAYCHECK DEDUCTIONS)

Look at your paycheck. Below, enter the amount you're paying monthly for any items that relate to your situation (again, if you're self-employed you'll have to estimate the amount of taxes you pay monthly):

Federal income taxes $ _________

State income taxes $ _________

Social Security taxes (FICA) $ _________

Unemployment taxes (FUTA and state unemployment taxes) $ _________

Medicare deductions $ _________

Medical insurance $ _________

Life insurance $ _________

Childcare $ _________

Other deductions (list by type) $ _________

Now, add all your monthly taxes and enter the total next to "Taxes" in the Expenses section of your financial statement. Since employees have their taxes withheld before they get paid, there should be no additional balance due, or liability, on their wage income. However, if you are self-employed and make quarterly estimated-income tax payments to the IRS and your state, make sure you include balances due next to "Other Debt" in the Liabilities section of your statement.

RICH DAD'S TIP

▲

"The reason so many people struggle financially is because every time they make more money, they increase their taxes and their debt."

CREDIT CARDS

For each credit card, fill in the amount you typically pay each month:

Credit card __________

Average monthly payment $ ________

Enter the monthly payment, or the total of all monthly payments, next to "Credit Card Payments" in the Expenses section of your statement.

Then below, fill in the total remaining balance due at month's end for each credit card (if you pay off your credit card balance each month, this amount will be zero):

Credit card ___________

Month's end balance due $ ___________

Record this balance, or the total of all balances, next to "Credit Cards" in the Liability section of your statement.

HOME MORTGAGE

List the monthly payment for each mortgage you hold, and for each equity line of credit or other home loan. List your monthly rent or other fees if you don't own your dwelling. For each mortgage, include the total amount of payment, including amounts for insurance, real estate taxes, and other fees, even if these are paid separately.

Home mortgage monthly payment $ _________

Equity line of credit monthly payment $ _________

Other home loan monthly payment $ _________

Add these numbers together and enter the total next to "Home Mortgage" in the Expenses section of your financial statement. Then list the balance you owe on each:

Home mortgage balance $ _________

Equity line of credit balance $ _________

Other home loan balance $ _________

Total the balances and enter the figure next to "Home Mortgage Loan" in the Liabilities section.

CARS

For each car you own, fill in your monthly payment:

Car monthly payment $ _________

Enter the figure, or the total of all figures, next to "Car Payments" in the Expenses section of your financial statement. Now record the balance remaining for each car you own:

Car loan balance $ _________

Enter the figure, or the total of all figures, next to "Car Loans" in the Liabilities section.

OTHER PAYMENTS, SCHOOL AND PERSONAL LOANS

Calculate the amount you spend on a monthly basis for food and clothing, and enter the total on your financial statement. Fill in the monthly payment for each school or personal loan you're paying off:

School or personal loan monthly payment $ _________

Take this figure, or the total of all school and personal loan payment figures, and add it to any other average monthly expenses you have remaining (that is, anything other than taxes, credit cards, home loans, and car payments, which you've already noted down). Remaining monthly expenses might include, for example, utility payments or travel and entertainment. Review your checkbook carefully for any regular payments you may have missed. Include any other deductions from your paycheck that would be considered expenses, such as insurance or childcare. Review your tax returns to make sure you've included expenses for items you may have deducted in earlier years but overlooked now.

Other payments $ _________

Enter the new total next to "Other Payments" in the Expenses section. Now you can add up all your expenses in the Expenses section and enter the figure next to "Total Expenses."

Next list the balance remaining for each school or personal loan for which you've included a monthly payment:

School or personal loan balance $ _________

Enter this figure, or the total of all such loan balances, next to "School and Personal Loans" in the Liabilities section.

OTHER DEBT

Now that you've completed your Expenses section, turn your attention to the remainder of the Liabilities section. For any additional debt you have over and above what you've already included, record the total balance due as a liability. For instance, perhaps you owe money to your parents but aren't currently making payments. The total balance you owe them should be listed as a liability even though you aren't making payments and therefore have no related expense for that liability.

Below, fill in the balance due on each of your additional debts:

Additional debt balance $ __________

Enter this figure, or the total of all additional-debt balances, next to "Other Debt" in the Liabilities section of your statement.

Now add up all the liabilities listed in this section and enter the figure next to "Total Liabilities."

NET WORTH

Remember, Rich Dad wouldn't consider your home, car, furniture, clothes, collectibles, or other personal property to be financial assets unless they put money in your pocket. If they take money out, they're doodads. That's why you'll see two versions of net worth in the Liabilities section of your financial statement: the banker version, which includes doodads, and the Rich Dad version, which excludes them.

Follow either one of the two equations below, depending on which version you want. Remember, the Rich Dad total is the more truthful reflection of where you are financially; it is how a sophisticated investor would view your financial statement:

Total assets (per banker, with doodads) – total liabilities = net worth (per banker)

Total assets (per Rich Dad, without doodads) – total liabilities = net worth (per Rich Dad)

WHERE ARE YOU?

Whew! You've come a long way. How many people can say they've created an honest, thorough financial portrait of themselves? You deserve a round of applause.

A quick glance at the totals in each section of your financial statement—total income, total expenses, total assets, and total liabilities—will give you a general idea of where you are financially. As you look at these totals, make sure you also review the cash flow patterns in the upper-right-hand side of the statement. Generally speaking, if the money you have coming in as income goes right out as expenses, you've got the cash flow pattern of the poor. If your income is used to pay expenses and liabilities, then the cash flow pattern of the middle class best describes you. You're bringing in money through earned income, which pays expenses and buys more liabilities, which you mistake for assets. In either case, poor or middle class, you need to read on and get your financial house in order.

TAKE NOTE

Most people don't prepare personal financial statements—they just try to balance their checkbooks. So congratulate yourself. You are now ahead of most of your peers.

RICH DAD'S TIP

▲

"Financial intelligence isn't measured by how much money you make, but how much money you keep, and how hard that money works for you."

What if you have more income and assets than expenses and liabilities? Then your Rich Dad net worth is impressive. You're building assets that create passive income, which in turn pays expenses. You're enjoying the cash flow pattern of the rich. Don't let that stop you from reading on—there is probably even more you can do to make your assets grow. Unless you're an ultimate investor, the Rich Dad program can still be of benefit to you.

Where to now? In the next chapter you're going to analyze your financial statement and set new long-term financial goals for yourself. Before we get to that point, however, let's take a detour. The subject that follows may not seem exciting, but it will help you keep essential information at your fingertips as you prepare to transform your life.

RECORDKEEPING: A NECESSARY EVIL

The value of keeping good financial records is that they'll help you track your cash flow, and you'll know exactly where to find what you need as you make future financial decisions, whether it's choosing investments, preparing taxes, or building your own business. Organizing your records may seem like a lot of boring work, but remember, it's going to help you reach your destination. A little time spent now can save you a lot of time and headaches later!

RICH DAD'S TIP

▲

"Know where your money goes."

Once you develop the habit of keeping records, you'll see that tracking personal expenses is pretty simple and one of the smartest things you can do. By capturing your expenses while they're still fresh in your mind, you'll be assured of claiming all legitimate tax deductions, no matter how small. These deductions can add up over the course of years and save you real money at tax time. Keeping track as you go will also save you an enormous amount of time and trouble when you're getting ready to prepare your tax return. And if you're ever audited by the IRS or your state government, accurate records are what you'll rely on most to back you up. Most important, your records will tell you if your assets are creating income for you, and how much.

One of the tricks of recordkeeping is knowing what to hold on to and what to throw away. Not every pay stub, bank statement, or invoice is going to reveal your financial circumstances or show you the direction in which you're headed. To get your true financial bearings, you'll have to collect and examine the right records. It doesn't do you much good to study a street map of Detroit if you happen to be lost in Pittsburgh.

There are four broad categories of records you should keep: income, expenses, tax records, and miscellaneous. Perhaps you're already saving many of these records now, but you haven't taken the time to organize them properly.

RECORDKEEPING

Name ______________________________ Date ______________

PERSONAL INFORMATION

Name: ______________________________

Address: ______________________________

____

Date, place of birth: ______________________________

Social Security number: ______________________________

Spouse's name: ______________________________

Date, place of birth: ______________________________

Social Security number: ______________________________

Child's name:			
Date, place of birth:			
Social Security number:			

Child's name:			
Date, place of birth:			
Social Security number:			

DEBTS (AUTO, EDUCATION, PERSONAL, CREDIT CARD, MORTGAGE, OTHER)

Credit card issuer:			
Address:			
Phone number:			
Account number:			
Interest rate:			
Normal payment:			
Required minimum monthly payment:			
Total balance due (with date prepared):			

Mortgage company:			
Address:			
Phone number:			
Account number:			
Interest rate:			
Monthly payment:			
Total balance due (with date prepared):			

Other loan institution:			
Address:			
Phone number:			
Account number:			
Interest rate:			
Monthly payment:			
Total balance due (with date prepared):			

BANK ACCOUNTS (CHECKING, SAVINGS, CDs, CREDIT UNION, OTHER)

Bank name:			
Type of account:			
Account number:			
Address:			
Phone number:			
Contact:			
Interest Rate:			
Average monthly income:			
Total balance (with date prepared):			
Credit union name:			
Type of account:			
Account number:			
Address:			
Phone number:			
Contact:			
Interest rate:			
Average monthly income:			
Total balance (with date prepared):			

BROKERAGE ACCOUNTS (STOCKS, BONDS, MUTUAL FUNDS)

Broker's name:			
Company name:			
Address:			
Phone number:			
Account number:			
Number of shares:			

Date purchased:			
Purchase price:			
Average monthly income:			
Interest or dividend income:			

INVESTMENTS HELD DIRECTLY BY YOU

Stock (company name):			
Address:			
Phone number:			
Number of shares:			
Date purchased:			
Purchase price:			
Average monthly income:			
Interest or dividend income:			

Mutual fund (fund name):			
Address:			
Phone number:			
Account number:			
Number of shares:			
Date purchased:			
Purchase price:			
Average monthly income:			
Interest or dividend income:			

Bond (issuer):			
Type of bond:			
Purchase price:			
Number of bonds:			
Date purchased:			
Maturity date:			
Average monthly income:			
Taxable or tax-free:			

REAL ESTATE INVESTMENTS

Property location:			
Date purchased:			
Purchase price:			
Real estate company:			
Agent:			

Address:			
Phone number:			
Average monthly rental income:			
Related mortgage balance:			
Mortgage company:			
Average monthly mortgage payment:			
Average monthly expenses other than mortgage:			

RETIREMENT PLANS

401(k), 403(b), or 457 plan (company name):			
Address:			
Phone number:			
Type of plan:			
Account number:			
Contact:			
Current balance:			
Average monthly increase (contribution) or income:			

Individual retirement account (company name):			
Address:			
Phone number:			
Account number:			
Contact:			
Current balance:			
Average monthly increase (contribution) or income:			

Roth IRA (company name):			
Address:			
Phone number:			
Account number:			
Contact:			
Current balance:			
Average monthly increase (contribution) or income:			

Keogh plan (company name):			
Type of Keogh plan:			
Address:			
Phone number:			
Account number:			
Contact:			
Current balance:			
Average monthly increase (contribution) or income:			

Pension plan (company name):			
Address:			
Phone number:			
Type of pension plan:			
Account number:			
Contact:			
Current balance:			
Average monthly increase (contribution) or income:			

INSURANCE PLANS

Whole-life insurance (company name):			
Address:			
Phone number:			
Account number:			
Agent:			
Value of insurance:			
Monthly payment:			
Current cash surrender value:			

Term-life insurance (company name):			
Address:			
Phone number:			
Account number:			
Agent:			
Value of insurance:			
Monthly payment:			

Auto insurance (company name):			
Address:			
Phone number:			
Policy number:			
Agent:			
Average monthly payment:			
Homeowner's or renter's insurance (company name):			
Address:			
Phone number:			
Policy number:			
Agent:			
Average monthly payment:			
Health insurance (company name):			
Address:			
Phone number:			
Plan/group number:			
Member number:			
Agent:			
Average monthly payment:			
Personal accident and dismemberment insurance (company name):			
Address:			
Phone number:			
Policy number:			
Agent:			
Value of insurance:			
Average monthly payment:			

INCOME RECORDS

If you're an employee, you should save your pay stubs and annual income statements for four to five years or for as long as your tax returns are still open for audit by the IRS. (Returns are normally considered open for three years after you file them.) If you're self-employed or you own your own business, hold on to any income-related documents for the same period of time. You should save your monthly bank statements as proof of deposits you made and to track any interest you earn.

If you own stocks, bonds, or mutual funds, retain any statements you receive from your broker for as long as you own the asset and for at least four years after the year you dispose of the related asset. These include monthly statements and confirmation slips verifying your orders to buy or sell securities. Record the name of each stock and mutual fund you own, along with the numbers of shares purchased, the date and price of purchase, and the date and price if you sell. For mutual funds, you may have to report income (capital gains) each year and be taxed on it. You'll want to keep a record on this income so you won't be taxed on it again when you sell your interest in the fund. For bonds, write down the name of the issuing institution, the number of bonds you own, the date and purchase price, and the date at which they mature. These statements will help you calculate the value of your investments at any given time.

Keep your Social Security card and any financial statements the Social Security Administration sends you, such as earnings and benefit-estimate statements.

Save annual statements from any retirement plans you participate in, such as 401(k) or 403(b) plans, IRAs, and pension plans. If you participate in a profit-sharing plan or a stock purchase plan offered by your employer, save those records, too.

FEAR: I'm afraid to see where all my money goes.

FACT: If you save your records, you'll be better able to fill out your financial statement. This will give you an accurate picture of your expenses—the first step toward reining them in. And you may find that some of your expenses are deductible for tax purposes.

FREEDOM: Knowledge is power. Knowledge reduces fear.

EXPENSE RECORDS

Save your credit card statements and your canceled checks; these will help you track your monthly expenses. If your bank doesn't return your canceled checks, use your monthly bank statement and your checkbook register instead. Also try to keep a written record of and receipts for any cash you spend. You'll want to include the amounts in your financial statement.

Be sure to save your mortgage statements. These are usually issued at the end of the year in time for you to prepare your income tax return. They show your monthly payment, break out the principal and interest, and report the amount being held in an escrow account to cover local property taxes and insurance. Also make sure you save any statements that report the status of other loans, such as car or school loans. Once all your loan statements are combined, you'll get an accurate picture of exactly how much money you owe.

TAX RECORDS

Hold on to your tax returns, with all the supporting paperwork, for at least three years after the year you file them, longer if you want to use them to help you track your financial growth. Save your tax return for any year in which you calculated a deferral of gain or established a value for an asset. For instance, when you sell a home and buy another one, you may be allowed to defer the gain from the sale of the first home, but to do that you need to keep records that track the value you're currently using. Also save receipts from any home improvements you make. You'll need these to help defer some of your tax burden if you sell your home for a profit. Save canceled checks for state and local income tax and for any property tax you pay. These taxes are deductible on your return.

You can deduct from your income tax a percentage of any contributions made to a qualified charity, so keep records and receipts for these. Include receipts for clothing or any other property you donate. You may need to get a valuation or appraisal for certain property you donate. If you volunteer for a qualified charitable organization, keep a record of the miles you drive when volunteering and again, hold on to these records for three years after you file.

If your medical expenses exceed 7.5 percent of your adjusted gross income, they'll be a tax deduction for you, so hold on to any medical records such as doctor's bills, receipts for prescription drugs, and insurance premiums.

Other potential tax deductions include expenses related to your job as an employee for which you were not reimbursed—what the IRS terms "miscellaneous deductions." These include:

- Work-related subscriptions to journals or magazines
- Mileage for business trips in your car
- Expenses incurred if you've attended conferences or meetings
- Financial planning and tax preparation fees
- The rental of a safe deposit box

TAKE NOTE

Don't waste time or space—know what to keep and what to throw out.

MISCELLANEOUS DOCUMENTS

Personal documents such as birth certificates, marriage certificates, divorce decrees, passports, and military enlistment and discharge papers should be saved forever. Keep a copy of current insurance policies including auto, health, home, and life. You or your attorney should keep the original copies of any legal documents, such as your will, power of attorney, living will, or trusts.

TOSS 'EM

It's not necessary to save *everything.* In fact, being a packrat will make it that much harder to manage the documents you really must save. Do a financial housecleaning by tossing:

- Bills from utility companies older than one year, provided they're paid in full
- Credit card statements for closed tax years, though you should save any statement that contains a charge you're contesting
- Pay stubs and other income-related documents for closed tax years
- Canceled checks for closed tax years
- Bank statements for closed tax years
- Outdated wills
- Documents regarding cars or other vehicles you no longer own
- Expired insurance policies
- Expired warranties
- Outdated annual reports and proxy statements

Create a list of any valuable property you own, such as jewelry or silverware, and keep receipts or appraisals with the list. Either photograph or videotape this personal property. Such documentation will help prove your ownership to an insurance agent if anything is stolen or destroyed.

ORGANIZING IT ALL

Now that you've reduced the clutter, you need a system to organize remaining records. After all, records kept but not found are useless.

There are many ways to get organized. Do it your way. A computer outfitted with the latest financial-planning program won't do you any good if you'd prefer making entries in a wide-ruled tablet with a pencil. If your system is user friendly, you'll use it.

Consider creating a file for each type of financial record. You can group related records in one file—for instance, all receipts for home improvements. No matter how your system's arranged, it's usually best to slip receipts and updated statements into a file as soon as you receive them.

The Personal Expenses Worksheet that follows is a recordkeeping tool that will help jump-start your effort to get organized. Don't be afraid to modify it to suit your needs. You might also check IRS form 1040, schedule A, which suggests ways to group and categorize records.

TAKE NOTE

Adopt whatever system of organization suits you. If it's user friendly, you'll use it.

IF YOU USE A COMPUTER. . .

Setting up a computer recordkeeping system can take some time, but once your system is established, it can make crunching the numbers and creating financial reports significantly easier and faster than doing the same by hand.

Can you design your own computer recordkeeping system? Yes, if you're a programming wizard. The simpler way is to purchase a financial management program, of which there are many on the market, and install it on your computer. The programs currently on the market will guide you step by step through the process of recording your financial data.

Once you learn to use it, a good financial management software package gives you easy access to your records and allows flexible management of your accounts. Here is just some of what you can expect from a good software program:

- Balances your checkbook
- Reminds you when bills are due and pays them
- Reconciles your accounts
- Analyzes your cash flow
- Creates financial reports and even generates graphs
- Estimates future income taxes and helps you prepare your returns
- May allow you to pay your bills on-line and automatically update your financial records

Congratulations! Now that you have all the records you need and you can access them easily, your financial housekeeping chores will be a lot easier. You've laid the groundwork for the more exciting work to come.

PERSONAL EXPENSES

Name ____________________ Date ____________

AUTO & TRUCK

Loan payments	
Auto lease	
Auto insurance	
Gasoline/Oil/Tires	
Repairs	
Security systems	
Registration	
Other	
Total	

CHARITIES

Church	
Other	
Total	

CHILDREN

Clothing	
Childcare	
Education tuition & supplies	
Education savings	
Wedding	
Private school	
Sports	
Child support	
Toys	
Religious training	
Other	
Total	

CLOTHING

Purchases	
Cleaning	
Alterations/Repairs	
Other	
Total	

EDUCATION

Tuition	
School Loans	
Dues/Subscriptions	
Books/Tapes	
Seminars	

EDUCATION cont.

Travel for seminars	
Other	
Total	

ENTERTAINMENT

Event tickets	
Wine/Liquor	
Videos purchase/rental	
Music	
Computer games	
Other games	
Vacations	
Travel	
RV	
Other	
Total	

EQUIPMENT & FURNISHINGS

Computer	
Computer software	
Home office	
Furniture	
Art/Sculpture	
Home entertainment center	
Other	
Total	

FOOD

Purchased food	
Meals out	
Other	
Total	

GIFTS

Wedding/Anniversaries	
Birthdays	
Holidays	
Other	
Total	

Boat ________
Vacation home ________
Pets/Pet food/Vet bills ________
Hobby supplies/Classes ________
Collectibles ________
Other ________
Total ________

HOUSING

Rent ________
Mortgage ________
Property tax ________
Insurance ________
Mortgage insurance ________
Assessments ________
Home security ________
Homeowners dues ________
Janitorial Supplies ________
Repairs/Improvements ________
Snow removal ________
Pool service ________
Lawn service ________
Garden tools ________
Other ________
Total ________

LEGAL AND ACCOUNTING

Accounting/Bookkeeping ________
Tax planning ________
Document preparation ________
Wills & trusts ________
Other ________
Total ________

MISCELLANEOUS

Interest ________
Alimony ________
Bank fees ________
Other ________
Total ________

PERSONAL CARE

Hair/Nail care ________
Personal items ________
Other ________
Total ________

Health supplements ________
Vitamins ________
Exercise equipment ________
Health club membership ________
Massage ________
Therapy ________
Medical insurance ________
Dental work ________
Eyeglasses/Vision exams ________
Medical co-payments ________
Hearing aids ________
Prescriptions ________
Other ________
Total ________

SUPPLIES

Home supplies ________
Linen ________
Cleaning ________
Laundry ________
Lawn & garden ________
Postage ________
Office supplies ________
Other ________
Total ________

TAXES

Federal ________
State ________
Payroll ________
Other ________
Total ________

UTILITIES

Electric/Gas/Sewer/
Water/Garbage ________
Cable TV ________
Basic telephone ________
Pager ________
Cellular phone ________
Long distance service ________
Internet provider/services ________
Other ________
Total ________

Set Your NEW GOALS

"It isn't how much money you make that counts, it's how much money you keep."

In this step you'll be analyzing the results of your financial statement. This will give you a clearer idea of exactly where you stand in Rich Dad's cash flow patterns of the poor, middle class or rich and provide a starting point for setting your new goals. But before you do that, you'll meet certain fictional people and find out all about their financial situations. Reading these stories and the financial analyses that accompany them will help you see how people in different quadrants have set different goals for themselves and found different avenues toward those goals, with varying degrees of success. Once you finish reading, you'll have a better idea how to get yourself from the quadrant you're in now to the quadrant(s) you want to be in.

Please note that in the Rich Dad program, wealth is measured in time, not money. (You should have your money working for you so you don't have to spend all your time working for money.)

CINDY'S STORY

Let's start the fictional scenarios with Cindy, in the E quadrant. Cindy was a single mom with a son entering his teens. Her life wasn't easy. She filed for bankruptcy, and at first it seemed like a dream come true—the creditors stopped calling her. Then she discovered how hard it is to survive without credit cards. In fact, she couldn't even rent a movie at her video store because the person there asked for a credit card to secure the rental. When her mother got sick Cindy wanted to fly home, but she didn't have the cash to go. Even if Cindy had been able to scrape together the money for a flight, she would have had to rent a car to get from the airport to her mother's house. If she couldn't rent a video without a credit card, she certainly couldn't rent a car without one. Cindy learned a hard lesson: Life without credit is no easy street.

Cindy was making $10 an hour at her full-time job as a file clerk. She also waitressed weekends at a local restaurant. Cindy had never been afraid of hard work, though work took her away from her son, Alex, who was beginning to act up with her gone all the time. Cindy

RICH DAD'S TIP

▲

"Wealth is measured in time, not money. You should have your money working for you so you don't have to spend all your time working for money."

had gross pay of $1735, less taxes of $285, leaving her with a net pay check of $1,450 per month from her full-time job. Her second job brought in another $60 per weekend, and she usually worked three weekends a month. Her monthly expenses were:

Rent for two-bedroom apartment	$500
Food	$600
Medical insurance	$160
Car repairs	$100
Gas	$100
Other	$170

TAKE NOTE

It doesn't matter how much money you make, but how your money flows.

Where was Cindy and where did she want to be? Cindy's money flowed in through earned income and out through personal expenses. She had no assets and no liabilities. Cindy had the cash flow pattern of the poor.

Cindy wanted the ultimate goal of financial freedom: to have her passive income meet her expenses. She wanted to own a home some day, but her main goal was to have a life free of the stress of not having enough money. She felt that $5,000 a month in passive income was more than she would ever need. First, though, she had to set some short-term goals. She wanted to increase the amount of money she made each month to achieve financial security while also spending more time at home with her son.

Worksheet

"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

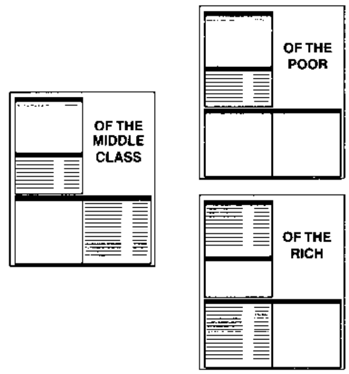
CINDY | BEFORE

Name Cindy   Date ______

INCOME	
Earned Income	
Job and Self-Employment	$ 1,915
Passive Income	
Real Estate (Net)	$
Business (Net)	$
Passive Income Total	$
Portfolio Income	
Interest	$
Dividends	$
Royalties	$
Portfolio Income Total	$
TOTAL INCOME *(Earned + Passive + Portfolio)*	$ 1,915

EXPENSES	
Taxes	$ 285
Credit Card Payments	$
	$
Home Mortgage (Rent)	$ 500
Car Payments (Repairs)	$ 100
Food and Clothing	$ 750
Other Payments	$ 280
TOTAL EXPENSES	$ 1,915
NET MONTHLY CASH FLOW *(Total Income less Total Expenses)*	$ 0

Cash Flow Patterns



What story do your numbers tell?

Cindy spent everything she made. She had no assets and no credit. She had the cash flow pattern of the poor.

ASSETS	
Bank Accounts	$
Stocks	$
Bonds	$
Receivables	$
Real Estate *(Fair Market Value less Mortgage)*	$
Business Value (Net)	$
ASSETS SUBTOTAL	$
DOODADS	
Home	$
Car(s)	$ 5,000
Other	$
DOODADS TOTAL	$ 5,000
TOTAL ASSETS per Banker *(Assets Subtotal + Doodads)*	$ 5,000
TOTAL ASSETS per Rich Dad *(Assets Subtotal only, do not add Doodads)*	$ -0-

LIABILITIES	
Credit Cards	$
Car Loans	$
School and Personal Loans	$
Home Mortgage Loan	$
Other Debt	$
TOTAL LIABILITIES	$ -0-
NET WORTH per Banker *(Total Assets per Banker less Total Liabilities)*	$ 5,000
NET WORTH per Rich Dad *(Total Assets per Rich Dad less Total Liabilities)*	$ 0

ANALYSIS OF CINDY'S FINANCIAL STATEMENT

The analysis is fairly simple because only Cindy's income statement is involved.

HOW MUCH DID CINDY KEEP?

Cindy's total monthly income	$1,915
Less total monthly expense	$1,915
Difference is how much she kept	$0
percentage of income kept	0

DID HER MONEY WORK FOR HER?

No—Cindy had no passive or portfolio income.

WHAT WAS HER INCOME AFTER TAXES?

Cindy's total income per month	$1,915
Taxes she paid per month	$285
Net income per month	$1,630
percentage of gross income paid in taxes	15%

HOW MUCH DID SHE SPEND ON HOUSING?

Total housing cost	$500
percentage of net income	31%

HOW MUCH DID SHE SPEND ON DOODADS?

Total doodad amount	$5,000
Total assets (banker version)	$5,000
Doodad percentage of total assets	100%

WHAT WAS HER RETURN ON ASSETS?

Cindy had no assets and no passive income, so there was no return on assets.

HOW WEALTHY WAS SHE?

Total assets	$0
Total expenses	$1,915

Cindy had zero wealth. If she lost her job she couldn't survive a single day.

CINDY'S FIVE-YEAR PLAN

Cindy could see from her analysis that she needed to build assets to provide passive income. She didn't know where to start, which meant first she needed to find some good advisors. In the past, her financial advisors had been her family. She had a close, supportive family, but all struggled financially, and she knew they would try to discourage her if she risked what little she had by trying something different.

Cindy couldn't afford to hire an advisor, so she sought help through programs sponsored by the local university. She had good secretarial skills and felt that she could make much more money by providing secretarial services out of her home than she made in her second job. But she had no computer and no credit to buy one. Her goals over the next five years were to:

- Find advisors who could help her start a small business
- Obtain the equipment for a small business
- Begin building a security fund for emergencies (three to six months' worth of living expenses)

How Cindy did. First Cindy contacted the local university to see if it offered any free programs for small businesses. She was referred to the Small Business Administration (SBA) branch on the university grounds. Cindy met with a representative during her lunch hour and in that short time learned about the free resources available, many of them on the Internet. Cindy discovered that she could use the computer system at the library to research other resources. Most importantly, she found out about the Self-Employment Trust. This trust, available in most states, gives free training to low-income people who want to start a business. The course includes basic business accounting, recordkeeping, marketing, and business planning. It's tough—and to graduate you have to produce a well-thought-out, developed business plan approved by your peers.

Cindy enrolled in the Self-Employment Trust and after a six-week course graduated with honors. This entitled her to a low-cost "micro loan" secured by the trust. The loan, in the amount of $2,000, went to purchase a computer, a printer, and printed brochures. Cindy distributed her brochures at a local copy store, and soon her phone began ringing with requests for resume and special project typing. She discovered she had a knack for cleaning up other people's prose and soon was receiving steady work from two local writers. She gave up her weekend job at the restaurant but kept her full-time job. Her new part-time self-employment soon paid an average of $800 a month, against which she expensed many items she used to pay for with before-tax money. The difference between the $800 and the $180 that she used to earn on her weekend job went to build up her security fund. There were a few expenses along the way, but at the end of five years she was able to get credit again and now had a savings account of $15,000 plus the confidence that she could succeed and reach her goal.

There were many unexpected benefits along the way. Grateful for the help she received in building her business, Cindy looked for a way to give back to her community. She volunteered to perform secretarial tasks for the local kitchen that prepared food for the elderly and shut-ins. Her son Alex began helping with lunch deliveries on Saturdays. He gained a lot of new "grandmothers," who encouraged him and gave him a positive outlet for his energy. While they were building financial security, Cindy and Alex were also acquiring a new extended family.

Worksheet

"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

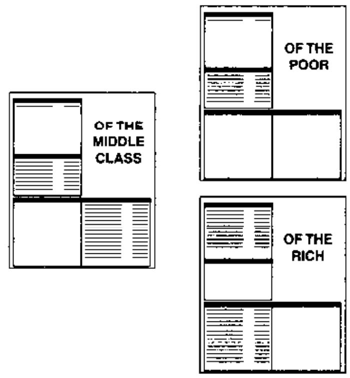
CINDY | AFTER

Name Cindy Date ____

INCOME	
Earned Income	
Job and Self-Employment	$ 2,535
Passive Income	
Real Estate (Net)	$
Business (Net)	$
Passive Income Total	$
Portfolio Income	
Interest	$ 40
Dividends	$
Royalties	$
Portfolio Income Total	$ 40
TOTAL INCOME *(Earned + Passive + Portfolio)*	$ 2,575

EXPENSES	
Taxes	$ 285
Credit Card Payments	$
	$
Home Mortgage (Rent)	$ 500
Car Payments	$ 100
Food and Clothing	$ 750
Other Payments	$ 280
TOTAL EXPENSES	$ 1,915
NET MONTHLY CASH FLOW *(Total Income less Total Expenses)*	$ 660

Cash Flow Patterns



What story do your numbers tell?

Cindy's business had moved her from poor to middle class. She had begun to build assets without building liabilities.

ASSETS	
Bank Accounts	$ 15,000
Stocks	$
Bonds	$
Receivables	$
Real Estate *(Fair Market Value less Mortgage)*	$
Business Value (Net)	$ 2,000
ASSETS SUBTOTAL	$ 17,000
DOODADS	
Home	$
Car(s)	$ 5,000
Other	$
DOODADS TOTAL	$ 5,000
TOTAL ASSETS per Banker *(Assets Subtotal + Doodads)*	$ 22,000
TOTAL ASSETS per Rich Dad *(Assets Subtotal only, do not add Doodads)*	$ 17,000

LIABILITIES	
Credit Cards	$
Car Loans	$
School and Personal Loans	$
Home Mortgage Loan	$
Other Debt	$
TOTAL LIABILITIES	$ - 0 -
NET WORTH per Banker *(Total Assets per Banker less Total Liabilities)*	$ 22,000
NET WORTH per Rich Dad *(Total Assets per Rich Dad less Total Liabilities)*	$ 17,000

HOW WEALTHY HAD SHE BECOME?

Total assets	$17,000
Total expenses	$1,915

Cindy was now almost "nine months wealthy." That means she could quit her job and stop working part-time and survive for almost nine months.

WHAT'S NEXT FOR CINDY?

After launching her business, Cindy took stock of her situation by preparing a new financial statement. She went through the exercise of "Where do you want to be?" and set new goals. Now her wish is to explore investing in order to build a passive income stream. As before, she plans to seek out advisors who can help her along the way. More than anything else, Cindy has gained a feeling of control over her financial situation. She's confident she can reach any goal she sets for herself with the right advisors and by creating a plan. Cindy has moved from the E quadrant to the E/S quadrants, and is making her way into the I quadrant.

DALE AND SUSIE'S STORY

At the opening of their story, Dale and Susie were in the E quadrant. In their mid-forties, they had two children set to start college in the next four years. On the outside, they looked like any prosperous American family. They had a nice suburban home with two new cars and a boat. Dale had a good job—better than any job anyone in his family had ever had. He was a manager who supervised a workforce of thirty. But below the surface bubbled a problem that threatened everything.

Dale was imprisoned in the E quadrant. He worried about his financial situation every time he looked at the balance due on his credit card statements. He worried about it whenever he thought of college tuition and retirement, for which he had nothing saved. He worried about it every time his company closed a division on a seeming whim. In a panic, he began working himself harder and indulging in the lifestyle of the rich on the weekends. He had his family's best interests in mind. He spent his leisure time either golfing with prospective clients or taking his superiors out on the boat to water-ski. During these outings Dale got lots of hot tips on the stock market. The people he spent time with looked prosperous, so they had to know what they were talking about. Dale had already gambled on a few tips and lost more than he'd made. His panic grew. In one bold move, he took out a third mortgage on his house to invest in a pre-IPO. The offering failed and he lost everything.

Susie felt pressure in a different way. She struggled in a job she hated, working as a secretary in a position with no opportunity for advancement. She felt guilty for the time spent away from her children and tried to compensate by making sure they had everything they needed. She was tired a lot and couldn't understand Dale's panic. She didn't want to know about money. She had never been good at numbers and left the finances up to her husband.

Dale's salary was $45,000 per year and netted him $2,900 a month. Susie's salary as a secretary was $25,000 per year and netted her $1,700 a month. Their monthly expenses were as follows:

Taxes	$1,235
Boat payment	$ 300
Three credit cards	
Balance $17,000	$350
Balance $16,000	$320
Balance $11,500	$230
Cars	
Leased	$560
Purchased	$450
Sports/music lessons	$200
Food/entertainment	$1,000
Golf	$200
Other living expenses	$300
Mortgage payments	
First $150,000	$800
Second $100,000	$870
Third $25,000 (interest only)	$295
Total expenses	$7,110

Where were Dale and Susie and where did they want to be? Dale and Susie had the worst-case cash flow pattern of the middle class: no true assets, and liabilities added to cover expenses. Dale wanted very badly to be rich. Susie wanted security and comfort. After looking at their financial story, they agreed they were neither rich, comfortable, nor secure. In fact, they were steamrolling down the road to financial ruin. They knew what they were doing was wrong, but until they corrected it, they reasoned, they wouldn't know what their goal was. Without an agreement on that goal, they had decided not to discuss financial matters.

Worksheet

DALE & SUSIE BEFORE

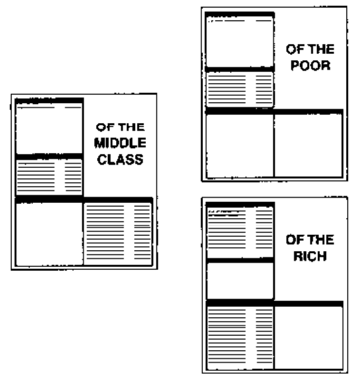
"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

Name Dale and Susie Date

INCOME	
Earned Income	
Job and Self-Employment	$ 5,835
Passive Income	
Real Estate (Net)	$
Business (Net)	$
Passive Income Total	$
Portfolio Income	
Interest	$
Dividends	$
Royalties	$
Portfolio Income Total	$
TOTAL INCOME (Earned + Passive + Portfolio)	$ 5,835

EXPENSES	
Taxes	$ 1,235
Credit Card Payments	$ 350
Card 3 = $230	$ 320
Home Mortgage (Rent)	$ 1,965
Car Payments	$ 1,010
Food and Clothing	$ 1,200
Other Payments	$ 800
TOTAL EXPENSES	$ 7,110
NET MONTHLY CASH FLOW (Total Income less Total Expenses)	$ – $1,275

Cash Flow Patterns



What story do your numbers tell?

Dale and Susie had the cash flow pattern of the middle class. Their expenses were more than their income & their debt was increasing.

ASSETS	
Bank Accounts	$ 2,000
Stocks	$
Bonds	$
Receivables	$
Real Estate (Fair Market Value less Mortgage)	$
Business Value (Net)	$
ASSETS SUBTOTAL	$ 2,000
DOODADS	
Home	$ 375,000
Car(s)	$ 15,000
Other	$ 23,000
DOODADS TOTAL	$ 413,000
TOTAL ASSETS per Banker (Assets Subtotal + Doodads)	$ 415,000
TOTAL ASSETS per Rich Dad (Assets Subtotal only, do not add Doodads)	$ 2,000

LIABILITIES	
Credit Cards	$ 44,500
Car Loans	$ 15,600
School and Personal Loans	$ 12,000
Home Mortgage Loan	$ 275,000
Other Debt	$
TOTAL LIABILITIES	$ 347,100
NET WORTH per Banker (Total Assets per Banker less Total Liabilities)	$ 67,900
NET WORTH per Rich Dad (Total Assets per Rich Dad less Total Liabilities)	$ –345,100

1st Mtge. 150,000
2nd Mtge. 100,000
3rd Mtge. 25,000

ANALYSIS OF DALE AND SUSIE'S FINANCIAL STATEMENT

HOW MUCH DID DALE AND SUSIE KEEP?

Total monthly income	$5,835
Less total monthly expense	$7,110
Difference is how much they kept	$(1,275)
percentage of income kept	0%

DID THEIR MONEY WORK FOR THEM?

Total monthly income	A = $5,835
Total earned income	B = $5,835
Total passive and portfolio income	C = $0
percentage passive and portfolio	C/A = 0%

WHAT WAS THEIR INCOME AFTER TAXES?

Total income per month	$5,835
Taxes paid per month	$1,235
Net income per month	$4,600
percentage of gross income paid in taxes	21%

HOW MUCH DID THEY SPEND ON HOUSING?

Total housing cost (mortgage plus real estate tax and insurance)	$2,200
percentage of net income	48%

HOW MUCH DID THEY SPEND ON DOODADS?

Total doodad amount	$413,000
Total assets (banker version)	$415,000
Doodad percentage of total assets	99.5%

WHAT WAS THEIR RETURN ON ASSETS?

Total assets (Rich Dad version) A = $ 2,000

Total passive and portfolio income B = $0 x 12 = $0

Cash-on-asset return (annualized income B/A) = 0%

HOW WEALTHY WERE THEY?

Total assets (Rich Dad version) $2,000

Total expenses $7,110

Dale and Susie had zero wealth. If they quit their jobs they couldn't survive a single day.

DALE AND SUSIE'S FIVE-YEAR PLAN

Dale had always been his own financial advisor and tax preparer. He was smarter than anyone else he knew, and he trusted himself more than he trusted a CPA. Dale also had a hard time trusting financial planners ("they just want to sell insurance") and stock brokers ("they just want to sell something safe").

While Dale and Susie had not yet agreed on an ultimate financial goal, they did agree, after looking hard at their cash flow pattern, that they had too much debt. With the pressure mounting, they decided to pursue the following five-year goals:

- Establish a five-year debt-reduction plan
- Find a CPA to review their tax records and prepare their tax returns if necessary
- Build an asset reserve, conservatively invested so that eventually, if needed, they would have three months' worth of expenses put aside

How Dale and Susie did. Having agreed to cut expenses wherever possible, Dale and Susie were successful in designing and following their debt-reduction plan. The going was slow, but eventually they eliminated all their consumer debt, and by the middle of the fifth year they had begun to build their security fund.

Finally realizing that he didn't have all the answers, Dale made an appointment with a local CPA for tax advice. The CPA discovered a number of deductions related to past investment expenses that Dale had not taken. He filed an amended tax return. Dale and Susie didn't get immediate tax relief, but now they had some carryover expenses to be used when they began making portfolio income. Moreover, Dale hadn't correctly reported a large carryover capital loss from bad investments. The loss, reported in an amended return, would reduce his taxable income by $3,000 per year until it was completely used.

Meanwhile, having almost completed the five years of debt reduction, Dale felt the need to play catch up. A college buddy had a friend who worked for a bank. There was a rumor flying through the bank that a local company trading as a penny stock was being courted by a company on the New York Stock Exchange. If the smaller company was bought up, a share of its stock trading at just pennies might suddenly become worth hundreds of dollars. Dale and Paul reasoned that a banker would surely know what was going on. Here finally was a good financial advisor, thought Dale. So he took his and Susie's security fund of $5,000 and with a cash advance on his credit card of $15,000 bought $20,000 of penny stock. By then, however, lots of people had caught wind of the rumor, and shares that had cost $0.10 each had climbed to $0.50 by the time Dale bought his 30,000 shares. He was encouraged by the surge in value. This must prove it's a good investment, he reasoned.

The hoped-for deal never came. Dale heard the news when he was at work, but it was a busy day and he couldn't get on-line to trade until late the next day. By that time, the stock was trading at $0.05. His $20,000 came to less than $2,000 after the cost of sale. His and Susie's security fund had plunged to $2,000, and now they owed $15,000 on a credit card that had been paid off.

HOW WEALTHY HAD THEY BECOME?

Total assets	$2,000
Total expenses	$4,200

Dale and Susie still had no wealth, but they had gained more control over their debt.

Worksheet

DALE & SUSIE AFTER

"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

Name Dale and Susie   Date ______

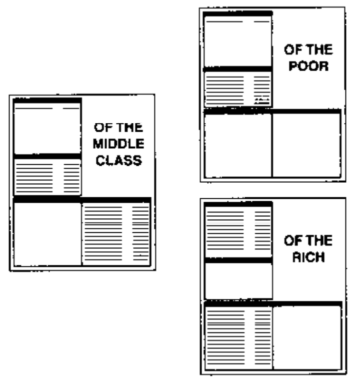
INCOME

Earned Income	
Job and Self-Employment	$ 5,835
Passive Income	
Real Estate (Net)	$
Business (Net)	$
Passive Income Total	$
Portfolio Income	
Interest	$
Dividends	$
Royalties	$
Portfolio Income Total	$
TOTAL INCOME *(Earned + Passive + Portfolio)*	$ 5,835

EXPENSES

Taxes	$ 1,235
Credit Card Payments	$
	$
Home Mortgage (Rent)	$ 1,965
Car Payments	$
Food and Clothing	$ 900
Other Payments	$ 100
TOTAL EXPENSES	$ 4,200
NET MONTHLY CASH FLOW *(Total Income less Total Expenses)*	$ 1,635

Cash Flow Patterns



What story do your numbers tell?

Dale and Susie still have the cash flow pattern of the middle class. Before though, they were sinking fast in debt. That has been reversed.

ASSETS

Bank Accounts	$ 2,000
Stocks	$
Bonds	$
Receivables	$
Real Estate *(Fair Market Value less Mortgage)*	$
Business Value (Net)	$
ASSETS SUBTOTAL	$ 2,000
DOODADS	
Home	$ 375,000
Car(s)	$ 10,000
Other	$
DOODADS TOTAL	$ 385,000
TOTAL ASSETS per Banker *(Assets Subtotal + Doodads)*	$ 387,000
TOTAL ASSETS per Rich Dad *(Assets Subtotal only, do not add Doodads)*	$ 2,000

LIABILITIES

Credit Cards	$
Car Loans	$ 15,000
School and Personal Loans	$
Home Mortgage Loan	$ 275,000
Other Debt	$
TOTAL LIABILITIES	$ 290,000
NET WORTH per Banker *(Total Assets per Banker less Total Liabilities)*	$ 97,000
NET WORTH per Rich Dad *(Total Assets per Rich Dad less Total Liabilities)*	$ −288,000

WHAT'S NEXT FOR DALE AND SUSIE?

Dale and Susie have finally had an honest discussion regarding their long-term financial future. Dale still wants to be rich, but he has listened to Susie's concerns and acknowledged her need for security. They know they can eliminate the new debt one step at a time, just as before. They've lost a lot of ground, but Susie is much more comfortable knowing where they stand. She and Dale have vowed to review their personal finances each month and look at the progress they've made. Until progress is made, Dale and Susie will remain in the E quadrant.

STAN AND MARTIE'S STORY

At the opening of their story, Stan and Martie were in both the S quadrant and the I quadrant, in the latter as accredited investors. Stan and Martie lived in the same neighborhood as Dale and Susie, and on the surface the two couples' financial situations appeared similar. Stan and Martie were slightly older, in their mid-fifties. For years they worked hard in their print shop. They bought into the neighborhood earlier than Dale and Susie, and the value of their house appreciated dramatically. Fifteen years ago they also bought two three-bedroom, two-bath homes as rentals. The value of those homes also increased.

For a long time, Stan and Martie felt secure. They had a high-equity position in the house and had always spent less than they made. They also had $250,000 invested in treasury bills and money market accounts. These safe investments gave them a 5 percent average return.

Their line had always been "slow and steady." Eventually, however, they started feeling that they were working too hard. If they didn't show up at the print shop, no work got done. They were in a bind. They had created jobs for themselves that they couldn't afford to hire someone else to perform. Furthermore, with technology advancing at dizzying speed, the print shop was in danger of becoming obsolete overnight.

The two rental houses were valued at approximately $350,000 each in the current market. They were each rented at $1,500 per month, and there was an underlying payment of $800 per month on the remaining debt of $60,000 each. Thus they produced a cash flow of $700 per month each. Stan and Martie's current monthly income was:

Earned	$10,000
Passive	$2,500

Their expenses were:

House mortgage	$900
Living	$2,000
Taxes	$2,600

Where were Stan and Martie and where did they want to be?

Stan and Martie still had one foot in the S quadrant and wanted out. Could they do something new with their business? They were aware of the American trend toward self-employment at home. With so many newly self-employed workers, surely there would be a need for a whole range of support services—Internet, printing, binding, secretarial, even conference rooms in which to meet clients. Stan and Martie had an idea: Why not combine a set of executive suites with several conference rooms and a receptionist and lease them out, while also offering the amenities of an on-site high-tech print shop? Stan and Martie were cautious. They didn't want to rush headlong into this new venture. They thought they would feel more secure with an alternative source of income to cover their expenses. They wanted to explore new possibilities with the business, not sell it. What they needed was passive income.

Worksheet

STAN & MARTIE BEFORE

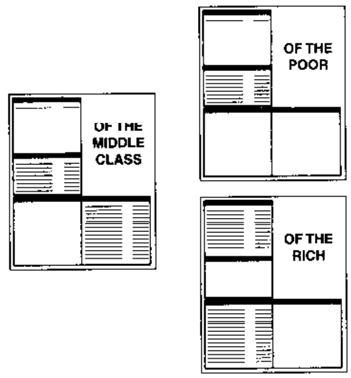
"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

Name Stan and Martie Date ________

INCOME	
Earned Income	
Job and Self-Employment	$ 10,000
Passive Income	
Real Estate (Net)	$ 1,400
Business (Net)	$ 1,100
Passive Income Total	$
Portfolio Income	
Interest	$
Dividends	$
Royalties	$
Portfolio Income Total	$
TOTAL INCOME *(Earned + Passive + Portfolio)*	$ 12,500

EXPENSES	
Taxes	$ 2,600
Credit Card Payments	$
	$
Home Mortgage (Rent)	$ 900
Car Payments	$
Food and Clothing	$ 1,200
Other Payments	$ 800
TOTAL EXPENSES	$ 5,500
NET MONTHLY CASH FLOW *(Total Income less Total Expenses)*	$ 7,000

Cash Flow Patterns



What story do your numbers tell?

Stan & Martie have a combination cash flow pattern of the middle class and the rich.

ASSETS	
Bank Accounts	$ 10,000
Stocks	$ 250,000
Bonds	$
Receivables	$
Real Estate *(Fair Market Value less Mortgage)*	$ 580,000
Business Value (Net)	$ 200,000
ASSETS SUBTOTAL	$ 1,040,000
DOODADS	
Home	$ 375,000
Car(s)	$ 40,000
Other	$
DOODADS TOTAL	$ 415,000
TOTAL ASSETS per Banker *(Assets Subtotal + Doodads)*	$ 1,455,000
TOTAL ASSETS per Rich Dad *(Assets Subtotal only, do not add Doodads)*	$ 1,040,000

LIABILITIES	
Credit Cards	$
Car Loans	$
School and Personal Loans	$
Home Mortgage Loan	$ 80,000
Other Debt	$
TOTAL LIABILITIES	$ 80,000
NET WORTH per Banker *(Total Assets per Banker less Total Liabilities)*	$ 1,375,000
NET WORTH per Rich Dad *(Total Assets per Rich Dad less Total Liabilities)*	$ 960,000

ANALYSIS OF STAN AND MARTIE'S FINANCIAL STATEMENT

Stan and Martie eagerly compiled their financial data in order to analyze it. They could be slow to move, but they were always open to learning.

HOW MUCH DID STAN AND MARTIE KEEP?

Total monthly income	$12,500
Less total monthly expenses	$5,500
Difference is how much they kept	$7,000
percentage of income kept	56%

DID THEIR MONEY WORK FOR THEM?

Total monthly income	A	= $12,500
Total earned income	B	= $10,000
Total passive and portfolio income	C	= $2,500
percentage passive and portfolio	C/A	= 20%

WHAT WAS THEIR INCOME AFTER TAX?

Total income per month	$12,500
Taxes per month	$2,600
Net income per month	$9,900
percentage of gross income paid in taxes	21%

HOW MUCH DID THEY SPEND ON HOUSING?

Total housing cost (mortgage plus real estate tax and insurance)	$1,100
percentage of net income	11%

HOW MUCH DID THEY SPEND ON DOODADS?

Total doodad amount	$415,000
Total assets (banker version)	$1,455,000
Doodad percentage of total assets	29%

WHAT WAS THEIR RETURN ON ASSETS?

Total assets (Rich Dad version)		$1,040,000
Total passive and portfolio income	B = $2,500 x 12 =	$30,000
Cash-on-asset return (annualized income B/A)		3%

HOW WEALTHY WERE THEY?

Total assets (Rich Dad version)	$1,040,000
Total expenses	$5,500

Stan and Martie were 189 months (almost sixteen years) wealthy. They could survive almost sixteen years if they quit their jobs, but they would have to sell assets.

STAN AND MARTIE'S FIVE-YEAR PLAN

Stan and Martie were surprised to learn how low their return on assets was. They hadn't fully understood the impact on their return of a changing real estate market. Now more than ever, they were determined to investigate changes in their business, and they were open to the idea of seeking advisors to help them.

Their five-year plan was to:

- Sell their highly appreciated rental properties and re-invest the money for a more reasonable return on capital
- Maintain a substantial security fund. Their goal was to have six months' worth of living expenses in reserve, including the cost of the mortgage on their new investment property
- Look into expanding their business
- Assemble a talented team of advisors to help with each of the above objectives

How Stan and Martie did. Because of their need for security and more passive income, Stan and Martie decided to assemble the real estate part of their team first, one agent specializing in residential homes in their area and one specializing in medium-sized income-producing properties. They learned about how to maximize returns in real estate deals through a tax-deferred arrangement known as the Starker, or like kind, exchange. This would allow them to sell property through a structured exchange facilitated by a Starker intermediary and replace the property with another one inside 180 days. As long as the new property's purchase price was equal to or more than the sales price of the initial property and all cash was "rolled" into the new property, there would be no tax currently due. In effect, taxes on this sale would be deferred until the new property was sold.

After both leases expired for their current tenants, Stan and Martie worked out an agreement whereby the tenants would stay on a month-to-month basis at half the rent and show the property on short notice. Stan and Martie quickly found buyers for their two homes. After all expenses, they would net $535,000. Not wanting to pay the taxes on that windfall, they sought out a Starker intermediary. As soon as Stan and Martie accepted the offers on the rental properties, they began looking for the new investment property required by the Starker exchange. With the help of their real estate agent, they found an apartment building and purchased it for $1.5 million. The apartment building would give them a net cash-on-cash return of 17 percent for their $535,000. This would yield a cash flow of approximately $85,000 per year. The payments were $7,800 per month, and according to Stan and Martie's agreement, they would put six months' worth of payments in secure investments. They sought out a financial planner to help them identify the best investment vehicles. The planner also recommended some other opportunities. As a result of his help, for example, Stan and Martie began a variable-whole-life insurance policy. This form of insurance offered them a guaranteed death benefit and accrued cash value. It allowed them to allocate a portion of each premium payment to one or more investment options. Now Stan and Martie could take advantage of many different mutual funds and thus combine investing with tax-free growth.

Finally Stan and Martie were able to put their dream in place. They spent two years and $100,000 investigating the possibilities for the new business. They had a few setbacks along the way. The most notable was their first business consultant. He was a well-spoken man with a lot of good ideas, but he did not follow through on his ideas. It took some time before Stan and Martie learned this lesson: Choose advisors who speak from their experience, not from their opinions. The next advisor had a lot of experience taking businesses public. He helped Stan and Martie identify their market niche and future possibilities.

Stan and Martie searched high and low for the best location for their business. Eventually they found space to lease, and three years after the idea was conceived, they opened their new business as a C corporation. Acting on advice from a management consultant, they developed their operation in such a way that their presence wouldn't be required every day. At the beginning they worked hard, but most of their time was spent writing operations and procedures manuals so that eventually someone else could fill in for them.

It took two years before they started seeing a profit, a delay that their well-designed business plan had forecast. Because they had planned for delayed profits, Stan and Martie had the capital reserves to see them through those first two years.

After five years, the business was producing $25,000 passive income per month. Their presence was no longer required for the business to operate. Their passive income from real estate had increased to $7,100 per month.

Worksheet

STAN & MARTIE AFTER

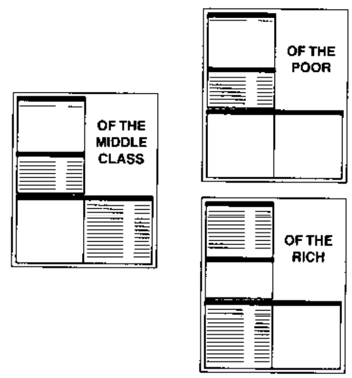
"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

Name Stan and Martie   Date ____

INCOME	
Earned Income	
Job and Self-Employment	$
Passive Income	
Real Estate (Net)	$ 7,100
Business (Net)	$ 25,000
Passive Income Total	$
Portfolio Income	
Interest	$ 500
Dividends	$
Royalties	$
Portfolio Income Total	$ 500
TOTAL INCOME *(Earned + Passive + Portfolio)*	$ 32,600

EXPENSES	
Taxes	$ 10,000
Credit Card Payments	$
	$
Home Mortgage (Rent)	$ 900
Car Payments	$
Food and Clothing	$ 1,200
Other Payments	$ 3,800
TOTAL EXPENSES	$ 15,900
NET MONTHLY CASH FLOW *(Total Income less Total Expenses)*	$ 16,700

Cash Flow Patterns



What story do your numbers tell?

Stan & Martie
have moved
to the rich!

ASSETS	
Bank Accounts	$ 100,000
Stocks	$
Bonds	$
Receivables	$
Real Estate *(Fair Market Value less Mortgage)*	$ 580,000
Business Value (Net)	$ 1,500,000
ASSETS SUBTOTAL	$ 2,180,000
DOODADS	
Home	$ 375,000
Car(s)	$ 60,000
Other	$ 30,000
DOODADS TOTAL	$ 465,000
TOTAL ASSETS per Banker *(Assets Subtotal + Doodads)*	$ 2,645,000
TOTAL ASSETS per Rich Dad *(Assets Subtotal only, do not add Doodads)*	$ 2,180,000

LIABILITIES	
Credit Cards	$
Car Loans	$
School and Personal Loans	$
Home Mortgage Loan	$ 80,000
Other Debt	$
TOTAL LIABILITIES	$ 80,000
NET WORTH per Banker *(Total Assets per Banker less Total Liabilities)*	$ 2,565,000
NET WORTH per Rich Dad *(Total Assets per Rich Dad less Total Liabilities)*	$ 2,100,000

HOW WEALTHY HAD THEY BECOME?

Total assets (Rich Dad version)	$2,180,000
Total expenses	$15,900

It would appear that Stan and Martie were 137 months (or 11.4 years) wealthy. However, their passive income of $32,600 was more than their total expenses of $15,900, so they were actually infinitely wealthy. Their assets were working for them and they didn't need to work.

WHAT'S NEXT FOR STAN AND MARTIE?

Stan and Martie look forward to the day when their business can operate without them going in every week and checking up on things. Within the next two years, it should be turning that corner. Currently they are leasing their business quarters, but the owner of the building has expressed an interest in selling. Stan and Martie lease one quarter of the space in the building; if they owned it, the lease from the other tenants would more than cover their own payment for office space. Thanks to their advisors, they know that a C corporation should not directly own real estate, so they plan to form a limited-liability company (LLC) to hold the property. In essence, the C corporation would buy the real estate and the LLC would own it, receiving rent from the C corporation. Stan and Martie have moved themselves completely out of the S quadrant and are now firmly established in the B and I quadrants as sophisticated investors.

FRANK AND MARIA'S STORY

At the opening of their story, Frank and Maria had already achieved the American dream. They were in both the B and the I quadrants, in the latter as sophisticated investors. Frank's parents, immigrants to the United States, had dedicated themselves to making sure their children carved out better lives for themselves. Maria's father had died young, and her mother had raised her along with four siblings. Early on, Maria understood that the people who owned property were the ones truly in control of their financial lives. As she and her single-parent family moved from one rental house to another, she saw that the rent her hard-working mother paid simply increased the landlord's wealth. She made herself a promise that one day she would be the landlord.

Maria and Frank met when she was working as a real estate agent, showing him a house. She was impressed with his intellect and drive, and he was impressed with her command of real estate. Maria had bought her first rental house at the age of twenty-two. When they married, Frank was an engineer at an automotive factory. Maria began building their real estate portfolio. Each commission she earned was invested in a property. She understood the need to maximize returns; when a property went up in value, she would flip it in tax-deferred Starker exchanges that provided more and more cash flow. Because Maria knew real estate and could spot good deals, she always bought below market. Within a few years the properties she bought had significantly appreciated in value, while the rent income tended to drag behind the increased equity. To maximize the cash flow return (and the return on invested equity), she sold these lower-performing properties for larger properties. With each transaction, she increased their net worth.

Eventually Frank and Maria had two children. Frank moved into research and designed two products for which the automotive factory obtained patents—and earned royalties. Frank and Maria discussed the possibility of him leaving and starting his own business. By that time Maria had built up their passive income to over $15,000 a month, and they didn't need the income from Frank's job anymore. They also had a nest egg to invest in the business. Frank knew there was a lot more to building a business than just a good idea. He planned to use the nest egg to pay for a team of good advisors who would get his business off on the right foot.

Frank quit work and invented a customized device to improve the fuel efficiency of vehicles. He obtained a patent for the device and set up a company to manufacture and install it in vehicles. Within ten years, Frank and Maria's passive income had increased to $50,000, with $25,000 coming from the business Frank had built. It was a true B quadrant business because he seldom needed to show up, and then mainly for board of director meetings.

At this point Frank and Maria's children were in high school and planning to go to college. Frank and Maria were anticipating college tuition payments. They were very interested in charitable giving. Frank served on the board of the local Animal Protection League. Maria gave her time to Childhelp USA, dedicated to the eradication of child abuse. Their income was:

Business	$25,000
Real estate	$20,000
Conservative investment ($1,000,000 x 6 percent)	$5,000
Total	$50,0000

Their expenses were:

House payment	$ 9,000
Living	$6,000
Charity	$10,000
Taxes	$15,000

Where were Frank and Maria and where did they want to be?
Frank and Maria were happy with their passive income. Frank was interested in taking his company public so that he could raise funds to transform it into a multinational business. He and Maria each wanted to give an endowment of $500,000 to their respective charities. In addition, Maria wanted to maintain a security fund of $1,000,000. They needed to find a way to fund the company's growth without putting their current position at risk and without jeopardizing their ability to pay the children's college tuition.

Worksheet

"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

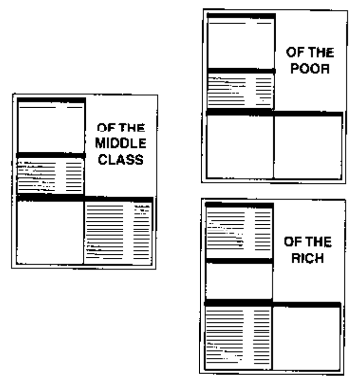
FRANK & MARIA BEFORE

Name Frank & Maria   Date

INCOME	
Earned Income	
Job and Self-Employment	$
Passive Income	
Real Estate (Net)	$ 20,000
Business (Net)	$ 25,000
Passive Income Total	**$** 45,000
Portfolio Income	
Interest	$ 5,000
Dividends	$
Royalties	$
Portfolio Income Total	**$** 5,000
TOTAL INCOME *(Earned + Passive + Portfolio)*	**$** 50,000

EXPENSES	
Taxes	$ 15,000
Credit Card Payments	$
	$
Home Mortgage (Rent)	$ 9,000
Car Payments	$
Food and Clothing	$ 2,000
Other Payments	$ 14,000
TOTAL EXPENSES	**$** 40,000
NET MONTHLY CASH FLOW *(Total Income less Total Expenses)*	**$** 10,000

Cash Flow Patterns



What story do your numbers tell?

Frank and Maria have the cash flow pattern of the rich.

ASSETS	
Bank Accounts	$ 50,000
Stocks	$ 1,000,000
Bonds	$
Receivables	$
Real Estate *(Fair Market Value less Mortgage)*	$ 1,000,000
Business Value (Net)	$ 2,000,000
ASSETS SUBTOTAL	**$** 4,050,000
DOODADS	
Home	$ 1,500,000
Car(s)	$ 150,000
Other	$
DOODADS TOTAL	**$** 1,650,000
TOTAL ASSETS per Banker *(Assets Subtotal + Doodads)*	**$** 5,700,000
TOTAL ASSETS per Rich Dad *(Assets Subtotal only, do not add Doodads)*	**$** 4,050,000

LIABILITIES	
Credit Cards	$
Car Loans	$
School and Personal Loans	$
Home Mortgage Loan	$ 1,000,000
Other Debt	$
TOTAL LIABILITIES	**$** 1,000,000
NET WORTH per Banker *(Total Assets per Banker less Total Liabilities)*	**$** 4,700,000
NET WORTH per Rich Dad *(Total Assets per Rich Dad less Total Liabilities)*	**$** 3,050,000

ANALYSIS OF FRANK AND MARIA'S FINANCIAL STATEMENT

Frank and Maria's financial position was complicated, and though both were financially literate, neither was involved in daily oversight of Frank's business or their investments. They had to have accountants prepare financial statements for their outside activities before compiling a statement of their own personal financial situation.

HOW MUCH DID FRANK AND MARIA KEEP?

Total monthly income	$50,000
Less total monthly expense	$40,000
Difference is how much they kept	$10,000
percentage of income kept	20%

DID THEIR MONEY WORK FOR THEM?

Total monthly income	A =	$50,000
Total earned income	B =	$0
Total passive and portfolio income	C =	$50,000
percentage passive and portfolio	C/A =	100%

WHAT WAS THEIR INCOME AFTER TAXES?

Total income per month	$50,000
Taxes paid per month	$15,000
Net income per month	$35,000
percentage of gross income paid in taxes	30%

HOW MUCH DID THEY SPEND ON HOUSING?

Total housing cost	$9,000
percentage of net income	26%

HOW MUCH DID THEY SPEND ON DOODADS?

Total doodad amount	$1,650,000
Total assets (banker version)	$5,700,000
Doodad percentage of total assets	29%

WHAT WAS THEIR RETURN ON ASSETS?

Total assets (Rich Dad version)	A =	$4,050,000
Total passive and portfolio income	B = $50,000 x 12 =	$600,000
Cash-on-asset return (annualized income B/A)		15%

HOW WEALTHY WERE THEY?

Total assets (Rich Dad version)	$4,050,000
Total expenses	$40,000

It would appear that Frank and Maria were 101 months (or 8.4 years) wealthy. However, their passive income of $50,000 exceeded their total expenses of $40,000, so in fact they were infinitely wealthy. Their assets worked for them so they didn't have to work.

FRANK AND MARIA'S FIVE-YEAR PLAN

As we've seen, Frank and Maria wanted to give charitable endowments as well as expand Frank's business into a multinational company. They wanted to do this without sacrificing their lifestyle and their security, and without squandering money that would go to their children's education. Their immediate goals were to:

- Communicate their vision to a financial planner, who would help them set up an appropriate savings plan for the endowment
- Investigate business possibilities and capital pools with an eye toward eventually expanding Frank's business

Based on Frank's conversations with others in his industry, he figured that during this preliminary phase of business development he would need approximately $100,000 to hire financial analysts, legal advisors, and accounting people. Later, as his business grew, he would require an expanded team of advisors.

How Frank and Maria did. Frank was surprised to find another asset surface during the process of financial analysis. His business had purchased key-man insurance ten years ago. This form of insurance compensates a company in case of the death of a key employee or owner, since the operation could go under without that person. Premiums paid on the policy are not a deductible business expense, but the proceeds at death are income-tax free. The policy had been bought not only to insure Frank's life in the critical opening years of his business but also to reduce the company's accumulated earnings, thus eliminating tax associated with potentially excessive accumulated earnings. As Frank's business controller explained, this insurance had been accumulating cash value. As it turned out, now Frank could borrow against the insurance's cash value at the low rate of 5 percent. There was a total of $610,000 available for him to borrow.

The biggest challenge for Frank was finding advisors who could elevate him from business owner to investor to ultimate investor. After a few months of intensive searching during which he asked people for referrals and did lots of interviewing, Frank built the team he needed. Five years later, he and his team had developed a business plan and launched their pre-IPO. It was a success.

Worksheet

FRANK & MARIA AFTER

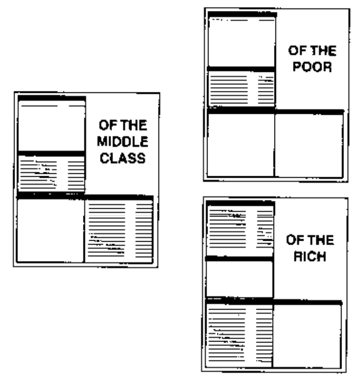
"WHERE AM I TODAY?" MY FINANCIAL STATEMENT

Name Frank & Maria   Date ____

INCOME	
Earned Income	
Job and Self-Employment	$
Passive Income	
Real Estate (Net)	$ 20,000
Business (Net)	$ 70,000
Passive Income Total	**$** 90,000
Portfolio Income	
Interest	$ 10,000
Dividends	$
Royalties	$
Portfolio Income Total	**$** 10,000
TOTAL INCOME *(Earned + Passive + Portfolio)*	**$** 100,000

EXPENSES	
Taxes	$ 30,000
Credit Card Payments	$
	$
Home Mortgage (Rent)	$ 9,000
Car Payments	$
Food and Clothing	$ 2,000
Other Payments	$ 19,000
TOTAL EXPENSES	**$** 60,000
NET MONTHLY CASH FLOW *(Total Income less Total Expenses)*	**$** 40,000

Cash Flow Patterns



What story do your numbers tell?

Frank and Maria still have the cash flow pattern of the rich, as they continue to grow their assets.

ASSETS	
Bank Accounts	$ 100,000
Stocks	$ 2,000,000
Bonds	$
Receivables	$
Real Estate *(Fair Market Value less Mortgage)*	$ 1,000,000
Business Value (Net)	$ 6,500,000
ASSETS SUBTOTAL	**$** 9,600,000
DOODADS	
Home	$ 1,500,000
Car(s)	$ 200,000
Other	$
DOODADS TOTAL	**$** 1,700,000
TOTAL ASSETS per Banker *(Assets Subtotal + Doodads)*	**$** 11,300,000
TOTAL ASSETS per Rich Dad *(Assets Subtotal only, do not add Doodads)*	**$** 9,600,000

LIABILITIES	
Credit Cards	$
Car Loans	$
School and Personal Loans	$
Home Mortgage Loan	$ 1,000,000
Other Debt	$
TOTAL LIABILITIES	**$** 1,000,000
NET WORTH per Banker *(Total Assets per Banker less Total Liabilities)*	**$** 10,300,000
NET WORTH per Rich Dad *(Total Assets per Rich Dad less Total Liabilities)*	**$** 8,600,000

HOW WEALTHY HAD THEY BECOME?

Total assets (Rich Dad version)	$ 9,600,000
Total expenses	$ 60,000

Frank and Maria were still infinitely wealthy because they had passive income of $100,000, which was greater than their expenses of $60,000.

WHAT'S NEXT FOR FRANK AND MARIA?

Frank and Maria are now halfway to their goal of $1,000,000 in endowment money. Maria's interest in charitable giving has grown, and she is thinking of setting up a family foundation that would fund causes to which she and Frank are devoted. Their combined business acumen could be applied to the foundation to create a positive impact on society. They're happy with their diminished role in the expanding business that Frank founded. Maria still watches the real estate market. They have security, passive income, and two children whom they've put through college and professional school. Frank and Maria are in the same quadrants as before—B and I—but with this difference: Instead of sophisticated investors, they're on their way to becoming ultimate investors. Their money is working for them.

RICH DAD'S TIP

"The poor and the middle class work for money. The rich have money work for them."

ANALYSIS OF YOUR FINANCIAL STATEMENT

Now that you've prepared your financial statement and read the stories told by some other people's financial statements, it's time to do an analysis of your own statement. This will indicate where you are and suggest ways you can set new goals. In this section you'll see some standard ratios used to analyze financial statements. Not all will be applicable to your scenario, but some will prove useful in moving you down the path to financial freedom.

RICH DAD'S TIP

▲

"You need to have your money work for you, instead of you working for money."

HOW MUCH DO YOU KEEP?

Your total monthly income A = $ ________________

Less your total monthly expenses B = $ ________________

Difference is how much you keep C = $ ________________

Percentage of your income you are keeping
C/A = ____________ %

Goal: Increase the percentage of income you keep. Start with 1% and increase it from there, if you have to.

DOES YOUR MONEY WORK FOR YOU?

Your total monthly income A = $ ________________

Your total earned income B = $ ________________

Your total passive and portfolio income C = $ ________________

What percentage of your income is passive or portfolio, that is, your money working for you? C/A = ______________%

Goal: Increase your percentage of passive or portfolio income. If you have no passive or portfolio income, start by buying assets that generate passive and/or portfolio income.

WHAT IS YOUR INCOME AFTER TAX?

Your total income per month A = $ ______________

Taxes you pay per month B = $ ______________

Your net income per month C = $ ______________

What percentage of your gross income is paid in taxes?

B/A = ____________ %

Goal: Decrease the amount of tax you pay. Consult your tax advisor to see if you are taking full advantage of the tax deductions allowed to you. If you have started a business, make sure you are deducting all legitimate business deductions.

HOW MUCH OF YOUR NET INCOME GOES TO HOUSING?

How much do you spend on housing each month?

Mortgage payment = $ ______________

Rent payment = $ ______________

Insurance (home) = $ ______________

Real estate taxes = $ ______________

Utilities = $ ______________

Maintenance = $ ______________

Total = $ ______________

How much do you spend as a percentage of net income?

Total/C = ____________ %

Goal: Keep housing costs under 33 percent of net income.

HOW MUCH DO YOU SPEND ON DOODADS?

Doodads aren't necessarily bad things. They're the reward for a job well done. Unfortunately, many people reward themselves first and never get around to building assets. The following figures will help identify your doodad habits. Note that total assets carries the tag "banker version." You'll recall that there is a fundamental difference between how Rich Dad calculates assets—and thus net worth—and how a banker does. Rich Dad defines an asset as something that puts money in your pocket. Thus, for example, your personal residence is not an asset. But when it comes time to do your personal financial statement for your banker, he or she will count your personal residence, if you have one, as an asset.

Total doodad amount $____________________

Total assets (banker version) $____________________

Doodad percentage of total assets
(doodad total/total assets) ____________ %

Goal: Keep your doodads under 33 percent of total assets. The lower the percentage, the faster your assets will grow.

WHAT IS YOUR RETURN ON ASSETS?

One way to increase your passive income is to reallocate your invested assets. This ratio will tell you overall how you're doing. If the return is low, you can look at where the assets are and decide whether you want to reinvest them. You may want to liquidate some of your doodads and invest that amount in assets to help you get started.

Total assets (Rich Dad version) A = $ ____________________

Total passive and portfolio income
B = $____________ x 12 = $____________________

Cash-on-asset return
(annualized income B/total assets A) ________ %

Goal: Increase your Cash-on-asset return

HOW WEALTHY ARE YOU?

Total assets (Rich Dad version) $ ____________________

Total expenses $ ____________________

Your wealth (Assets /expenses) ______________months

Total passive income $ ____________________

Note: Once your monthly passive income exceeds your monthly expenses, you're infinitely wealthy because your assets are working for you.

Goal: To purchase assets that generate passive and/or portfolio income in excess of your monthly expenses.

WHAT IS YOUR CASH FLOW PATTERN?

The numbers you've come up with tell a story about your cash flow pattern. Which of the stories below best describes you?

Poor. If you have the cash flow pattern of the poor, you're using earned income to pay expenses. There are no assets and no liabilities. You could own lots of things and owe nothing on them. But if, in addition to having no debt, you have no passive income or assets, your cash flow pattern is that of the poor.

Middle class. If you have the cash flow pattern of the middle class, you're bringing in money primarily through earned income, which goes to paying expenses and building more liabilities, creating more expenses. If this is your pattern, you're rewarding yourself with doodads and building liabilities. This is the toughest pattern to change. Your cash flow is building more and more debt.

Rich. The cash flow pattern of the rich is to build assets that create passive income, which in turn pays expenses. The term rich here refers to the cash flow pattern only. What counts isn't whether someone makes $5,000 per month or $500,000 per month. What counts is whether that person's assets pay his or her expenses, with additional cash going each month to build assets. That is the cash flow pattern of the rich. Someone who makes $50,000 per month might have the cash flow pattern of the middle class. It is not the amount you have, but what you do with it that counts.

RICH DAD'S TIP

▲

"It's not the numbers, but what the numbers are telling you. It's not the words, but the story the words are telling you."

FEAR: I make $5,000 a month and all I have are liabilities. How can I build assets?

FACT: If you stop rewarding yourself with doodads, you'll stop amassing liabilities (bad debt).

FREEDOM: When you stop amassing liabilities (bad debt), you'll start building assets.

Take Control of Your CASH FLOW

"Making more money will not solve your problems if cash flow management is your problem."

The primary reason most people have money problems is that in school they were never taught cash flow management. Without this training, they wind up working harder and harder in the belief that making more money will solve their problems. Unfortunately, more money often just sends people deeper into debt. More money won't solve problems if cash flow management is the problem.

As CEO of the business of your life, you've created a personal financial statement and analyzed it. The next step is to take control of your cash flow.

DEBT QUIZ: HOW DEEPLY DUG IN ARE YOU?

The cash flow management plan you develop depends on your level of personal debt. To get a sense of how deeply dug in you are, look at the list below. If you can answer yes to any of the questions, put a "1" in the box alongside:

- ❑ Do you pay your bills late?
- ❑ Have you hidden a bill from your spouse?
- ❑ Have you neglected repairing the car because of insufficient funds?
- ❑ Is there family tension because of overspending?
- ❑ Have you bought something recently that you didn't need and couldn't afford?
- ❑ Do you regularly spend more than your paycheck?
- ❑ Have you been turned down for credit?
- ❑ Do you buy lottery tickets in the hopes of getting out from under?
- ❑ Have you put off saving money for a rainy day?
- ❑ Does your total debt (mortgage excluded) exceed your rainy-day reserve?

Add up the numbers in the boxes. Is your score 0? Good for you! You're in control of your cash flow. Skip this section and proceed to the next chapter. If you score in the 1 to 5 range, however, you may need to reduce your debt by following Rich Dad's program. If you score in the 6 to 10 range, watch out—you may be headed towards financial disaster. The higher the score, the more urgent it is that you increase your financial literacy.

TAKE NOTE

A debt-reduction plan will compel you to live within your means before you try to increase your means.

RICH DAD'S CASH FLOW MANAGEMENT PROGRAM

To get control of your cash flow, first you need to establish short- and long-term goals. In the margin, write down what you want your cash flow to be in one year and what you want it to be in five years. These goals are meant to help you map out a debt-reduction plan.

The Rich Dad philosophy is to expand your means so that you can live the lifestyle you desire. Though this philosophy doesn't embrace the notion "cut up your credit cards and live below your means," if you're so deeply in debt that you cannot even imagine expanding your means, you'll need to follow a debt-reduction plan first. Debt reduction will get you out of the hole and on the path to financial freedom.

Your debt-reduction plan will compel you to live within your means before trying to increase your means. The initial step should be this: Pay yourself first. Put aside a set percentage of any and all payments you receive, whether from work or other sources. Buy three piggy banks, one for saving, one for tithing to charity, and one for investing. Put one dollar in each piggy bank each and every day (or more if you can). At the end of the month, deposit the money in the savings piggy bank in a secure savings account or mutual fund. Give away the money in the charity piggy bank to a qualified charity or a religious organization of your choice. Deposit the money in your investment piggy bank in an investment savings account, and *don't take it out* until you're ready to invest it some other way. Think of each dollar in your investment piggy bank as an employee ready to work hard for you.

If you absolutely cannot pay yourself first, follow the Rich Dad course of action outlined below, up to the point where you eliminate unsecured debt. Then try once again to pay yourself first. Here is the Rich Dad program:

1 Control spending
2 Eliminate unsecured debt
3 Review your credit rating

Not all of these steps will apply to your situation. Just follow the ones that do and soon enough you'll find you can live within your means.

DO

WHAT THE RICH DO

CONTROL SPENDING

When you find yourself deep in a hole, you need to stop digging. And that means curbing your spending—avoiding the temptation to buy doodads like a robot lawn mower, a car that gets ten miles per gallon, or a second pair of high-end athletic shoes. Admittedly, this requires willpower. Nowadays frugality is out of favor. To get out of debt, though, you need to adopt the old-fashioned virtue of delayed gratification.

By cutting back on doodads, you'll increase the percentage of income you keep. It's important not to consider this a temporary step. If you truly want to stay out of debt and enjoy security, comfort, or riches, you ought to make purchasing assets instead of doodads a life-long practice.

RICH DAD'S TIP

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"When you find yourself deep in a hole, you need to stop digging."

There are hundreds of ways to trim a budget. For example, you can practice wiser money management. Here are some ideas to inspire you:

- Pay bills on time to avoid late fees.
- Use only one credit card until you get control of your spending.
- Pay off your credit card balance each month to avoid finance charges.
- Find a credit card with a lower interest rate and no annual or transfer fees, then consolidate your debts so you will pay less in interest and fees.
- Don't use automated-teller machines (ATMs) that charge a fee—you'll be paying for your own money!

You can also adopt wiser shopping habits:

- Try paying cash; use a charge card only for emergencies.
- If it ain't broke, don't fix it. The avocado-green refrigerator stays!
- Don't go to the mall to browse, and never buy on impulse.
- Switch to less expensive brands of everything from shampoo to cars. When buying big-ticket items (necessities only, of course), read magazines like Consumer Reports to make sure you're getting quality along with a lower price tag.
- Be patient and wait for a sale.
- Shop at wholesale clubs and discount department stores.
- Respect your budget; if you've reached the $200 food limit, skip

the potato chips or the ice cream.

- Buy generic medicines or find a discount pharmacy.
- Consider starting a part-time business, even if you have a full-time job, and review your expenses to see if any could be deductible business expenses.

Then there's travel and entertainment, a doodad black hole for many people. How can you stop your money from getting sucked away?

- Don't take a vacation until you have the money to pay for it.
- Shop for discount airfares—or drive.
- Pump your own gasoline.
- Cut back on meals out, whether they're eaten at a four-star restaurant or your local fast food outlet.
- If you're a movie lover, go to a matinee instead of an evening show, and bypass the concession stand. Better yet, rent a video.
- Resign from the country club. Play on public golf courses, and join the local YMCA if you want to use exercise equipment or a swimming pool. Trim your budget further by walking or jogging.

TAKE NOTE

For many people, travel and entertainment are a doodad black hole.

When it comes to wise budgeting, household expenses are another area ripe for reining in. The following ideas are meant to inspire you only—there are dozens of other ways to cut:

- Turn the thermostat down and the lights off.
- Winterize your house from top to bottom, insulating pipes, drafty windows, crawl spaces, and other energy-guzzling areas.
- Cut back on telephone or Internet service fees by shopping around. Curb your cell phone use.
- Shop for lower-cost insurance and raise your deductible.
- Don't run the dishwasher unless it's full.
- Don't water your lawn every day.
- Cut the grass yourself.

You're probably thinking, Save $2 by changing shampoos and $10 by cutting back on cell phone chatter? That's small potatoes. In fact, you'd be surprised how quickly those savings add up. If you save $25 a week—and most people can easily trim that much—you'll have $1,300 a year to put towards your credit card balance. Save $40 a week and you'll have $2,080!

THE WASTE-WATCHER'S DIET

Write down enough belt-tightening measures to yield at least $150 in savings each month (or as much as you can realistically save), then commit to shedding your budgetary flab. Your financial health depends on it.

I agree to cut back on	for a monthly savings of
____________________	____________________
____________________	____________________
____________________	____________________
____________________	____________________
____________________	____________________
____________________	____________________
____________________	____________________
____________________	____________________
Signed ______________	Total $ ______________

RICH DAD'S TIP

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"There's a good reason it's called disposable income: most people throw their extra money away. That's buying doodads! How will the assets ever grow?"

ELIMINATE ALL UNSECURED DEBT

Simply speaking, there are two types of debt: secured debt and unsecured debt. *Secured* debt is debt with collateral behind it, such as your home mortgage or car loan. *Unsecured debt* is debt with no collateral behind it, for example, personal loans, medical bills, and the charges on your credit card. Once you've cut expenses, the debt you should attack first is unsecured debt. While some unsecured debt is unavoidable—most is unnecessary, the result of unbridled spending. In the Rich Dad program, there are also two types of debt, good debt and bad debt. Review your unsecured and secured debts to see if they are good or bad debts. Rich Dad would consider most unsecured debt bad debt. Remember, good debt is debt that buys an asset, so it is usually secured debt.

CREDIT CARD CAVEAT

Credit cards can be wonderful bookkeeping tools, particularly if you use one credit card for business purposes and another for personal use. But beware—credit cards are only useful if you pay off the total balance due each month, thereby eliminating interest charges. One reason many people get mired in debt is that credit card companies make it so easy. Every day, it seems, an offer for a new card arrives in the mail, a current creditor increases your limit, or a store grants "instant" credit. Credit is a consumer's dream—and soon-to-be nightmare. What can you do? Simple: Don't get sucked in.

Credit cards have benefits, to be sure. With a credit card you can secure rental car reservations, purchase tickets over the phone, and solve the problem of checks that stray in the mail. But there are so many types of cards that you have to shop to find a budget-friendly one. Just the card alone—forget your charges—can eat a big hole in your pocket. There are late fees, over-limit fees, and annual fees, the latter of which can approach a whopping $100. As for annual percentage rates (APRs), they can reach as high as 26.5 percent. Does the APR really make any difference? Say you're paying $500 a month on a $10,000 balance. With an APR of 18 percent, it'll take twenty-four months to pay off the loan, and you'll also be paying almost $2,000 in interest. With an APR of only 9.5 percent, it will take only twenty-two months to pay off the loan, and you'll pay $1,000 less in interest. Now let's assume you only pay $175 on the card. It would take you 131 months, or almost 11 years, to pay off the $10,000 at 18 percent and 77 months, or over 6 years, to pay off the $10,000 at 9.5 percent, and you will have paid $12,872 and $3,364 in interest respectively.

RICH DAD'S TIP

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"Every time someone lends you money, you become his employee because your debt becomes an asset in his asset column and a liability in your liability column."

TAKE NOTE

Late fees, over-limit fees, annual fees—credit cards can eat a big hole in your pocket. Paying only the minimum required on your card will keep you in debt forever, making you an employee of the credit card company.

WHERE TO DO YOUR CREDIT CARD HOMEWORK

Aside from scrutinizing the fine print of offers received in the mail, you can surf the Internet to shop for the best credit card deals. The following sites offer advice, information, and calculators to determine what your credit card might cost you:

- Bankrate.com *(www.bankrate.com)*
- Quicken.com *(www.quicken.com)*
- CreditChoice *(www.creditchoice.com)*
- iVillage: Money Life *(www.ivillagemoneylife.com)*

RICH DAD'S TIP

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"Every liability you have is someone else's asset."

Why would anyone pay for a higher-rate credit card? Some people don't know what rate they're being charged, and that they might have better options. They've never read the fine print on credit card agreements. Others fall for "reward" carrots. Maybe this carrot has been dangled before your eyes: "Gasoline charged to this card will receive the 'cash' rate per gallon." That may sound good, but watch out—if you don't pay in full within twenty-five days, you may owe a $29 late fee and rack up interest at 24.5 percent. Or maybe you've been promised a 4 percent rebate on each purchase at a toy store. If you think 4 percent off a board game buffers a 19.4 percent APR and a $29 penalty each time your payment's a day late, think again.

Clearly, getting out of debt requires credit savvy. Examine the terms of your credit card agreement. If you don't like what you see, call the company and see if it will lower its rate to keep you on board. If not, start looking for a better card. When you find one with a lower APR, make sure it isn't a temporary promotional offer. Also make sure there aren't any transfer fees. You don't want to incur debt to consolidate debt.

HOW TO DIG YOURSELF OUT

Depending on your liabilities, getting free of unsecured debt could take some time and patience. Since interest charges are compounding your problem, the sooner you start a reduction plan, the better. Try this step-by-step strategy:

1. If possible, pay off all your unsecured debt with your rainy day reserve, then replenish your savings posthaste.
2. If you have no cash reserve, prioritize bills representing unsecured debt. First cover food, medicine, utilities, gasoline, any child support, and taxes if you're self-employed.

LIQUIDATE YOUR CREDIT CARD LOANS

Take stock of your unsecured credit card debt by filling in the chart below. In the margin, reorganize the list in descending order of interest rate. Pay off the card with the highest APR first, then proceed down the line.

Credit Card ______	Mimimum monthly payment ________	Balance ________	Interest rate ___
Credit Card ______	Mimimum monthly payment ________	Balance ________	Interest rate ___
Credit Card ______	Mimimum monthly payment ________	Balance ________	Interest rate ___
Credit Card ______	Mimimum monthly payment ________	Balance ________	Interest rate ___
Credit Card ______	Mimimum monthly payment ________	Balance ________	Interest rate ___

Always transfer the amount you've been paying on one card to the next in full, so that your payment will increase. In other words, the monthly amount you were paying on the card just paid off—$200—plus the minimum payment on the next card—let's say $45—will be the new amount you now pay on the next card—a total of $245. Continue this process until all your credit card debt is paid off.

7. When your unsecured debts are paid off, close all but one or two credit card accounts, and continue to pay them off each month.
8. Redirect the monthly amount of the payment on the last credit card, including the extra $150, to your investment account or toward reducing other bad debt.

If you've made it this far, you deserve a round of applause. Now, what about paying yourself first? Maybe you haven't been able to do that. This is the time to start. Get your three piggy banks, one for saving, one for tithing to charity, and one for investing. Each day put the same amount in each piggy bank. Every month, make your separate deposits as described earlier. Remember, the money destined for an investment savings account should be kept in that account until you're ready to invest it some other way. Once you've invested a dollar into the asset column, never take it out of the asset column. This is your "employee," and it will generate your eventual passive or portfolio income—the true beginning of financial freedom.

RICH DAD'S TIP

"Think of every dollar in your asset column as an employee who works hard for you so you don't have to work so hard. Once you put a dollar in your asset column, never take it out."

REVIEW YOUR CREDIT RATING

Records of all the financial transactions you make—from retail purchases to home equity loans—are fed to credit bureaus, which digest the data and issue a credit report. The report grades your credit worthiness and is available to anyone with whom you wish to do business. Based on your rating, creditors will decide not only whether to grant you a loan or card but also what interest rate to charge you. The lower your rating, the higher your interest rate. You're legally entitled to review your report, and you should do so. Errors are frequently made and should be corrected. The Federal Trade Commission's Bureau of Consumer Protection has guidelines for disputing inaccuracies (www.ftc.com). To order a copy of your report, contact any or all of these major credit bureaus:

- Trans Union (1-800-888-4213; *www.transunion.com*)
- Experian (1-888-397-3742; *www.experian.com*)
- Equifax (1-800-685-1111; *www.equifax.com*)

If you're a homeowner and your report is excellent, find out whether you're receiving the best possible mortgage rate. Nationwide, homeowners spend $100 million more than necessary each year because they don't know they qualify for lower interest.

TAKE NOTE

A secured debt, which is collateral-backed, can be bad debt if it's incurred for a doodad that doesn't generate income.

REDUCE SECURED DEBT THAT IS BAD DEBT

Remember secured debt—the kind of debt that has collateral? Presumably you've been paying it off all along; otherwise the car dealer would have repossessed your vehicle or the bank would have foreclosed on your home. Once you've reduced your unsecured debt, it's time to review your collateral-backed debt. Don't let the word *collateral* fool you. On Rich Dad's balance sheet a good debt is a collateral-backed debt—a liability, loaned to you for an asset that generates income. As long as your asset generates positive cash flow, which means your asset is paying for the related debt, it is good debt. Consider reducing or eliminating all bad debt, even if it is secured.

Getting control of your cash flow means minimizing secured-debt doodads. Here are a few ways you can achieve this goal:

- Once you've paid off unsecured debt and started pay-yourself-first savings, tithing for charity, and investing piggy banks, you can consider using any extra funds to pay off more of your mortgage, auto loan, or home equity line of credit. Consult your financial advisor as to whether this is appropriate. You may have a very low interest rate on your home mortgage and it may be better to invest the additional funds in an asset that has a higher interest rate. This way your asset will be paying your mortgage.

AUTO ADVANTAGES

With some auto prices approaching the cost of a small home, consumers can't be lazy about comparison shopping. Here are a few money-saving resources available to car buyers:

- **CarPoint (*www.carpoint.msn.com*). This allows you to browse one hundred models inside and out, determine invoice prices, and contact local dealers.**

- **Consumer Reports New Car Price Service (1-800-651-4636; *www.consumerreports.org*). For a nominal fee, this provides up-to-date pricing information. You'll find out what a model actually costs a dealer, giving you a basement price for negotiating.**

- **CarBargains (1-800-475-7283; *www.checkbook.org*). Once you've selected a make and model, this nonprofit service will obtain firm, rock-bottom quotes from five local dealers for a fee of $165.**

- Refinance your home at a lower interest rate.
- Keep your old car as long as repairs are not too costly.
- If you need a car, consider leasing one or buying a secondhand one in good condition. Another option: shop for a new car through an auto-buying club or on the Internet, which can save hundreds or even thousands of dollars.

TAKE EMERGENCY MEASURES

For some people, cutting back on secured and unsecured debt won't be enough. If you absolutely must, you can resort to other measures to dig yourself out. The following options are not without risks, so be

DO YOU NEED HELP?

If your struggle with debt is more than just circumstantial, you should seek professional support. Chances are you'll need free or low-cost counseling. Watch out for scams offering instant "credit repair." Instead, seek out one of the following services:

- The National Foundation for Credit Counseling (1-800-388-2227; *www.nfcc.org*).This nonprofit service, funded in part by contributions from credit card companies, offers educational programs and confidential credit consultation. For those deep in debt, a counselor will draw up a relief plan and negotiate more favorable payment terms with creditors.
- Consumer Credit Counseling Services (1-800-388-2227). This provides the same services as the aforementioned organization and is also partially funded by credit card companies.
- Debtors Anonymous (1-781-453-2743; *www.debtorsanonymous.org*). Modeled on Alcoholics Anonymous, this support group follows a twelve-step program to help members overcome compulsive spending.

vigilant. You could see your credit rating dip, or find yourself mired even deeper in debt.

- Call your creditors and negotiate reduced payments or balances. Many creditors, afraid of customer bankruptcy, will bargain because they prefer dimes on the dollar to nothing.

- You may need to seek counseling. Is your indebtedness due to unforeseen, catastrophic medical or legal bills—or does it signal a chronic problem? In the latter case, you may need counseling to discover why you're financially self-destructing. If you don't change your relationship to money and how you think about money, any debt relief you achieve will be short-lived.

- Radically downsize. Sell one of your cars, move into a smaller home, or pay rent.

- Make more money. Get a higher-paying job or a second job, or start a part-time business. But don't make the mistake of people stuck in the E quadrant—don't let the extra money give you a false sense of solvency. Remember, if you start a part-time business you may be able to deduct some of your expenses as business expenses that would not otherwise be deductible.

- Borrow from your life insurance policy. With accumulated cash value, you can borrow up to 95 percent at low interest. But you'll be borrowing from yourself and converting an asset into a liability.

- Take out a home equity loan or line of credit. Both tap into the equity you've built in your house and have the advantage of tax-deductible interest. Remember, however, this option turns unsecured debt into secured debt, with your house as collateral; since your house doesn't generate income, it would still be bad debt.

- Borrow against assets. Your employer may allow you to borrow up to half of the money in your 401(k). Depending on the return and liquidity of your other investments, you might also pull funds from elsewhere in your portfolio. For example, it may make sense to sell stock earning 8 percent in dividends to pay off a card with a 16 percent APR. Again you're borrowing from yourself.

THE VERY LAST RESORT: FILE FOR BANKRUPTCY

If you've explored every option and still cannot pay off your creditors, you may have to file for personal bankruptcy. This step should be the last resort, not to be taken lightly or without the advice of an experienced attorney. Rich Dad believed you should avoid bankruptcy at all costs. He said, "Take responsibility for your actions. Avoid bankruptcy by finding ways to increase your income, renegotiate your debts, and pay off your debts, even if it takes years." Filing bankruptcy will blight your credit report and make it difficult to get credit or a mortgage.

Individuals usually file under Chapters 7 and 13 of the U.S. Bankruptcy Code. Chapter 7 is best for people with too much credit card debt. A court liquidates most of your assets to pay creditors as much as possible, then erases all remaining unsecured debt. You may keep some or all of the equity in your home and car, and future income won't be prey to creditors. But you'll still have to pay secured debts, taxes, and any alimony and child support.

Chapter 13 is most appropriate for those who have disposable income yet are at risk of defaulting on secured debts or on taxes, alimony, or child support payments. Under Chapter 13, creditors have to accept a court-ordered repayment plan lasting three to five years. A trustee gives you a bare-bones budget and allocates all remaining income to creditors after renegotiating payment terms. Usually, secured debts are paid in full, unsecured debts in part.

A FRESH START

Those who change their ways can begin rebuilding credit with a secured credit card. It works like this: You deposit money in a special savings account, then are issued a card with a credit limit equal to the amount of savings. In case of a missed payment, the money serves as collateral. The APR may be higher and the grace period shorter than for standard cards, but after a year of timely payments you may be issued a standard card. You should pay the full amount due each month to re-establish good credit and avoid interest charges. Similarly, you can build up a passbook account and get a bank to issue a loan against it. After a few years of responsible credit behavior, you may be able to get a mortgage from the bank.

RICH DAD'S TIP

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"Take responsibility for your actions. Avoid bankruptcy by finding ways to increase your income, renegotiate your debts, and pay off your debts, even if it takes years."

LIFE AFTER DEBT

One great asset of the rich is that they think differently. People who think the way everyone else does wind up having what everyone else has. And what is that? Hard work, heavy taxes, liabilities mistaken for assets, a lifetime of debt, exhaustion and anxiety. Keeping up with the Joneses can be lifelong drudgery.

RICH DAD'S TIP

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"Know the difference between good debt and bad debt. Eliminate the bad, increase the good, and you'll be well on your way to financial freedom."

People who follow the Rich Dad program don't try to live like the Joneses; they try to expand their means to buy assets, so that eventually they'll have income from their assets pay for their doodads. The debt reduction portion of this program is only for people who are so deeply in debt that they cannot imagine the concept of expanding their means. Most people who follow this part of the program find themselves living within their means in five to seven years, although some may be debt free within a matter of months. As soon as they're debt free, they're ready to pay themselves first and invest in assets that will allow them to live the lifestyle of which they dream.

Have you come this far? Congratulations! Now that you're living within your means, it's time to expand your means. It's time to become an investor.

Become AN INVESTOR

"Investing is not a get-rich-quick drama. Investing is a plan, often a dull and almost mechanical process of getting rich."

Having reduced expenses and paid off debts, you're ready for a fresh start. If your goal is security and comfort rather than riches, you should develop your financial plan accordingly. The first part of this chapter will give you the tools for making smart investments and gaining a secure financial foothold. That is, it will help you become an average investor. Once you're on firm fiscal ground, you might decide to venture farther and invest in real estate. Later in the chapter, you'll encounter helpful tips on finding and purchasing income-producing property. After a successful foray into real estate, who knows? You may well find that you want to become a professional investor. You can choose your financial future.

THE SEVEN RULES OF INVESTING

Before launching yourself as an investor, you should commit the Seven Rules of Investing to memory. If you follow these rules during your journey, they'll keep you on the straight and narrow path toward comfort and security.

Rule 1: Know what kind of income you have to work with.
Are you dealing with earned, portfolio, or passive income?

Rule 2: Convert earned income into portfolio income or passive income as efficiently as possible. This will not only put your money to work for you but also increase the chances that your funds will grow. For example, an investor might purchase a multifamily home, live in one unit, and rent out the others to cover the debt service, or rent out all the units for a positive cash flow, investing the profits in securities. A good advisor can tell you how to handle investments in ways that maximize tax efficiency.

Rule 3: Purchase securities with positive returns. Obviously, securities are bought to serve as assets, yet some securities lose value and become liabilities. While no investment is risk free, the educated investor will more often than not buy securities that provide a good return on investment.

RICH DAD'S TIP

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"Investing is less risky than being an employee. Skilled investors are in control of their investments; employees are under the control of their employers."

Rule 4: Become your own best asset—instead of your own liability. A good investor buys undervalued securities in a bear market or lucrative real estate in foreclosure. A bad investor locks in losses on a stock by panicking in a market slump. An educated investor is emotionally neutral when making investment decisions.

Rule 5: Be prepared for anything; don't try to predict what will happen or when. Investing is a skill, not a science. The Zen swordsman disciplines body and mind to counter any blow spontaneously; he does not anticipate the moves of an opponent, for that impedes his ability to react. Likewise, professional investors know they cannot control the real estate or stock market, let alone the global economy. Instead, they train themselves to be financially intelligent, to think confidently and creatively when opportunities or problems arise.

Rule 6: Learn to trust that, when a good deal presents itself, the funding will be close behind. Sophisticated investors know a money-making deal when they see one, and nothing generates financial backing like the prospect of success. The opposite also holds true: If respected investors are all rejecting a deal, an investor should heed the red flag.

Rule 7: Know how to evaluate risk and reward. There is risk in every investment, but risk is a relative term. An investor who can understand a company's financial statement, evaluate a business system, or take the pulse of the stock market has a greater chance of buying an asset than a liability. Since risk is often directly proportional to reward, anyone who hopes to become wealthy must be able to invest more aggressively than someone who's content to be secure. The more financially educated you are, the less risk you're taking.

RISK-TOLERANCE QUIZ

What is your risk-tolerance factor? Answer the following questions:

_____ Do you consider your mortgage your best investment?

_____ Do you regularly invest in your 401k but flinch at the thought of buying stock?

_____ Do you avoid buying stocks during a market downturn?

_____ Do you regard real estate investing as a high-stakes gamble?

_____ If you have $2,000 to invest, do you put it in a CD without considering that it might earn more interest elsewhere?

_____ Are you hoping that Social Security will provide a safety net for your old age?

_____ Is starting your own business a prospect you would never consider?

_____ If someone you admire asked you to enter into a business partnership that had potential, would you flat out reject the offer?

_____ Are you fearful of losing your job because of the income loss?

_____ Do you stay awake at night worried about losing your job because you think you don't have the skills to find another?

If you answered yes to all these questions, your risk tolerance is woefully low. Rich Dad would define low risk tolerance as the riskiest result of all, since you're relying on your savings, employer, and government to take care of you. If you answered yes to only five, your risk tolerance is average. If you answered no to all, congratulations—you have the stomach for risk that could someday bring you riches. Remember, without some risk, there can be little reward.

THE TEN INVESTOR CONTROLS

Because investing is about risk control, before you set out on this exciting adventure you should absorb the Ten Investor Controls. Investing requires discipline and confidence. While being mindful of outside forces you cannot control—a surprise bid by a competitor, or a new Securities and Exchange Commission regulation—you must take charge of a number of aspects of your financial life so that you can manage risk. How many you control will determine what level of investor you become. The Ten Investor Controls are:

RICH DAD'S TIP
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"Investing isn't risky; not being in control is risky."

1. Control over yourself
2. Control over income/expense and asset/liability ratios
3. Control over the management of your investments
4. Control over your taxes
5. Control over when you buy and sell
6. Control over brokerage transactions
7. Control over the entity, timing, and characteristics of your investments
8. Control over the terms and conditions of agreements
9. Control over access to information
10. Control over philanthropy

Many people find investing risky because they aren't in control. If you're still not in control—not mentally prepared to become a successful investor—then you should turn your money over to a professional financial advisor or team trained to manage your investments. But if you desire more control over your financial life, following this program will help you gain that control. While you'll still benefit from the advice of professionals, you're about to become an investor in your own right.

BECOMING AN AVERAGE INVESTOR

Many people become investors with paper securities. Almost all of these people, average investors, before making their first purchase, run up against a dizzying array of paper securities. How do you pick the winners from among the thousands of stocks, bonds, and mutual funds available today? Here are some tips:

- Call on several financial planners or stockbrokers, and interview your prospects. Ask about their credentials, investment strategies, the range of services provided, and any fees charged. Ask them for a suggested portfolio of stocks, then compare the different portfolios to see if you can spot a commonality among the recommendations.

- Review corporate prospectuses, watch stock indexes, and read business periodicals. You'll hone your financial intelligence and keep abreast of economic trends. Many companies post their balance sheets on-line for easy access. Mutual funds are happy to send you their prospectuses. And there are good periodicals available at your library or bookstore, including *Barron's* (which publishes the Lipper Analytical Services index of value funds and growth funds), *Forbes* (which lists an annual honor roll of top-performing funds), the *Wall Street Journal*, and *Kiplinger's*. This will increase your financial literacy and better prepare you to meet with your financial advisors.

- Put together a sample portfolio. Performing a dry run with a handful of stocks, bonds, or mutual funds will acclimate you to the process of investing. Research the performance history of each of your fictional securities, review balance sheets and prospectuses, track daily market prices or interest rates. If you end up "losing" money, don't lose faith—consider it a lesson in resilience. Remember, investing alone is the territory of the S quadrant. To become a B, you have to invest with a team.

- Join an investor group. There are thousands of small-investor clubs under the auspices of the National Association of Investors Corporation (call 1-877-275-6242, or log on to *www.better-investing.org*). Clubs usually have about a dozen members who meet regularly to report on research and ideas, pool money, and vote on which securities to buy. If you prefer flying solo, you can join the American Association of Individual Investors, which among other tools offers seminars and a monthly publication on investing strategy (call 1-800-428-2244 or log on to *www.aaii.com*).

STOCKS

RICH DAD'S TIP

"The reason most average investors lose money is because it is often easy to invest in an asset but difficult to get out. Your exit strategy is often more important than your entry strategy."

If you're investing in paper securities, to ensure growth of assets you should invest in stocks. Picking stocks was not part of Rich Dad's plan to become rich because he had no control over the management of the companies that various stocks represented. If, however, this is one of the routes you elect to take, then you'll have to do your homework. Historically over the long term, stocks have averaged an 11 percent annual return, yielding twice the gains of bonds or CDs. Unless you have the time to educate yourself seriously in stock analysis and to monitor your portfolio, you should find a competent financial planner or broker to assist you in building your portfolio. If you're going to invest on your own, start small and build your portfolio slowly until you have a firm understanding of both the market and stock analysis.

BEFORE YOU BUY STOCK, DO YOUR HOMEWORK

The most efficient way of sizing up a stock is to look at its price/earnings (P/E) ratio, that is, the share price divided by earnings per share. P/E ratios are published daily with stock prices. As a rule, stocks with the lowest P/Es in their sector tend to be underpriced and therefore a good buy. High P/E ratios indicate that the price is too high, earnings are low, or both.

Before you buy stock, you should judge the health of a company by analyzing its financial statements. You can request copies of financial statements by calling a company's investor relations or shareholders department. The most important financial statement a company issues is its annual report. This document explains the business strategies of the company and details its financial standing to shareholders.

RICH DAD'S TIP

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"When I look at the financials of a business, I look at its guts. I can tell if the business is fundamentally strong or weak, growing or declining. I can tell if the management is doing a good job or wasting a lot of the investors' money."

An annual report will include the company's *balance sheet*, which lists assets (such as cash, inventory, equipment, and accounts receivable or money that is owed to the company) and liabilities (such as accrued expenses and accounts payable or money that the company owes). The difference between total assets and total liabilities is the stockholders' equity. Carefully review the notes to the financial statements for pending transactions or other pertinent disclosures by management.

When you're reading a balance sheet, compare the current year's numbers with those of previous years. The balance sheet of a healthy company might include:

- High quick and/or current ratios (generally 2 to 1), which indicates that the company has enough current or liquid assets to pay its liabilities:

  quick ratio = liquid assets/current liabilities

  current ratio = current assets/current liabilities

- Low debt-to-equity ratio, which depends on the portion of the company financed by outsiders (debt) and that financed by insiders (equity):

  debt-to-equity ratio = total liabilities/total equity

Negative indicators might include:

- Increasing long-term debt
- Ever-increasing accounts receivable without an increase in sales, suggesting the company may not be timely collecting from its customers

The company's *income statement* lists its revenues and expenses. Revenue is the money a company receives for doing business; expenses are what it costs to run the business. Compare the numbers for the current year with numbers from the previous years. Do you see a steady, or accelerating, increase in revenue? That signals a growing company. If revenues increase faster than expenses, then the company's profits are increasing; if revenues decrease faster than expenses, then profits are decreasing. Another positive indicator is a net income that increases from year to year.

Two ratios you'll want to review are the gross margin percentage and the net operating margin percentage, which are generally calculated and presented as part of a company's financials. The higher these percentages the better.

The income sheet also states earnings per share. This number is found by dividing the company's net after-tax income by the stockholders' equity (the number of outstanding shares). For example, if a company's net income after taxes is $220,354 and it has 8,000 outstanding shares, the earnings per share would be $220,354 divided by 8,000, or $27.54. If this number increases from year to year, it may indicate a good investment.

If you look at the balance sheet and the income sheet together, you can learn even more about the company's financial health. For example, if inventory (listed on the balance sheet) is growing faster than revenue (listed on the income sheet), the company may be having a hard time selling its product, or it may be gearing up for expansion into a new market. You'll want to know which. If a company's accounts payable (listed on the balance sheet) is increasing faster than its revenue, then the company could have a cash flow problem.

The *statement of cash flow* indicates how much money has come into the company and where it was spent. This statement also indicates how much money has left the company. If more cash is leaving than coming in, this company may not be your best investment.

Other financial statements required for publicly traded companies include the 10-K and the 10-Q. A 10-K is an expanded version of an annual report. Like an annual report, it is issued once a year, but it

WHERE TO DO MORE HOMEWORK ON STOCKS

Considering stocks? Check them out in these publications, most of which should be available at your public library: *Moody's Handbook of Common Stocks* and *Handbook of Dividend Achievers* (for copies, call 1-800-342-5647, ext. 7601, or log on to *www.fisonline.com*); *Morningstar StockInvestor* (to subscribe to this newsletter, call 1-888-736-0780 or log on to *www.morningstar.com*); and *Standard & Poor's Stock Reports* and Stock Guide (for a copy, call 1-800-221-5277 or log on to *www.stockinfo.standardpoor.com*).

If you're really serious about stock investing, check out the Securities and Exchange Commission's website at *www.10kwizard.com*, which maintains a database of almost 70,000 corporate financial reports.

contains more detailed financial and business information and less promotional verbiage. A 10-Q is released on a quarterly basis. Unlike the 10-K or the financial statements in the annual report, 10-Qs are usually unaudited by accountants. A 10-Q may be helpful if you want to detect financial changes early, but make sure you compare it with the annual report or the 10-K to get a better picture of a company's financial health.

It's important not to rely on financial statements alone in making your investment decisions. Ask questions about the industry. A company may have strong financial statements but a major product that has just been made obsolete by the new product of a competitor. This is another reason not to operate alone. Your broker might have a better understanding than you of the company's history and its position in the industry. Should you choose to analyze potential companies on your own, remember that you will still be operating from the left side of the CASHFLOW Quadrant. You are competing against the financial management teams of multi-billion dollar funds. A single sale or purchase by a large fund could shift the market for a particular stock and wipe you out before you have the opportunity to react.

WHAT TO DO WHEN BUYING STOCK

Once you've done your homework and consulted with a financial planner or broker, it's time to take the plunge. To make informed decisions, you need to review the list of dos and don'ts:

- Recognize that you aren't in control of the management of stock investments. You're investing in the management of the companies.
- Maintain meticulous records of all transactions. If you work through a discount broker, be sure you'll get a year-end tax statement.
- Sell when others are buying, buy when others are selling (but only if the company is sound). Better yet—unless you're a sophisticated stock picker—leave your money in for the long term.
- Be careful when buying "best picks"; they may be one-time performers or overpriced due to popularity.
- Invest in a minimum of five stocks, so if one does poorly the others may buffer the loss.

TAKE NOTE

A purely mechanical, or quantitative, way of picking stocks outperforms 80 percent of the professional stock pickers.

WHAT NOT TO DO WHEN BUYING STOCK

- Never invest in a company without reviewing its financial status, prospectus, and SEC reports.
- Don't give your broker the authority to trade without your approval.
- Don't be afraid to disagree with a broker's strategy or stock pick. At the same time, you should think twice before ignoring the advice of a broker who has always steered you right.
- If you're picking stocks yourself, it's not a good idea to invest in too many. Remember, you're the one who has to track them.
- Don't sell low in a slump only to turn around and buy high. Avoid transactions through panic; keep your emotions under control.
- It's best not to buy stocks beyond your risk tolerance.
- Unless you have keen investor skills, don't switch back and forth between stocks, trying to catch the next wave.

BONDS

The average investor often buys bonds as part of an overall plan for security and comfort. While bonds are generally considered safe investments, you can still lose money with them. Keep in mind the seesaw effect of interest rates and value: If interest rates rise, the value of your bonds goes down, and vice versa. Keep in mind, too, that over time inflation can cause the value of the fixed-rate interest payment as well as the principal to erode. The rich often use bonds as part of their overall investment strategy. In a volatile stock market they may use bonds to "park" their money until it is time to re-enter the market (usually when everyone else is exiting).

If after doing your homework you decide to buy bonds as part of your comfort/security portfolio, you should review the following tips before making your first purchase.

WHAT TO DO WHEN BUYING BONDS

- Buy T-bills yourself to eliminate commissions. You can do this through TreasuryDirect, which allows purchases on-line at *www.savingsbonds.gov* or by phone at 1-800-943-6864.
- If you want to calculate yield and tax advantages accurately, buy bonds through a financial planner or broker.
- Buy when interest rates are high or recession looms.

RICH DAD'S TIP

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"Avoid transactions through panic; keep your emotions under control."

WHERE TO DO YOUR HOMEWORK ON BONDS

There are two helpful websites for people fishing for bonds. "Investing in Bonds" (*www.investinginbonds.com*) is an educational guide to the different types of bonds. It provides current prices and credit ratings for corporate and municipal bonds and treasuries, as well as instructions on how to read bond-market tables. "U.S. Savings Bonds On-line" (*www.savingsbonds.gov*) explains how to buy, sell, and reinvest in bonds. It also lists upcoming auctions, prices, rates, and yields, and allows direct purchases through TreasuryDirect.

- To minimize risk of default, stick to bonds with "AA" ratings or higher.
- Hold bonds at least a year to benefit from the capital gains tax rate.
- Buy bonds that mature in five years or less to avoid volatility.

When buying revenue-backed municipal bonds, carefully evaluate the financial viability of the project producing the revenue.

WHAT NOT TO DO WHEN BUYING BONDS

- Don't invest a significant portion of your portfolio in bonds. Remember, you need growth.
- Don't buy bonds when interest rates are low or unstable.
- Don't get lulled into complacency. Bonds can be downgraded, defaulted on, or "called" (paid off) before maturity, so your anticipated income stream could suddenly dry up.
- Avoid speculative, high-yield ("junk") bonds.

MUTUAL FUNDS

Mutual funds are investment vehicles for a person to use as part of his or her financial plan to be secure or comfortable, not rich. Because of built-in management, mutual funds may be a better choice than stocks for new investors who lack the resources to pay a full-service broker or to create a diversified portfolio. Selecting mutual funds is not that different from selecting stocks, since you must first decide what types of funds you're interested in, then evaluate their past and current performance.

BEFORE YOU BUY INTO A MUTUAL FUND, DO YOUR HOMEWORK

Before sinking your dollars into a mutual fund, be sure to read its prospectus carefully. The prospectus is a financial document required by the Securities and Exchange Commission (SEC) that describes the fund to potential investors. You can request a copy from the mutual fund company itself—either by phone or through the company's website—or from your broker.

The SEC requires that each prospectus contain certain information that makes it easier for you, the investor, to compare different funds. This information may be organized differently from one prospectus to another; use the document's table of contents to guide you to the information you're looking for.

Compare your financial objectives with the fund's. As you read over a prospectus, compare your own financial objectives with those of the fund. For example, are you looking for aggressive growth (which could yield high returns over the long term, but with a lot of volatility in between) or value (which could yield lower returns over the long term, but with less volatility in the meantime)? The type of companies in which a stock mutual fund invests will also tell you whether the fund matches your investment goals. Are they small-cap companies carrying high risk but potentially high returns? Are they large-cap blue chip companies that offer a generally safe return on investment but no room for explosive growth? And what about risk? For example, are you willing to accept the risk involved in an international fund, which is vulnerable to fluctuating international currency rates?

Avoid funds with high fees and expenses. Closely examine the fees and expenses laid out in the prospectus. You want to minimize the amount you pay over and above your investment. Compare the operating expenses of any funds you're researching and avoid those with high figures. Management fees range anywhere from 1 to 5 percent, which over time can significantly reduce capital gains. In some cases, you may be required to pay a load, or commission, when you buy or sell shares. You'll recall that a front-end load is a commission charged at the time of purchase. A back-end load is charged if you sell your shares before a specific period has elapsed. A level load is a flat annual fee. In general, you're better off looking for no-load funds. Don't forget to read the fine print; footnotes may outline additional fees or expenses.

Examine the fund's financial condition. A prospectus will present you with a condensed version of the fund's financial condition. Required information includes current and historical data (up to ten years) of the fund's total returns, as well as yields, turnover rate, and dividends, interest, or capital gains paid per share. A high turnover rate, meaning that the fund frequently sells investments and buys new ones, might mean increased commissions to brokers and other related costs, which could reduce the fund's returns to you. Look for decreasing expense ratios over time; this indicates that expenses haven't increased even if the size of the fund has.

Beware of funds with inexperienced managers. Check the fund manager's credentials carefully, and see how long the manager has been in charge. Has this person been around for a while? How has the fund performed during this period? Think twice about investing in a fund whose manager has been in charge for less than five years—that person's inexperience may cause your investment to underperform.

Request additional information. Prospectuses don't always include all the financial information to which you're entitled access. For example, the *statement of additional information* is an SEC-required document that offers in-depth detail about such things as the fund's investment strategies, restrictions, past performance, and specific investments. The statement of additional information also mentions any legal actions pending against the fund. You should request a copy of this document if it's not included in the prospectus.

Similarly, if you're not sent copies of a fund's quarterly and annual reports, request them. They outline the fund's performance and may compare it to the performance of other funds over different periods of time—a valuable tool when you're deciding whether to buy into a fund.

WHAT TO DO WHEN BUYING MUTUAL FUNDS

- Pick funds that have a proven track record and a manager who has been around for more than five years.
- Pick funds that meet your investment objectives and risk tolerance.
- Select no-load funds, all other things being equal. If you're interested in a load fund, make sure its performance is worth the fee.
- Invest primarily in equity (stock) funds if you want growth.
- If you're comfortable bypassing a securities dealer, buy shares directly from the fund or bank to avoid paying sales charges. Discount brokers offer reduced sales charges.
- Invest in four or five funds for diversification.

WHERE TO DO MORE HOMEWORK ON MUTUAL FUNDS

Before snatching up a hot performer, do your homework carefully. Like mutual funds themselves, resources on mutual funds are a dime a dozen, so pick carefully. Some of the best are *Morningstar FundInvestor* (a newsletter) and *Morningstar Mutual Fund 500* (a book), which you can order by calling 1-888-736-0780 or logging on to *www.morningstar.com*. Another is the *Value Line Mutual Fund Survey*. For this useful source, call 1-800-634-3583 or log on to *www.valueline.com*.

- Unless you need the income, reinvest dividends.
- Keep all of your fund statements for your tax records.

WHAT NOT TO DO WHEN BUYING MUTUAL FUNDS

- Don't invest in a fund if you haven't reviewed its prospectus and performance history.
- Don't panic. The worst thing you can do is sell when the market's dipping, and buy when it's high.
- Don't buy aggressive-growth funds if you're averse to risk.
- Don't switch back and forth between funds, trying to catch the next wave. By the same token, don't rest on your oars and stick with a fund that isn't performing or that changes its objectives. Seek the advice of a financial planner.

RETIREMENT PLANS AND ACCOUNTS

In addition to straightforward paper securities, average investors often avail themselves of retirement plans and accounts. Remember, a retirement account is a good vehicle for your plan to be secure and comfortable. Because retirement plans offer tax advantages and free money, they can be a good place to park some of your money. You should take advantage of any employer-matching opportunities. By making premature withdrawals difficult or costly, retirement plans train you to invest for the long term. If you're employed, check with your company's division of human resources to be sure you fully understand your pension benefits or retirement account. If you're nearing retirement age and are vested in a non-portable, defined-benefit pension plan, think twice about switching jobs; you may not gain in salary as much as you lose in guaranteed lifetime benefits. If you're self-employed or unemployed, you should explore all your options before committing to one.

Below you'll find different options listed; explore the one that best suits your current income and employment status.

RICH DAD'S TIP

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"Getting rich is automatic—if you have a good plan and stick to it."

IF YOU'RE AN EMPLOYEE, YOU CAN:

- Maximize your contributions to a 401(k); at the very least, invest the amount your company matches.
- If you have no company-sponsored plan or make less than a certain amount of income, invest up to $2,000 in a traditional or Roth IRA. The income levels change each year, so check with your tax advisor.
- If your level of income allows you to qualify, invest up to $2,000 in a Roth IRA.

IF YOU'RE SELF-EMPLOYED, YOU CAN:

- Consult with a tax specialist or financial planner about whether a defined-contribution Keogh plan is right for you, or whether one of the following IRAs is better.
- Invest as much as 15 percent of your net earnings—up to an income ceiling of $170,000—in a SEP-IRA

WHERE TO DO YOUR HOMEWORK ON RETIREMENT

While there is no substitute for the guidance of a seasoned financial planner or tax consultant, you can also get helpful advice on retirement through the Internet. Most financial websites provide an overview of various retirement vehicles as well as tax and investing tips to help you fix your long-range objectives. Here are a few you might want to try: InvestorGuide (*www.investorguide.com*), SmartMoney (*www.smartmoney.com*), and Quicken (*www.quicken.com*).

- If your earnings are on the low side, yet you can afford to invest more than 15 percent of your income, contribute up to $6,000 to a SIMPLE IRA, with a possible "match" of up to $6,000 more.
- If you're older, have high earnings, and must build retirement assets in a hurry, set up a defined-benefit Keogh plan through your tax advisor.

IF YOU'RE UNEMPLOYED, YOU CAN:

- Contribute up to $2,000 to a traditional or Roth IRA if you earn no income and your spouse earns $150,000 or less.

Once you've determined which plan is right for you, begin payroll deductions or write a check as soon as possible. Don't wait until April 15 to send in your IRA money. The sooner you invest, the sooner your contribution starts growing. That doesn't mean it will make you rich. Don't forget that a retirement account is a vehicle only for a financial plan to be secure and comfortable.

ANNUITIES

Annuities are yet another vehicle for the average investor. When deciding whether to invest in an annuity, you have to weigh the advantages of annuities against their disadvantages. Annuities, you'll recall, are attractive because they guarantee investors income for life and remove the headaches associated with investment management. However, tax advantages are minimal: Contributions are not tax deductible, distributions are taxed, and when the annuitant dies assets are subject to taxes. If this prospect doesn't turn you off to annuities, then at least you should do your homework thoroughly—and if at all possible, consult a financial planner, tax advisor, or insurance agent.

WHAT TO DO WHEN BUYING AN ANNUITY

- Evaluate whether the benefit of tax deferral on annuity earnings is better than paying lower capital gains on earnings from a taxable investment.
- Think twice about buying a fixed annuity, which offers no growth or hedge against inflation. Variable annuities offer diversified investments and growth.
- Review the annuity fund's prospectus carefully for investment

WHERE TO DO YOUR HOMEWORK ON ANNUITIES

One of the first things you need to determine when contemplating an annuity is whether you'd be better off buying mutual funds. To make a decision, try running the numbers on T. Rowe Price's "Variable Annuity Analyzer" software (order on-line at *www.troweprice.com*). This free program compares the performance of the firm's no-load variable annuity with that of various no-load mutual funds.

If you've decided that a variable annuity is right for you, you can check company ratings in Morningstar's Variable Annuity database, accessible through *www.insure.com*, or through Duff & Phelps Credit Rating Company, which can be reached at *www.dcrco.com* or by calling 1-312-368-3198. Quickquote, found at *www.quickquote.com*, compares the costs of various fixed annuities based on your age, initial investment, and payout preferences. If you're computer illiterate, check your local library for a copy of *Standard & Poor's Stock Guide,* which tracks a selection of annuity funds each month.

performance and payout options.

- Do business only with an insurer that has an "AA" credit rating. You can lose some or all of your investment if a company goes under.
- Make sure fees and surrender charges (for early withdrawal) are competitive.
- Resolve to stay invested for the long term.

WHAT NOT TO DO WHEN BUYING AN ANNUITY

- Don't buy an annuity with money you may need before age fifty-nine and a half, as you'll be subject to large penalties and taxes on early withdrawals.
- Don't buy an annuity if you expect to be in a tax bracket of 28 percent or higher when you retire, because benefits are taxed as regular income—not at the capital gains rate of 20 percent.
- Don't buy an annuity for estate purposes, as heirs will have to pay estate and income tax on benefits.

Don't forget, annuities can be part of your overall financial plan, but they won't help you if your plan is to be rich. Many people expect their income to go down when they retire; if your plan is to be rich, you should expect your income to continue increasing, which means you'll need better investment vehicles than this.

BECOMING A PROFESSIONAL INVESTOR

Perhaps, after learning the techniques of average investing, you've experienced disappointment with the results or even a surge in confidence. You've decided that you want to be more than an average investor. Up till now, the only real opportunity you've had to diversify your investments has been through paper securities. Rather than dabble further there, you might decide the time has come to advance to a new investor level: real estate. With your very first successful venture, you'll understand what it means to put other people's money to work for you. Remember, it doesn't take money to make money. You'll have an asset that keeps pace with inflation, generates wealth, and shelters it from taxes.

RICH DAD'S TIP

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"It doesn't take money to make money."

WHY REAL ESTATE WORKS

The majority of the wealthiest people today own real estate. What do the rich know about real estate that you don't know? Their secrets are:

- Leverage
- Tax benefits
- Appreciation

LEVERAGE

This is the lesson of leverage: If you've raised $10,000, you could buy $10,000 of stock or find a $100,000 investment real estate property, use the $10,000 as a down payment, and finance the $90,000. You understand the meaning of leverage if you understand the difference between creating a $10,000 asset and creating a $100,000 one.

While the cash invested in either case is the same, $10,000, which is likely to appreciate more quickly or generate more income, the $10,000 asset or the $100,000 asset? The benefit of leverage is that you're able to use other people's money, in this case the bank's money, to greatly accelerate the growth of your own net worth.

TAX BENEFITS

There are many benefits for the real estate investor under current tax laws. For example, a married couple can sell their personal residence in which they have lived for two of the previous five years for a gain and not pay tax on $500,000 of that gain. This is a tremendous gift that Congress has given to homeowners.

But that's not the only benefit of real estate. You can also defer tax from the gain on a sale of investment property by "rolling" property in a like-kind exchange. In other words, you can sell a property and, instead of paying capital gains tax, exchange the property for another, and then another. Like-kind exchanges allow you to "roll forward" the gain from the original property to other properties. In this way you, and not Uncle Sam, can decide when you'll pay taxes.

You can also offset the income you earn from real estate with depreciation, which results in a "paper loss" or a "paper deduction." The government allows you to deduct a portion of the value of your property according to a prescribed formula. For example, under current law you can depreciate a residential rental building over 27.5 years. Thus while you may actually be receiving a cash flow from the property, you may pay little or no tax on the cash you receive depending on the amount of depreciation allowed. That's surely the best of all possible worlds.

Here's a handy tax tip: If you have a flair for seeing what "could be" in a home and have some skill in decorating or home improvements, consider buying a home for your personal residence that you fix up and sell after occupying for two years. If you currently pay income taxes at an average 31 percent federal and state rate and you make a modest $30,000 on the fix-up, you've actually just found $43,478 in equivalent extra income. (Includes tax savings of $13,478.) And you can repeat this every two years!

APPRECIATION

Real estate values go up. Sure, on any given day a property may not be worth more than it was the day before, but over time property values do go up. That's called appreciation. The benefit of appreciation in real estate is that you can use other people's money—the bank holding the mortgage and the tenants paying you

QUALIFYING AS A REAL ESTATE PROFESSIONAL

The government restricts the amount of loss you can deduct from real estate against your income from other sources. Your loss is limited to a total of $25,000, and may be phased out if you're considered a high-income taxpayer. The IRS definition of a high-income taxpayer changes every year; ask your CPA or tax advisor about the current parameters. However, if you qualify as a real estate professional under the IRS definition, you can deduct *all* of your real estate losses against other income. Either you, or your spouse, needs to have one or both of the following qualifications:

- More than half the time you spend working has to be devoted to "qualified" real estate activities. If you have a regular job, the IRS will want proof that you've worked in such real estate activities. If you work part-time, you'll need to show the number of hours you worked your job and in qualified real estate activities. If you have no other outside employment and no obvious trade or business (such as with a Schedule C), then you only need the second qualification below.
- More than 750 hours out of the year have to be spent in qualified real estate activities.

What is qualified real estate activity? Any activity in which you "develop, redevelop, construct, reconstruct, acquire, convert, rent, operate, manage, lease, or sell" real estate. And guess what? You don't have to be the one performing the work. You can be supervising, meeting, planning—in other words, performing any of the activities that running a business entails.

RICH DAD'S TIP

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"Make your money on the buy, not the sell."

rent—while getting the benefit of the appreciation. To reap the benefit of appreciation, you have to follow Rich Dad's advice and make your money on the buy, not the sell. In other words, buy a property at the right price. That way if the property does go down in value in the short term, it doesn't matter. You aren't counting on the sale of the property to make money.

PREPARE FOR OPPORTUNITY

The way to succeed in real estate, as with any investment, is to prepare yourself to seize opportunity when you see it. For example, you might identify a few neighborhoods in the "working class" area of your community. Regularly visit the neighborhoods. If you have a dog, take it for a walk and examine houses at your leisure. Ask people in the neighborhood if they know of any houses for sale, and soon you'll be flush with insider information about real estate in the area. Look for signs of lapsing interest in the house such as a yard going to weeds. This could signal an impending sale, for example, by aging occupants who are no longer capable of upkeep. It could be a good buying opportunity. If a house comes up for sale, watch how long it's on the market and what the ultimate selling price is. This will give you good background information in case you decide to buy your first property. If you're working with a real estate broker, ask this person to run a sales history report for the past six months in the neighborhood.

There are many types of real estate properties that you may want to investigate. Some examples are single-family residences, multiple-family units (duplexes on up to large apartment complexes), commercial office space, industrial warehouses, and land. There are also many different things you can do with real estate. You can buy a property for quick resale. This is known as a flip. You can buy a

INVESTING FROM THE RIGHT SIDE OF THE CASHFLOW QUADRANT

Rich Dad would encourage you to invest from the right side of the quadrant. In real estate, this means viewing real estate as a passive activity. If you buy properties to fix up yourself and then sell, or properties that you plan to manage yourself, you'll be operating from the left side of the quadrant. This can be a good way to get started in real estate. The goal for many, though, is to invest as a business owner and investor—from the right side of the quadrant. This means you'll have systems and a team to perform the work of renovation, upkeep, and management.

property to fix up and then sell. Or better yet, you might buy a property to hold long term and rent to tenants. You could develop land. You could convert apartments into condominiums and sell them. You could have buildings constructed.

START SMALL

Rich Dad taught the importance of mastering a formula and then learning another formula. A basic formula in real estate is to start small, for example, with one single-family residence. You want to start small because that way the cost of any lessons you learn along the way will be small, not large. After you've mastered the formula of buying and either selling or renting single-family residences, you may decide that you want to graduate to another type of real estate, such as commercial or industrial. But start small and start simple to get the best results!

RICH DAD'S TIP

▲

"Master a formula and then learn another one."

LOOK FOR A PROBLEM TO SOLVE

One way to seize opportunity in real estate is to find a problem you can solve. You may "fall in love" with a beautiful house where everything is done, but then so will other people. Would you rather buy or sell a house that everyone wants? The price will be lower on the property that has a problem. If the problem is something that can be easily and inexpensively fixed, you'll reap the greatest profit. Make sure you have members in your team such as a home inspector who can spot potential problems and a general contractor who can fix them. Some examples of easily fixed problems might be peeling paint, a dead lawn, and outdated colors, carpeting, or wallpaper. A little bit of work or elbow grease can result in tremendous profit for you.

LOCATION, LOCATION, LOCATION—SOMETIMES...

You might have heard the saying that there are three ways to find a good piece of property: location, location, location. While location is important, it isn't the only consideration when you're seeking investment opportunities. The best location for a commercial property—a busy street with lots of traffic—would be a bad location for a residential property. Look at property for the following characteristics:

- ***Construction.*** What type of building is it? Could there be a potential problem such as a bad roof or termite damage in a wood building?

A GOOD DEAL THAT COULD BANKRUPT YOU

Diane Kennedy, CPA and Rich Dad Advisor, tells the story of one of her former clients, Joe. A new freeway interchange was slated for construction within three years, and Joe recognized that the land adjacent to it was much cheaper than it would be three years down the road. So he purchased one acre for $175,000. Three years later the property had climbed in price to $575,000. What a great deal for Joe, you might say! Sadly, no. Joe had bought the property with a high-interest bank loan, and six months before the interchange was completed and the property went up in value, he went bankrupt and lost the property. Raw land isn't an asset until it sells and you receive cash that you can turn into passive income. Meanwhile, it's a liability. Joe hadn't counted on that liability. He didn't have the resources to cover the loan payments and other costs. Someone else bought the property during a bargain-basement foreclosure sale. A great deal for one person can be a bad deal for someone else.

- ***Condition.*** What shape is the building in? Is there a significant amount of maintenance needed? Does the yard need sprucing up? If it's a commercial property, are there any lurking environmental problems?
- ***Consistency.*** Does the home fit in the neighborhood? Are its style and grounds consistent with those of other properties in the neighborhood?

THE DOUBLE-EDGED SWORD OF DEFERRED MAINTENANCE

Deferred maintenance refers to maintenance that previous owners of a property have neglected. They have "deferred" upkeep to the future. Deferred maintenance can run the gamut from simple painting and yard work to large projects such as a new roof or furnace. Some of the best real estate opportunities are found where deferred maintenance is cosmetic and relatively inexpensive. A little bit of paint

USE YOUR TEAM TO EVALUATE YOUR PROPERTY

The best money you ever spend on a real estate purchase may very well be the money you spend for a professional inspection. A professional inspector will check your property for any potential problems such as maintenance that the previous owner has put off or safety code violations. The inspector will prepare a "condition report" that you can then present to the seller, who may fix the problems or actually reduce the cost of the house to cover the repair costs. Don't be afraid to ask!

can make a house look new again. Replacing a roof or a furnace, however, can be expensive and have little perceived value for a prospective buyer. Sometimes deferred maintenance will work in your favor—but not always. Make sure you're on the right side of the deal!

REAL ESTATE TEAM MEMBERS

Who will act as your real estate advisors? That depends on your personal circumstances and goals. Common members for a real estate team include:

- Real estate agent/broker
- Insurance agent
- Real estate attorney
- Mortgage broker or loan officer
- Home inspector

One of the most important members of your team is the real estate agent or broker. This person is usually considered a "seller's agent" because when the sale is consummated he or she is paid a percentage of the sales price by the seller. Because agents and brokers are only paid when the sale occurs, they're usually motivated to see a sale go through at highest price. Don't expect the broker to find a good deal for you. After all, if the broker is also an investor and can recognize a good deal, chances are he's already snapped it up!

You must be able to describe clearly what you want to your agent or broker. Describe the price range, location, and other specific parameters. The broker can be a great source of information regarding comparably priced properties, known as comps. Use your broker to improve your education, but don't expect this person to make your real estate decisions for you. That's your job.

HOW TO GET STARTED

As mentioned earlier, your best bet is to get acquainted with an area so that you can recognize a deal when it presents itself. It's usually easier to sell or rent a home in the lower price range. Typically, real estate investors look for houses under the median price in a given area. Look for problems you can easily and cheaply fix. Read the classified ads in your local newspaper. Hand out business cards with your name and the message "I buy houses." Hang a notice at your local supermarket. Tell your friends you're interested in buying homes. Expand your network. Go to open houses to get a sense of pricing, quality, and demand. Keep educating yourself about fair market value or you won't know a good deal when you see one. How do you do this?

- Research local listing prices on the Internet.
- Check your paper every week for recent sale prices, and drive by some of the properties.
- Ask your realtor to run off comparable listings for the past year. If properties have sold, note the difference between the asking price and the sales price. If properties are languishing on the market, determine what strikes they have against them.
- Familiarize yourself with traffic patterns, zoning regulations, and development plans for the neighborhood or commercial district you want to buy into.

LINE UP FINANCING

Before you go looking for a building, look for a lender. It may or may not be the same lender with whom you ultimately sign a mortgage agreement. At this point, your main goal is to ask these questions:

WHERE TO FIND REAL ESTATE

Don't depend solely on your realtor to find properties. As you walk or drive through your locale, keep your eyes peeled for "For Sale" signs. Pick up free listing brochures at your supermarket. You can also search property listings on the Internet. For example, the National Association of Realtors features a nationwide database of residential properties at *www.realtor.com* and commercial properties at *www.commercialsource.com*. Sale prices of homes sold nationwide after 1987 can be found at *www.domania.com*. And up-to-date information about Housing and Urban Development homes for sale is available at *www.hud.gov*.

- What are current mortgage interest rates, and are they expected to change?
- Given the type of property you're considering, what financing terms does the bank offer?
- How long does it take to get pre-qualified or pre-approved for a loan?

A bank may not be the best source of real estate financing for you. Check with mortgage companies, particularly those that offer more than one line of financing. People who have the designation "mortgage broker" run these types of companies. They have the ability to shop for loans that will best fit your circumstances.

In advance of your visit to the bank or mortgage company, you might try running your own mortgage analyses using home-computer software or websites such as "The Intelligent Mortgage Agent" at *www.homefair.com*. Calculate the debt service for several properties of varying cost and size, and estimate the potential amount of income you would receive from a rental arrangement. If you plan to hold the property until you can sell it for profit, make sure you have adequate cash reserves to hold you until the sale goes through.

What if you have little or no money for a down payment and the banks turn you away? You'll have to make up for lack of cash with extra determination. There are a number of options available to the cash poor. You might be able to take out an equity loan on your home, or obtain seller financing, or borrow from your life insurance policy. Some banks offer "shared-appreciation mortgage" programs allowing buyers to put less down in return for a share of the profits. Credit unions often give mortgages, and the Federal Housing Administration (FHA) has special financing programs that require no money down. Another option is to form a group of investors and establish a partnership or corporation to purchase the property. If all else fails, you can ask a relative or friend to help out, in which case make sure you put repayment terms in writing.

RATE YOUR PROPERTY

Many of the same features you look for in a home can be used to rate investment real estate. A property's location and quality are the alpha and the omega of a good buy. Location comes first. A stunning property in a terrible neighborhood is almost never a good deal, whereas a run-down home in a prime location has the potential for significant gain. However, location means nothing if the numbers don't work.

When assessing location, keep in mind the property's access to public transportation, shopping, and schools; the safety, quietness, and overall appearance of the neighborhood; the proximity of police and fire protection; the property's value relative to the area; and potential changes in zoning regulations. When assessing quality, look

GAIN A COMPETITIVE EDGE

Fortune, as they say, favors the prepared mind. A letter from a lender stating that you are pre-qualified or pre-approved for a mortgage will increase your negotiating power with sellers. What do these terms mean? When you're pre-qualified, the lender attests to the amount of mortgage you can carry yet stops short of approving you for financing. When you're pre-approved, the lender commits to providing a mortgage up to a specified limit. If you're in a seller's market, pre-approval is vital to beating out the competition.

FEAR: I'll never come up with enough cash for a down payment on rental real estate.

FACT: There are many ways to obtain a down payment. For example, you might be able to take out an equity loan on your home, or obtain seller financing, or borrow from your life insurance policy. If the property is a wise investment, the money should be easy to find.

FREEDOM: Once you've found a vehicle to finance a down payment, you'll start putting other people's cash to work for you.

at the property's curb appeal, structural integrity, floor plan, and square footage; the number of units; the lot size and landscaping; the condition of mechanical systems and appliances; interior and exterior cosmetics; the availability of parking; asbestos, lead, radon, and other potential environmental hazards; and compliance with current zoning regulations.

Once you've found a property that passes muster, dig deeper by asking these questions:

- Do you have the time and money to repair and maintain it, or can you afford a management company with the rental income the property will generate?
- Has the property been on the market a long time, and if so, why?
- Why does the owner want to sell?
- Are current tenants paying their rent on time?
- Is there a "bad apple" who will be hard to evict?
- Is the property under rent control?
- Are leases all coming up for renewal at the same time, or at staggered dates? You wouldn't normally want all your tenants to vacate at the same time.

- Is the property in foreclosure, and if so, why?
- Ask your broker to prepare comps for similar properties in the neighborhood. How does this property value compare to them?
- Is this property priced to sell?
- How long do other properties tend to stay on the market?
- Do the amenities of the property add to or detract from the value? For example, a swimming pool in Phoenix, Arizona, might be a good idea, while a swimming pool in Montreal, Quebec, may not be equally attractive.

The answers will help you determine whether or not the property is overpriced and how eager the owner is to strike a deal, thereby putting you in a better negotiating position should you decide to buy.

Now for the ultimate test: Does the property generate a positive cash flow? Remember, you want to invest in an asset, not a liability. Don't take numbers provided by the owner or realtor at face value. Run your own, allowing for vacancy time and possible nonpayment of rent. Don't fudge the figures because you feel this is a good buy. Like Dragnet's Sergeant Joe Friday, you should just gather the facts.

Bear in mind the Rich Dad method of buying real estate. You should see dozens of properties for each one you buy. The only way to understand the real estate market is to look at what's available and study the numbers. You should feel free to make a lot of offers, some even ridiculously low. After all, no price is too low if the seller says yes, and sometimes the seller will.

WORKSHEET: DETERMINING CASH FLOW

Cash requirements

Down payment	$________
Closing costs	$________
Holding cost	$________
Fix-up costs prior to rental	$________
Total cash requirement	$________

Gross income

Rental income	$________
Other (parking fees, laundry, etc.)	$________
Subtotal	$________
Vacancy and bad debt allowance	- ________
Total gross income	$________

Expenses

Maintenance	$________
Repairs	$________
Utilities	$________
Landscaping	$________
Management fees	$________
Advertising	$________
Legal and accounting	$________
Insurance	$________
Property taxes	$________
Debt service (mortgage + interest)	$________
Other	$ ________
Total expenses	$________

Gross income	$________
Expenses	-________
Before-tax cash flow	$________

If you do come up with a positive before-tax cash flow, then calculate the cash-on-cash return:

$$\text{cash-on-cash return} = \frac{\text{positive before-tax cash flow}}{\text{total cash requirement}}$$

If the cash-on-cash return is 10 percent or more, this property may be a good buy. Some real estate investors use 20 percent as their go/no go decider. If the return comes under 10 percent, ask yourself whether rental increases and appreciation would make the investment worth your while.

NEGOTIATE YOUR DEAL

If after doing your calculations and homework, the property looks like it could be a good buy, determine your highest walk-away price. At what place does this property no longer make financial sense? Remember, use your calculator, not your heart! Don't lead off with your highest walk-away price. And don't let your broker talk you out of your offer. In most states, the real estate broker is required to make all offers. Don't worry about hurting the seller's feelings. This is a business deal.

You'll be writing up an offer that the broker will present to the seller or seller's agent. Make the property subject to property inspection and the receipt of suitable financing for you. You might also make the offer subject to lawyer's review and to your review and acceptance of

FEAR: I can't find a deal anymore.

FACT: There are real estate deals in every city. People with know-how can find them. In a high seller market, if you locate a property with a problem that can be easily solved, you can make more money, faster.

FREEDOM: Look for a problem you can easily solve and you'll have a potential deal.

Homeowner Association requirements, or CC&Rs (covenants, conditions, and restrictions). In the initial offer, write up the offer with you as the buyer plus "and/or assigns." Jane Doe would write up an offer as "Jane Doe and/or assigns." The phrase "and/or assigns" allows you to designate another buyer prior to closing. If you and the seller are able to agree to a transaction, you'll want to consult with your tax advisor about the best entity for holding the property.

The seller will likely come back to you with a counteroffer. You don't need to respond immediately to a counteroffer, and when you do, it can be with a counteroffer of your own. Bear in mind that in negotiation it is sometimes better to wait a little before responding. Once you've signed an agreement, it's time to bring in your whole team to make the transaction work for you in the best possible way.

BUYING A PROPERTY

Once you've found a property you can afford, one that has an adequate cash flow and good cash-on-cash return, it's time to buy. Now you'll be negotiating a purchase contract. This is a document signed by both you and the seller that identifies the property, the purchase price, any contingencies to be met prior to closing, and the date of closing. Though purchase contracts are legal and binding, you can buy a few days by including a clause that states the contract is contingent upon review by your attorney. Here are other steps to take prior to closing:

- Have an attorney set up a business entity to protect you from personal liability. Understand the various options available to you, and choose the entity that best suits your overall financial plan.
- Talk to a tax specialist about maximizing tax advantages.
- Have the property inspected.
- Find the best financing terms.
- Draw up a standard lease for new tenants.
- Set up an accounting system to track income and expenses, or hire a management company to do it for you.
- Buy title, hazard, liability, and possibly rent-interruption insurance.

SELLING/RENTING YOUR NEW PROPERTY

The closing is over. Congratulations! You're the owner of a property that's going to put other people's cash to work for you. Now you have to take care of your investment. If you're one to roll up your shirtsleeves and begin cleaning, painting, and planting, you'll be increasing the value of your property with so-called sweat equity. But sweat equity can be intolerably time consuming, and besides, you may be employed elsewhere. In that case you can line up a fleet of dependable contractors or even hire a property manager to oversee maintenance, repairs, and leasing arrangements. If you intend to rent the property, a good property manager will free you up to launch additional enterprises and further increase your cash flow.

Now that you're a real estate investor, here are a few things for your to-do list:

- Maintain building and grounds so they are safe and sanitary.
- Make capital improvements if they ensure increased appreciation or rental income.
- Keep records and receipts for all expenses and income, as required by the IRS.
- Establish separate escrow accounts for tenants' security deposits.
- Refinance your property if interest rates drop significantly.

Keep in mind that, according to current tax law, to qualify for the lower tax rate applied to long-term capital gains, you must hold a property for at least a year. If you sell in less than twelve months, your gain will be taxed like regular income. If you've depreciated the property, the total amount of depreciation taken will be "recaptured" and taxed like regular income, no matter how long you've held the property.

If you're comfortable with your experience in small-investment property, you might graduate to mixed-use buildings that have commercial space on the ground floor and residential units above, or to pure commercial or industrial property. Eventually, you may generate so much passive income that you can forego a paycheck. In that case, you will have moved from the E or S quadrant into the B quadrant. But that's the subject of the next chapter.

Enter the B QUADRANT

"In moving to the B quadrant, your goal is to own a system. Think of the system as your bridge to financial freedom."

Step 5:
Enter the
B Quadrant

Congratulations! You've come to the realization that the only thing keeping you on the left side of the quadrant is lack of action, or fear. You've decided to break out and build, or buy into, a business system. Consider this system a bridge that will allow you to cross safely from the left side to the right side of the CASHFLOW Quadrant—your bridge to financial freedom.

No one crosses over to the B quadrant automatically. It takes a lot of legwork, everything from choosing your own business to selecting a team of advisors, writing a business plan, and raising capital. This chapter is a guide that will walk you through the steps. Let's start at the very beginning.

CHOOSE YOUR BUSINESS

Presumably you've done an honest self-assessment and come to the conclusion that you possess—or will work hard to develop—the leadership skills required for entrepreneurship.

Once you've decided you have the right stuff, you have to choose what sort of business to go into. Remember, where you are today is the result of decisions made years ago. Where you are tomorrow will be the result of decisions made now. Your choice is important.

TAKE STOCK

The world is full of business opportunities just waiting to be discovered, but they're not going to fall into your lap—you've got to seek them out. The key is knowing where and how to look.

First, you need to take stock of your skills, your financial goals, and your dreams. Then you need to find opportunities to bring the three together. You can start your search by looking in your local newspaper. Your local newspaper is full of information about classes, lectures, and services available to people who want to start up businesses. Courses are frequently offered by community colleges,

DO YOU HAVE THE RIGHT STUFF?

The successful entrepreneur isn't a specialist. He or she is a jack-of-all-trades with a broad array of character strengths and leadership skills. Before launching yourself in the B quadrant, ask yourself which of the following adjectives apply to you—and which you need to develop.

PERSONALITY TRAITS	PRACTICAL SKILLS
Outgoing	Decisive
Energetic	Communicative
Flexible	Comfortable with the big picture and small details
Dependable	Organized
Independent-thinking	Cooperative (a team player)
Resourceful	Willing to seek help
Self-motivated	Money smart—Financially Literate
Persistent	Streetwise

TAKE NOTE

Experience will hasten the decision about what sort of business to pursue.

local chambers of commerce, real estate brokerages, and even banks. If you learn about a class that might be helpful, take it. You'll be interacting with classmates and teachers who may give you invaluable ideas about what sort of business venture to launch. And don't hesitate to approach investors and business owners. Most people are happy to talk about themselves and share their ideas—seize the opportunity to learn from experts.

GET FIRSTHAND EXPERIENCE

Firsthand experience will shorten the process of deciding what sort of business to pursue.

You might try getting a part-time job in an industry you're considering. In addition to answering the question of whether you like the industry, practical experience may spark ideas for your own business. Let's say you get a job at a local ice cream store. The place is crowded, especially in the summer, but it offers no tables or chairs for customers—they have to lick their cones in the parking lot. Furthermore, there are no other ice cream stores in the area. Maybe, you think, an ice cream store with a few tables and chairs would draw a bigger crowd in summer as well as a winter crowd.

DO RESEARCH

In addition to getting firsthand experience, you should do some research. How many businesses of the sort you're interested in operate in your community? Check out the competition. Think like a customer. Take careful note of what you think these companies do right and what they do wrong. Is there room for a business that would do things differently? Researching the competition will help guide your decision about what type of business to enter.

TAKE NOTE

Researching the competition will help guide your decision about what type of business to enter.

Extend your research further. Look at mainstream publications like *The Wall Street Journal, The New York Times, The Los Angeles Times*, and *Time*. These report on various trends—for example, economic, political, demographic, and technological—that might affect what business you choose. For example, let's say you have experience designing software, and you read an article reporting that more and more Americans are working in home offices. This demographic trend might inspire you to start up a company that offers an accounting software program to the self-employed.

FEAR: I'm not capable of discovering or inventing new products.

FACT: Starbucks didn't discover coffee, and Michael Dell didn't invent computers. To build a business you don't have to make it new; you just have to make it better. Meeting customer need is key.

FREEDOM: Keep your mind open to customer need and you might fulfill your own financial need.

PART TIME OR FULL TIME?

You also have to decide whether to work part or full time. Of course, this depends on your personal financial situation. Will you or your family suffer if you quit your full-time job to start a business? If so, then maybe you should launch a part-time business on the side and leave your regular job only when the business has grown enough to supply a steady income. Going into business part time is an excellent way to test the waters. If you have the interest and stamina to keep on going, then chances are you'll eventually be able to devote yourself full time to the venture.

PART TIME DOESN'T HAVE TO MEAN HALFHEARTED

Dell Computers is a giant-sized company that was started on a part-time basis—in a dormitory room at the University of Texas. As history has shown, the enterprise was anything but halfhearted. Student Michael Dell had to drop out of the University of Texas because his part-time job was making him far richer than he would have been had he stayed in school and studied.

STARTING YOUR OWN BUSINESS

Of all business options, starting your own company is the most difficult because you'll be a lone ranger, developing every system on your own. It is also potentially the most rewarding, for if you succeed you can say that you did it your way. Let's assume you've assessed yourself and the answer is yes, you do have what it takes to create a company—the burning desire, the resourcefulness, the flexibility, the discipline, the organizational and leadership skills, and the willingness to make financial sacrifices. You've taken stock of your experience and interests and decided what type of business you'd like to launch. So, where do you begin? Here is just a partial list of the steps you'll have to take:

- Name your business
- Begin to seek funding sources
- Search for outside advisors
- Set up a relationship with your banker
- Protect proprietary information
- Write a business plan
- Select your location
- Plan ahead for bookkeeping, accounting, and office systems
- Decide on pricing strategies
- Determine employee needs
- Prepare your marketing plan
- Seek insurance coverage
- Address legal issues
- Fine-tune your cash flow budget
- Set up your office
- Hire employees

IF THERE'S A WILL THERE'S A WAY: GUIDANCE FOR THE START-UP ENTREPRENEUR

Feeling faint of heart? Then take heart: There is an abundance of resources out there to give you support and guidance. You might start by consulting *E-Myth* by Michael Gerber, David Bangs' detailed *Start-Up Guide: A One-Year Plan for Entrepreneurs*, as well as the bimonthly magazine *In Business*, which offers plenty of tips for companies with fewer than ten employees. If funding is a major stumbling block, pick up a copy of *Borrowing to Build Your Business* by George Dawson. On-line sources that cater to small businesses are plentiful too. Check out the following websites, which provide information on all aspects of business development as well as links to other sites: *www.richdad.com, www.americanexpress.com/smallbusiness,* and *www.smallbiz.suny.edu.* Invaluable help can also be found by attending trade shows, interviewing trade association executives, looking into programs offered by your local college or the Small Business Administration (phone 202-606-4000), or contacting counselors from the Service Corps of Retired Executives (*www.scoredc.org*).

RICH DAD'S TIP

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"The B quadrant requires knowledge of both systems and people."

As you can see, by no means are start-ups for the faint-hearted. To keep on track, let your mission statement serve as your beacon. Start with it and end with it, and revise it along the way if necessary. In the process, you'll discover that all setbacks can be resolved. Even if you don't see profits right away—and you probably won't—the experience you gain from a start-up will be worth its weight in gold. If you discover your market niche, and your product or service ends up making the consumer's life better, easier, or happier, then eventually you will prosper.

RICH DAD'S TIP

"In moving to the B quadrant, your goal is to own a system and have people work that system for you."

BUYING A BUSINESS

What if you want to avoid the headaches of a start-up, but you're itching to captain your own ship and you can obtain the capital to do so? In this case, you may want to buy an existing business. First you'll have to weigh some of the pros and cons:

PROS	CONS
• No long, risky start-up period • All systems in place • Existing customer base • Faster route to profitability than with a start-up • Existing goodwill of the business	• The danger of buying a lemon • Skeletons in the closet • Sticky personnel issues, such as possibly firing people and changing the way they work • Potential competition by the seller • Existing ill-will of the business

If the pros win, then you'll need to proceed with caution. Remember that business brokers, who are chiefly interested in making a sale because of the commission it will earn, may not be a reliable source of information about the business's real value. The following steps will help you determine whether the business, once bought, is going to stay afloat:

- First, ask why the seller is selling. It may be the most important question you ask. Talk to customers. Are they satisfied?
- Do a background check on owners and key personnel. Have they left a trail of unpaid debt, or do they offer you a clean slate?
- Inspect all recent tax returns, and don't take any financial statements at face value. It is best if the financial statements are accompanied by an audit letter from a reputable CPA firm; however, many businesses may not have audited financial statements. In this case, it may be worth the expense to have a CPA review the financial records on your behalf.
- Search for hidden liabilities that don't show up on the balance sheet, and consult with an attorney. When is the office lease up, and will the rate be raised thereafter? Has the value of receivables been overstated? Will you be inheriting employee obligations? Litigation?
- Assess the true value of the assets. These include hard assets such as equipment and inventory as well as soft assets such as the company's name and reputation. Review the intellectual property that you will be purchasing along with the business and make sure it is transferred properly to you as the new owner.
- Find out whether industry competition has recently heated up—and whether that's the reason the owner is selling.
- Consider asking for a non-compete clause so the seller doesn't open a similar business and "steal back" the customers and goodwill you think you're buying.

Successful businesses do not come cheap. The current owners have worked hard to build their profitable enterprise, and the price will reflect the lessened risk that such success represents. If you have the capital to buy the company, the skills to run it, and the stamina to stick with it, you may well be on your way to financial freedom. Remember, however, if you buy a business that requires you to be there, you've purchased a job—an S business. When you can hire a manager or president to run it and your presence isn't required, then you've turned that S business into a B business. This is the path many B businesses have taken.

FRANCHISING

Say you don't have the courage for a start-up or the breadth of experience to buy a business. Then maybe franchising is the ideal choice for you. Franchising is a readymade business system that offers a promising avenue into business ownership. A reputable franchise gives you the advantage of a tried and true business operation, saving you the headaches and risk of developing your own. Moreover, because of the high success rate of franchises, banks are more willing to loan you money for a franchise than for a start-up.

TAKE NOTE

When you buy a franchise, you're buying a proven operating system.

FRANCHISE TYPES

You'll recall that franchising is a method of business whereby a franchisor grants a franchisee the right to use a particular trademark or to market a particular product. In trademark or distributor franchising, the franchisee gains this right but does not receive a

DID YOU KNOW?

In the mid-1950s, franchises were almost unheard of. By the mid-1990s they represented over a third of all retail trade in the United States, and some half a million Americans owned franchise outlets. Why the phenomenal rise in franchising? At the most fundamental level, this method of doing business represents the American dream. A person who purchases the rights to a franchise isn't just "buying a job"—he or she is pursuing a dream of financial independence, self-management and above all, personal fulfillment.

Additional information on how to pursue your personal dream is available in *The Franchise Bible: How to Buy a Franchise or Franchise Your Own Business*, edited by Erwin Keup and Vickie Reierson, and in Michael Powers's *How to Open a Franchise Business*. For additional resources, including the names of attorneys and other experts well versed in franchising, click on to *www.businessnation.com/franchises.*

ARE YOU TAILOR-MADE FOR FRANCHISING?

The more yes answers, the closer the fit.

- Do you want your own business without starting from scratch?
- Are you extremely organized?
- Do you see problems through until they're solved?
- Do you adapt easily to new ideas and changing circumstances at work?
- Do you enjoy working with people?
- Have you had at least five years of experience in some other leadership role?
- Would your family support you in a new business?
- Are you willing to risk your savings on a business venture?
- Can you live with the restrictions of a franchise agreement?

comprehensive business format. Coca-Cola is the most famous example of a trademark franchise. The soft drink is produced by independent bottling companies, each of which buys the right to the name, the secret recipe, and an exclusive distribution territory from the parent company or franchisor. In business-format franchising, the franchisee gains not only the right to the trademark or product but also a business track record, thus eliminating the trial-and-error process that ruins many a small business owner. The classic example is McDonald's. McDonald's became the world's most successful franchise by developing an assembly-line system for producing hamburgers that maximized production, minimized labor costs, and tripled profits.

A typical business-format franchise offers the franchisee:

- A licensed trademark
- A training program
- An operations manual

- Specifications, quality standards, and blueprints
- Ongoing assistance in systems such as advertising and purchasing

EVALUATING YOURSELF—AND THE FRANCHISE

Franchising takes a special type of person. The franchisee has to be both entrepreneurial and compliant—that is, willing to conduct business the franchisor's way. Nothing is more tragic than courtroom fights that occur because the person who buys the system won't do things the way the system's creator wants them done.

If you find that you do have the right personality for franchising, next you'll have to evaluate the franchise. Will the price of admission wipe you out—or open the way to a steady stream of future profits? Is the franchise a scam operation—or a bona fide ticket to business ownership?

THE PRICE OF SUCCESS

In most business-format franchises, the franchisee pays an initial fee, ongoing royalties charged on gross sales or net revenues, and advertising fees. The initial fee could be anywhere from several hundred dollars for a Jazzercise franchise to almost a million dollars for a fast-food franchise. Royalties and ad fees can range from 0.5 percent to 15 percent of gross sales.

Before signing a franchise contract, make sure that the initial fee includes only money that can be justified as a cost component, such as recruiting or training. And find out whether the initial fee, royalties, and ad fees are comparable to those required by other franchises in the same industry. If you have any doubts about the fee structure, consult a lawyer or an accountant.

SCANNING FOR SCAM ARTISTS

In 1980 the Federal Trade Commission introduced extensive franchise reform, in part to protect unwary investors against unscrupulous or bogus franchisors. Most states also have strict franchise laws on the books. While most franchises are legitimate businesses, the regulatory safety net does not catch all abuses, and you should never enter into a franchise agreement without some preliminary investigation. Here are some steps you can take to protect yourself:

- Be skeptical of ads that promise huge profits and require no experience.
- Before paying a fee, review the disclosure document laying out the franchisor's lawsuit history, audited financial statements, and substantiation of earnings claims. The franchisor is required by law to produce a disclosure form prior to contract signing. Have your attorney and accountant review the document for any hidden dangers, which they can spot quickly.
- Make sure the franchisor is registered with the state if required.
- Ask current investors for their thoughts on the franchise, but beware of "singers"—references hand-picked by the franchisor to give trumped-up testimonials.
- Call the Better Business Bureau in cities where the franchise exists to determine if complaints have been filed.
- Verify with your state attorney general that the franchise is licensed, is in good standing, and has no complaints filed against it.

Whatever you do, don't let the above warnings turn you off to franchising. There are plenty of reputable franchises out there just waiting for franchisees with the right stuff. If you do your homework and find a good outlet, you'll be realizing your dream of business ownership while minimizing the headaches traditionally associated with start-ups. And you're more likely to realize eventual profits through franchising than through your own small business. That's because the franchise hands you a known commodity to sell. From

FEAR: If I buy into a franchise, some scam artist will rip me off.

FACT: Federal and state laws protect you against bogus operators. The disclosure form should reveal any hidden dangers in a franchise.

FREEDOM: Learn the law and you'll enter the B quadrant by way of a legitimate franchise.

Auntie Anne's pretzels to Jiffy Lube tune-ups, franchise products and services cater to the common denominator in public taste. What more reliable market could you ask for?

NETWORK MARKETING

Perhaps the cost of buying into a franchise is too much for you. Then you might want to try network marketing. Typically when joining a network marketing company, you buy a starter kit that contains training and advertising materials, often for as little as $200.

TAKE NOTE

In addition to comprehensive training and minimal start-up costs, network marketing offers you the choice of either full- or part-time work and the option of working at home.

Why so cheap? Partly because of low overhead. Network marketing is commonly conducted by word of mouth, though some organizations are currently expanding through the Internet, direct mail, and telemarketing. Typically a distributor, also known as a marketer, buys a product from the network marketing company, sells it to customers and earns a commission, usually at least 25 percent. The distributor also recruits or sponsors other distributors, for which he or she receives ongoing compensation under one of a variety of compensation plans which vary from company to company. Network marketing's direct distribution channel attracts customers by keeping prices lower than in the traditional retailing business system.

The benefits of network marketing can be enormous. In addition to comprehensive training and minimal start-up costs, this method of doing business offers you the choice of either full- or part-time work, and the option of working at home. You take on minimal risk while working for a reputable national or international business. By recruiting downline distributors to earn passive income for you, you free up your time and simultaneously take control of your financial future. Network marketing can give you precious experience in running a small business as well as the opportunity to develop communications and leadership skills. Automated order processing, distribution and accounting systems prevent many of the headaches associated with traditional start-ups. Most important of all, network marketing gives you the chance to invest your money with pre-tax dollars because you are operating a business, making you much more money in the long run.

EVALUATING YOURSELF—AND THE NETWORK MARKETING COMPANY

Are you right for network marketing? Many of the traits that make for a good franchisee also make for a good network marketer. You'll need to be:

- ***Courageous.*** Moral support may be hard to come by at first.
- ***Receptive.*** Can you take advice from people more experienced than you?
- ***Congenial.*** You should concentrate on training and developing people rather than making money—the profits will follow later.
- ***Passionate and communicative.*** Products don't sell themselves; people sell products—and in the case of network marketing, business opportunities—by communicating with passion.
- ***Persistent.*** Rome wasn't built in a day, and network marketing isn't for get-rich-quick wannabes.
- ***Self-disciplined.*** Though you'll probably have a mentor to guide you, you'll still have to set up a daily routine for doing business and stick with it.
- ***Able to deal with rejection.*** A network marketer must learn to accept rejection and move on.

PYRAMID SCHEMES AND OTHER MONKEY BUSINESS

Before committing yourself to a particular company, you should take the time to evaluate it. Network marketing has gotten a bad rap because of pyramid schemes. Pyramids, which exist solely for the purpose of signing up recruits, are illegal in many states, and the pall of suspicion they have cast over network marketing as a whole is unfortunate, considering how many network companies are honest operations.

Start your assessment by asking whether the company's product or service is legitimate. You can call your local Better Business Bureau to see if complaints have been filed. Don't rely on the spiel of one of the company's super salespeople. Instead, ask that person for a copy of a monthly sales report, or better yet, talk with unbiased folks who have had dealings with the company but who won't be selling to you. As with franchises, beware of breathless pitches in the mail, over the phone, or in small-business magazines that promise you quick profits with no experience required. These may be generated by ghost companies trying to sell you information about bogus business opportunities.

TAKE NOTE

In selecting a network marketing company, your best bet is look for a good training program, satisfied distributors, a well-oiled distribution system, and a compensation plan that has been successful for years.

Next ask whether the company offers strong, ongoing educational programs and a sound mentoring system. Regularly attend company meetings (ideally, you'll comparison shop by attending meetings of other networking outfits as well). Learn about the organization's systems and compensation plans. Get to know the distributors. Do you respect and enjoy being with the people who work for this company? Your best bet is to select a business with a good training program, satisfied distributors, a well-oiled distribution system, and a compensation plan that has been successful for years. Once the company meets all these criteria, then ask yourself whether the company's product or service is one you believe in and can share confidently with others. If, after all this legwork, you're convinced that you've found a business with a track record that also sells something you can stand behind, then you've laid a solid foundation for future financial independence.

LAUNCHING YOURSELF IN NETWORK MARKETING

It sounds so simple: You sign a distributor agreement, receive a starter kit, order some products, and you're ready to roll! It is not that easy. Just as with any business, there are details to attend to. Among the most important:

- ***Deciding on the legal form of ownership.*** Will your business be a sole proprietorship, partnership, C corporation, limited-liability company, or S corporation?
- ***Choosing a company name.*** You probably won't be allowed to use the network company's name as your own.

EXTRA HELP FOR THE NETWORK WANNABE

For detailed tips on building your network marketing business, see Richard Poe's *Wave 3 Way to Building Your Downline* and *Wave 4: Network Marketing in the 21st Century* (the latter deals with electronic marketing). Another valuable book is *Your First Year in Network Marketing* by Mark Yarnell and Rene Reid Yarnell. On-line sources include *www.networkmarketingnews.com* and *www.we-build-dreams.com.* To keep abreast of legal issues that can affect your business, check out *www.mlmlaw.com.*

- ***Selecting marketing materials.*** These may include business cards, stationery with your letterhead, presentation folders, catalogs, and direct mailers.
- ***Meeting zoning requirements.*** Even if you're a home-based business, you'll have to find out whether there are zoning restrictions on your activity.
- ***Obtaining a local and perhaps a state business license.***
- ***Figuring out how to pay taxes.*** C corporations pay income taxes directly, but sole proprietorships, partnerships, certain LLCs, and S corporations pay income taxes as part of the owner's personal income—meaning the appropriate amount from each check should be deposited in a separate account and paid to the IRS quarterly.
- ***Deciding who will do your bookkeeping.*** Will it be you, or a bookkeeping or accounting firm? Handling your own books, at least in the beginning, will teach invaluable lessons about managing cash flow, keeping tax records, and budgeting.

CHOOSE YOUR MENTORS AND YOUR TEAM

Now that you've chosen your business, it's time to choose your team. If you were planning to scale Mount Everest next year, wouldn't you want to speak with someone who had survived the journey to the top? You'd be surprised how many people, starting the climb up their own financial mountains, ask the advice of people who are languishing below sea level. It doesn't occur to these climbers that their advisors have little or no firsthand experience. The world is full of S quadrant types trying to tell others how to enter the B or I quadrant. Seek out a mentor who "walks the talk"—someone who has already achieved what you would like to achieve. For instance, you would not want someone who achieved his or her success in real estate to necessarily become your mentor for building a business to sell restaurant supplies.

As you begin, you'll also need a team of advisors. You should not risk the ordeals of building or investing in businesses without the expert help of others.

RICH DAD'S TIP

▲

"You don't need to know every answer, but you do need to know who to call for the answer."

FIND A MENTOR

Amateurs might not have coaches, but professionals do. One of the most important steps you can take upon entering the B quadrant is to set aside any discomfort you might have about asking for help. Seek out role models and learn from them.

Fishing for prospects isn't all that difficult. It's a matter of swallowing your pride, working up your courage, and approaching people. Businesspeople are busy but they are generally willing to share their success stories. Many talented folks in the B and I quadrants are willing to lend a helping hand. You can seek them out through the following avenues:

- Successful business people that you know. They may know someone who has succeeded in the business you have chosen and be willing to introduce you.
- Your local civic and volunteer organizations. Join several

FEAR:	I can't pester busy people by asking them to mentor me.
FACT:	Many high achievers relish the chance to mentor those who express a genuine passion to learn. High achievers like to share their experiences.
FREEDOM:	Swallow your fear of approaching winners, and you'll start turning yourself into a winner. Remember to consider how you can help your potential mentor. It is the concept of exchange.

organizations and you will meet others who may have experienced success in the very business you are starting.

- Your local newspaper and local TV news station. Start by looking for successful people in your own backyard. Which of them do you admire and would you like to approach?
- Your local chamber of commerce. Your chamber of commerce and other local business organizations sponsor classes, seminars, and social events for you to meet potential mentors.
- The business department of a community college near you. Community colleges often offer mentoring programs in association with local businesses.
- The Small Business Administration. This division of the U.S. Department of Commerce has an excellent mentoring program staffed with experienced people from all over the country. Call 1-800-8-ASK-SBA or check out the SBA website at *www.sba.gov*.

Perhaps the easiest way to convince someone to mentor you is the direct approach. Don't hesitate to call or write. Be polite. State clearly what you want and why you've thought of this person. You may be surprised at the response. Chances are your candidate mentor will be flattered by your interest and, like most people, will enjoy talking about what he or she knows best. You might suggest having lunch

RICH DAD'S TIP

"What are you willing to give in exchange for receiving guidance? Your relationship with your mentor is based on the simple concept of exchange."

together. If this pans out, go prepared, and pay the bill. You're conducting an interview of sorts. Do what the professionals do and write your questions out beforehand.

ONCE YOU'VE FOUND A MENTOR. . .

You probably won't get all the information you need after a single meeting. What you want to do is establish an ongoing relationship. You want someone who will teach you everything, then be available for support once you're on your own. The problem is, what's in it for the mentor? Why should this person bother to take you under his or her wing? While it may be true that at this time your resources are limited, that doesn't mean you have nothing to offer.

Find out what your mentor needs. Fortunately for you it's unlikely to be money, since this person is already financially successful. Feel out your mentor. In exchange for information and training, offer whatever you can in the way of help. The possibilities are endless, and of course depend on the nature of the business and your own field of expertise.

A QUID PRO QUO: REPAYING YOUR MENTOR

You want to learn all about a business and someone has agreed to teach you. How can you return the favor? Let's say your mentor has achieved financial freedom through real estate. You could offer to perform maintenance tasks such as plumbing and painting, or to landscape properties going up for sale. Perhaps your mentor operates a limousine service. You might propose washing the vehicles and keeping them filled with gasoline. What if it's a business to which you cannot directly contribute? In that case, you could ask if there are personal errands to be performed, such as shopping for groceries, chauffeuring children to activities, or walking pets. Don't overlook any rare or useful skills of your own. Can you prepare Indonesian food or tailor clothes? Teach piano or raise prized orchids? Make your talents known. You might just have one that fills a niche and makes your mentor as grateful to you as you are to your mentor.

APPROACH BUSINESS AS A TEAM SPORT

Some people insist on doing their own tax planning and legal work to save money. What they're really doing is ignoring their businesses. While they may save money in the short run, the eventual cost of not paying advisors will be much larger. If you really want to succeed in business, you can't go it alone. No one who is successful ever does.

When you do decide to put together a team, remember there is truth in the adage "You get what you pay for." Free advice is usually worth exactly what you pay for it—nothing. You should consider paying the professionals on your team well. Why? Because if those people use their specialized knowledge to support you, they'll make more money for you.

TAKE NOTE

It doesn't pay to scrimp. If the people you hire for your team use their specialized knowledge to support you, they should make you money. The more money they make, the more money you will.

Putting together a good team will require effort as well as money. Look at it as effort well spent. There are plenty of professionals—lawyers, accountants, tax planners, and the like—who will claim they can help you, and maybe they can. But you're looking for more than that advisor. You want their support, their encouragement, and their respect. What you don't want is someone telling you that you aren't capable of doing something when you know deep down that you are. You want to explain your goal and have professionals help you get there. The good professional will identify the risks, know how to minimize them, and ensure that the route you take doesn't inadvertently run afoul of some law. Hire professionals who will support your goals, not question them.

AN EXERCISE: SAY NO TO THE NAYSAYERS

If you're surrounded by naysayers, it's time to reconsider the company you keep. Here's a simple exercise to make you aware of the company you keep.

Write down the six people with whom you spend the most time. Children count as one person. Personal friends may not automatically qualify, but co-workers, spouses, neighbors, and members of any religious organization or charity may. After each person's name list the quadrant in which he or she earns money. Next list what type of investor that person is: just starting, accredited, qualified, sophisticated, inside, or ultimate. If you don't know, take an educated guess.

Now, take a look at the CASHFLOW Quadrant:

Place the initials of the people you spend time with in the appropriate quadrant. Then put your initials in the quadrant that currently describes you. In different color ink, put your initials in the quadrant in which you want to be five years from now. If the people you spend time with are in the quadrant that's your five-year goal, congratulations—you're surrounded by like-minded folks who will support you. If not, beware of naysayers. You may want to change the company you keep.

SHOPPING FOR A TEAM

Depending on your specific plans, there are numerous professionals who might make suitable team members. Most likely your team will break down into four general categories: financial, legal, real estate,

CRABS IN A BOX

Diane Kennedy, a certified public accountant and a Rich Dad Advisor, tells a parable from her childhood when she and her family would go catch Dungeness crabs on the Oregon coast. They would bait a trap with a funnel-like opening designed to let the crabs in but not out. If they caught more than one crab they would store the catch in a shallow open box without worrying about losing any. Though the crabs were large enough to escape the box and scuttle back into the water, oddly enough, they didn't. As soon as one attempted escape, the other crabs in the box would pull it back. Diane says that some friends and advisors are just like those crabs—if they think your goals are too big, too daring, they'll pull you back into the box.

Diane suggests that upon receiving negative comments, you ask yourself two questions:

1. Did the naysayers fail at some venture? If so, they might be saying you can't succeed when in truth they're afraid *they* can't succeed.
2. What are their comments really telling you? Sometimes a negative remark signals fear of change. Most people don't want to budge and they don't want you to budge. Because if you budge—if you pursue your goals—you might be leaving them behind.

Don't listen to the naysayers who try to hold you back. Find good advisors and follow your dreams.

and insurance. Once you've scheduled initial appointments with candidates, it's a good idea to make a complete list of the questions you plan to ask. This way you'll cover all your bases during the first interview, possibly saving yourself money and time.

There are certain generic questions you should ask of every potential advisor, no matter what his or her profession. These include the following:

- What are your credentials? (You wouldn't have a surgeon operate on your heart without first checking his or her credentials. The same goes for an advisor whose advice will affect the shape of your financial future.)
- In how many areas of my financial and business life would you be able to assist me?
- What are your references?
- How long have you been in business? How long have you been with this particular company or firm? (If a candidate has frequently changed companies, it could signal trouble. Be prepared to call a former employer.)
- Do you have a lot of clients? (Too many isn't necessarily good—you'll be squeezed into the schedule.)
- Are your clients generally people whose goals are similar to mine? (If most of the clients have goals that vary radically from yours, this person might not be the advisor best suited to your situation.)
- What are your fees, and how do you charge them?
- Would you be willing to meet with the other members of my team to discuss my financial and business plans?

RICH DAD'S TIP

▲

"People say building a business is risky. I say not building a business is risky, especially if you can assemble a team of qualified advisors."

As you listen to the answers, feel out candidates to gauge whether or not you'd be able to work with them. Are these people with whom you feel comfortable? People you can trust? You may have to interview two or three individuals before finding the right person for each member of your team.

YOUR FINANCIAL TEAM

At the beginning of your venture, your may need financial planners, stockbrokers, tax advisors, and bankers. Later, as your business expands, you might seek the help of other financial advisors such as bookkeepers, accounts payable and receivable clerks, auditors, and cost accountants—but for now, stick with your basic financial team. It's important that your team meet on a regular basis. You'll get the best advice only if they understand your overall financial and business plans. There's another advantage to meetings—they can turn into brainstorming sessions that generate tremendous ideas and opportunities.

FINANCIAL PLANNERS

Financial planners can be of invaluable help. Among other roles, a financial planner provides advice on cash management and budgeting, tax planning, investment strategies, estate planning, and insurance needs. This person's job is to assess your financial situation and help you develop a customized, detailed plan to help you reach your goals. You might want an advisor just to give you a fiscal fitness report, someone who can help you determine your long-term goals and with whom you can consult periodically. Or you might want a planner to play an active day-to-day role in managing your money.

About credentials. While financial planners need no credentials to practice other than being registered if the state they're in requires it, fortunately for you, some financial planners are credentialed. In addition to at least three years of experience, *certified financial planners* (CFPs) have to complete a course of study and pass a two-day exam covering everything from insurance and investments to estate planning and taxes. Some financial planners are also insurance agents. In addition to several more years of experience, *chartered financial analysts* (CFAs) have to complete a course of study and pass a rigorous exam covering portfolio management, securities analysis, accounting, economics, and ethics.

TAKE NOTE

Knowing how individual advisors get paid will prevent surprises and help you decide whom to hire.

How financial planners are paid. Knowing how individual advisors get paid will prevent surprises and help you decide whom to hire. Some financial planners are paid by *commission*, that is, a percentage of any investment or insurance product you buy through the planner goes into his or her pocket. Some financial planners charge an hourly or flat fee for services rendered. Still others charge a fee for advice, then a commission on each service, insurance policy, or investment you purchase. In a *fee-offset* arrangement, planners charge a fee for developing your investment plan, then reduce the fee if you also purchase investments, insurance, or other services through them.

What to ask when shopping for a financial planner. Many planners offer a free initial consultation. Take advantage of this; go in with your

HOW TO FIND A FINANCIAL PLANNER

When it comes to finding a financial advisor, you're probably better off doing your own research than listening to the advice of friends and neighbors. The first place to start is with successful business people. Ask them which financial planners they use. If they're happy with their planners, you're off to a great start. If not, here are some professional organizations you can contact:

The Financial Planning Association
1615 L Street, NW
Washington, DC 20036
1-800-282-7526
www.fpanet.org

The National Association of Personal Financial Advisors
355 West Dundee Road, Suite 200
Buffalo Grove, Illinois 60089
1-888-333-6659
www.napfa.org

The Investment Counsel Association of America
1050 17th Street, NW, Suite 725
Washington, DC 20036-5503
(202) 293-4222
www.icaa.org

Securities and Exchange Commission
Office of Investor Education and Assistance
450 5th Street, NW
Washington, DC 20549-0213
(202) 942-7040
www.sec.gov

The National Association of Securities Dealers
1735 K Street, NW
Washington, DC 20006-1500
(301) 590-6500
www.nasd.com

prepared list of questions and find out what you can expect. In addition to the generic questions already mentioned, you should ask the following:

- How often will I get a statement of my accounts? Monthly or quarterly?
- Can I see sample plans (anonymous, of course) that you've executed for other clients?
- Do you have a copy of the ADV form, part II? (This form, filed with the state and the Securities and Exchange Commission, shows the planner's education, fees, investment approach, and most importantly, whether the planner has ever been in trouble with a regulatory agency or court.)
- Do you represent a single entity in any area? For instance, do you sell a specific type of insurance only?

STOCKBROKERS

The typical broker is what is called a *full-service broker*, that is, someone who handles all sorts of transactions and advises you on investment choices. Also known as an *investment consultant* or *asset manager*, a full-service broker gathers information about stocks and bonds suitable for your situation. If you decide to buy a stock, the broker makes the trade. You can expect a full-service broker to take the time to get to know you and to service your account properly. A *discount broker* provides a no-frills version of this same service, but without the investment guidance and often relying on research done by other companies. At a discount brokerage, you may not work with the same broker from transaction to transaction. Don't expect a discount broker to hold your hand, or for that matter, to remember your name. Today, many people operate through on-line brokerage accounts. While this may be beneficial from a fee perspective, it allows for little if any interaction with trained professionals. You may be functioning in the S quadrant as your own stock advisor.

How brokers are paid. A broker's earnings come from how often and how much you buy and sell, not from your investment's success. Brokers usually get paid on commission. *Up-front fees* or *loads* are commissions you pay at the time you invest. *Back-end fees* or *deferred loads* are commissions you pay when you take your money

HOW TO FIND A BROKER

Asking successful friends and family for the names of brokers is one way to start. You can also get names by calling brokerage firms. Many brokers belong to civic and business associations that hold meetings open to the public. Brokers also hold seminars designed to educate and win potential clients. Watch your local newspaper for these, or call brokerage firms in your area and ask if any seminars are scheduled. Attend as many seminars as possible so that you can see the broker in action, as well as learn the subject matter presented. Whether a broker is with a nationally known or a local firm makes little difference. What matters is how comfortable you feel with this person, and whether he or she is willing to work on your behalf.

TAKE NOTE

Keep in mind that your objective is to earn a good return on your investment, not to pay a lower commission.

out of the investment. *Mark-up* or *spread* is a commission that applies to bonds. The broker buys the bond at one price and sells it to you at a higher price. The difference between the two is the broker's commission. Trades executed frequently, or in quantity, may result in your paying a smaller commission, but keep in mind that your objective is to earn a good return on your profit, not to pay a lower commission.

About credentials. Brokers need no specific credentials other than passing basic proficiency exams known as Series 6 and Series 7. It's best to choose a broker with at least some credentials and with enough experience to be of real help. A broker who earns a license to do business is issued a Central Registration Depository (CRD) number. Any complaints filed against the broker will be listed with the CRD under that number. Brokers may earn designations such as *certified financial planner, certified fund specialist, chartered mutual fund consultant*, or—the most prestigious credential—*chartered financial analyst*. You can run a check on any broker by calling the National Association of Securities Dealers (1-800-289-9999) and the office of your state securities regulator. It's also a good idea to call any agency from which the broker claims to have earned a credential.

What to ask when shopping for a broker. During your first interview you should expect to define the relationship you want to have with your broker. In addition to the generic questions, the following are pertinent:

- What is your basic investment philosophy?
- May I see a sample monthly statement? Can you explain how to read it?
- What is your CRD number?
- Is your firm a member of the Securities Investor Protection Corp (SIPC)? (The SIPC can provide you with some protection should a firm become insolvent or avoid its financial responsibilities.)

TAX ADVISORS

Tax planning is an essential financial strategy of the rich. To manage this all-important aspect of your finances, it pays to hire a professional you can trust and with whom you feel comfortable. Remember, whoever helps you with your tax planning will learn all the details of your financial life intimately. Choose carefully.

About credentials. There are many tax advisors who have no certification and minimal educational training. You should seek out those who are credentialed and have specific knowledge. *Accredited tax preparers* (ATPs) and *accredited tax advisors* (ATAs) have to complete a course offered through the College of Financial Planning and pass an exam administered by the Accreditation Council for Accountancy and Taxation. *Enrolled agents* have at least five years' experience working for the IRS. Many hold master's degrees in taxation or accounting and are fully qualified not only to offer tax advice and prepare your taxes but also to represent you before Uncle Sam should the need arise. If you're audited, you can only be represented before the government by an enrolled agent, a tax attorney, or a *certified public accountant* (CPA). A CPA must have at least a bachelor's degree, usually in accounting, pass a national exam, and be certified by the state in which he or she practices. The CPA should be a member of his or her state society as well as the American Institute of Certified Public Accountants. Not all accountants are CPAs. Some CPAs also earn the designation *personal financial specialist*, or PFS. The PFS handles broad financial planning and must meet rigorous educational and peer-review requirements.

RICH DAD'S TIP

▲

"Instead of living below your means, focus on increasing your means through asset buying and proper tax planning."

HOW TO FIND A TAX ADVISOR

Ask business owners or those with financial goals similar to yours for recommendations of tax advisors. Another good source is your state's society of CPAs. Check also with these national agencies:

The National Association of Enrolled Agents
200 Orchard Ridge Drive, Suite 302
Gaithersburg, Maryland 20878
1-800-424-4339
www.naea.org

National Society of Accountants
1010 North Fairfax Street
Alexandria, Virginia 22314
(703) 549-6400

American Institute of Certified Public Accountants
1121 Avenue of the Americas
New York, New York 10036
1-888-777-7077
www.aicpa.org

How tax advisors are paid. There's no set way that tax advisors charge, though their fees tend to be tied to experience. Typically, tax preparers charge by the hour or by the number of forms it takes to prepare your return. Others charge a flat fee. If you expect to consult your advisor on the buying and selling of investments, settle on a fee up front.

What to ask when shopping for a tax advisor. In addition to the generic questions, you should ask the following:

- Do you have expertise in small businesses?
- What types of businesses and clients do you work with? (Unless you're willing to pay for on-the-job training, you want someone knowledgeable in your business.)

FEAR: I'm better off saving money and not hiring a tax advisor.

FACT: If you own a business, a tax advisor can save you time, prevent errors, and maximize tax savings.

FREEDOM: If you spend money on a tax advisor now, you'll save money later.

- How conservative are you when it comes to deductions? (You don't want someone who avoids taking a legitimate deduction for fear of raising a red flag at the IRS.)
- Are you familiar with the tax laws in all the states in which I may be subject to tax?
- How will you handle any penalties or interest due if there's a miscalculation on my return? (While you'll be liable for the tax due, good tax advisors stand behind their numbers and will pony up if they've made mistakes.)
- Will you represent me before the IRS if my return is audited?
- Will you review my last three years of tax returns? (This is a wonderful way to judge the tax preparer's expertise. It's very common for good tax advisors to find additional tax savings for new clients.)

BANKERS

Since all banks generally provide the same services, it's important that you select a banker, not a bank. A local bank where you are personally known and have access to the decision makers is probably preferable to a large regional bank where you're likely to be judged by the size of your bank balance.

What you want is a so-called *relationship banker*. Relationship bankers are customer-service oriented. They look for ways to make mortgage and business loans that not only are profitable for the bank but also fit customers' individual circumstances. Another type of banker that might be of help is one whose institution has been pre-approved by the Small Business Administration to make loans to start-up companies under the Preferred Lenders Program. For more information, call the SBA's Answer Desk at 1-800-827-5722, or check the SBA website at *www.sba.gov.*

How bankers are paid. Banks make their money primarily by charging interest on loans, though often there are charges for other services, such as minimum-balance fees for checking accounts. Beyond the basic banking services, many banks offer investment and estate-planning services, which are charged separately.

What to ask when shopping for a banker. Ask to meet with the bank president, other top officers, or the branch manager to discuss your financial goals and banking needs. If they don't seem interested in a meeting, or they regard your goals as even slightly out of the ordinary, this is probably not the bank for you. If you get a positive response, here are some suggested questions:

- Do you have recommendations for how I might meet my financial goals?
- Does your institution stick strictly to a formula when determining loans? (While there are often more reasons to refuse a loan than to grant one, you want to be sure that in your case the bank takes an open-minded approach.)
- How are decisions made in your loan-review process, and how can I work with the people who make them?
- Can I see the bank's financial statement and bank-rating reports? (Check the bank's financial health by asking to see any of the reports issued by bank-rating services such as Sheshunoff Ratings Services, Veri-bank, and Bauer Financial Reports.)
- What deposit insurance do you have, and how far would protection be extended to my account?

YOUR LEGAL TEAM

As you set off on your business venture, you may require more than one lawyer since the law has become highly specialized. Which of the various legal specialties is best suited to your needs? *Business* *lawyers* advise on all corporate matters ranging from drawing up legal papers for start-ups to settling partnership issues. *Real estate lawyers* review real estate contracts and mortgage papers and represent clients in closings. *Tax lawyers* handle matters involving federal, state, and local taxes and are invaluable when it comes to interpreting the complicated tax code. They won't prepare tax returns but are often associated with people who will.

Intellectual property lawyers are especially important in business. They advise clients on matters involving ownership and rights in the use of technology, information, and other aspects of business tools and products. For example, they advise clients on such things as obtaining and maintaining trade secret rights, copyrights, trademarks, and patents. They help you license the use of software, of endorsements, and of characters like Mickey Mouse. And they assist you in negotiating and drafting contracts with others if there's a chance an activity will create intellectual property, for example, when developing products, advertising, and marketing materials. If you believe you have a product that can be patented, make sure your

HOW TO FIND A LAWYER

Although many attorneys now advertise, this is not the best way to find one. To jump-start your search, ask your team members for referrals. Typically, your advisors will have networks of attorneys with whom they work. Since they already know you and your preferences, they should be able to recommend an attorney to your liking. Some lawyers belong to local civic organizations. Make a point of joining these organizations and attending their social functions to cross paths with potential advisors. You could also check with your local bar association for referrals. Bar associations can provide background information on attorneys and may have on record any complaints that have been filed. You can also try your public library. Go to the reference librarian and ask to see The Martindale-Hubbell Law Directory. This gives a complete listing of lawyers by state and specialty. Martindale-Hubbell also has a website at *www.martindale.com/locator*.

intellectual property lawyer is also a patent attorney. Patent attorneys must pass a national patent bar in addition to the bar exam for the state, or states, in which they practice. While all patent attorneys are intellectual property attorneys, not all intellectual property attorneys have passed the patent bar.

About credentials. Practicing law without a license is a crime in most states, so be sure that at a minimum your lawyer has a law degree and a license. Beyond this, it might behoove you to look for an attorney who wears more than one hat. Intellectual property attorneys should also have technical or scientific background. Some attorneys are also CPAs or hold other financial credentials. Remember, however, credentials for financial planners vary. If you're hoping to hire a lawyer who doubles as a financial planner, be sure to check out his or her credentials in both areas. You might also want to find a lawyer who is licensed in more than one state, for instance, should you buy real estate in an adjacent state.

How lawyers are paid. While it's true that good attorneys can be expensive, it may be more expensive for you in the long run not to have competent legal counsel. Legal fees incurred to resolve disagreements over contracts and agreements not properly documented will be much higher than any fees you'll pay for proper documentation in the beginning. At any rate, having an experienced attorney may be essential to your enterprise, in which case it's worth the cost.

To perform routine legal services such as property title searches or real estate contract reviews, most attorneys charge a flat fee, or *fee-*

FEAR: I can't possibly hire legal help. A lawyer would empty my coffers.

FACT: A good lawyer will prevent others from emptying your coffers by protecting you against potential lawsuits and other contingencies.

FREEDOM: Hire legal help now and you won't have to bail yourself out of a legal hole later.

for-service. Should you need ongoing advice from an attorney, he or she will probably charge an hourly rate. Hourly rates can run into the hundreds of dollars, so it's important to know a lawyer's rate ahead of time. Will you be relying heavily on legal services? Then you might want to negotiate a lower rate or ask for a ceiling on the amount charged. If you keep your lawyer on a *retainer*, that is, if you pay a set amount of money on a regular basis, you're guaranteed legal services whenever they're needed. If an attorney is managing your assets, for instance handling the sale of property, he or she may charge a *percentage fee* based on a percentage of the assets involved. A *contingent fee* usually applies to situations where money, especially from personal injury, is likely to be awarded. If you win the case, your attorney takes a percentage of the award. If you lose, the attorney gets nothing.

Be sure to ask if the attorney charges separately for out-of-pocket expenses such as copying charges, long-distance phone calls, and filing fees. These can add up, and it's best if there are no surprises when the final bill comes.

What to ask when shopping for a lawyer. As with anyone on your team, you need to feel at ease with your attorney. You want someone trustworthy, able, and experienced. In addition to the generic questions, here are some that will help you gauge your comfort level with a potential attorney:

- What areas do you specialize in?
- Are you licensed in more than one state?
- Are you, or is someone in your firm, admitted to the patent bar?
- Will anyone else in your firm be working on my behalf? (You don't want to discover later that your legal needs have been handed off to another member of the firm, perhaps someone less experienced. However, it may be to your advantage to have less experienced staff perform some of your work, since they bill at much lower rates. The point is to understand the firm's work and billing policies.)
- What can I do to help keep costs down?
- How often can I meet with you? (You want to avoid an attorney with a heavy caseload who won't have time for you.)

RICH DAD'S TIP

"Don't buy real estate based on what your eyes tell you. Buy it based on what your mind tells you, rationally."

YOUR REAL ESTATE TEAM

It's a good idea to establish an ongoing relationship with a realtor, someone who knows your community and those surrounding you. This person will help you make rational decisions about real estate, keeping you informed of property rentals, purchases, and sales, and perhaps more importantly, of opportunities that are right for you.

Keep in mind that real estate agents, also called *conventional agents*, represent sellers. Technically, it's the real estate agent's job to find a buyer for the seller and close the deal. If you go into a real estate office looking for property to buy, the agents you meet there represent the sellers. If you make an offer on a property but confess to the agent that you'd be willing to go higher, the agent is obliged to pass that information along to the seller.

You might want to consider working with a *buyer broker* instead. If you promise to work with this person exclusively, he or she will bring potential properties to your attention and handle any negotiations on your behalf. Many buyer brokers also help with financing, insurance, and inspection matters. The downside is that buyer brokers can also act as conventional agents, in which case they're handling both sides of the deal and might not be acting in your best interest.

If you plan to go into real estate as a business, later on you'll probably need to expand the real estate part of your team to include people such as mortgage brokers, insurance agents, and house inspectors.

About credentials. There's little difference between real estate agents and brokers. An agent is someone who has taken classes, passed an exam, and been issued a license by the state. A broker is an agent who has taken additional classes, passed an exam, and received a license to operate a real estate office. Brokers usually have more experience than agents, who work for them. Realtors are agents or brokers who belong to the National Association of Realtors. Most agents and brokers are realtors.

How real estate agents are paid. Agents are usually paid a commission, somewhere between 5 and 7 percent, when the sale of a property is complete. In some cases, buyer brokers split commissions with sellers' agents. Some agents will agree to negotiate their commission percentage ahead of time, or will even

How to Find a Real Estate Agent

Getting references from satisfied income-property owners is one of the best ways to find a realtor. You can also check with your local board of realtors, or find the biggest real estate firms around and schedule interviews with their top agents. You might consider attending a few open houses in your area, not to buy houses but to meet agents. Watch how agents present homes, and ask plenty of questions. Another avenue is to check with property management companies and escrow and title companies in your area.

negotiate for a flat or hourly fee. However, don't be too drawn by the glitter of potential savings through negotiation. Too low a commission will lessen the agent's incentive to work on your behalf.

What to ask when shopping for a real estate agent. The first thing you'll want to know is whether a realtor is working full or part time. A full-time realtor is the best choice of advisor if you're up to your elbows in real estate investments, but a part-time agent might be all you need when you're starting out and looking at just a few properties. In addition to inquiring about a realtor's status in this regard, and posing the generic questions, you'd do well to ask the following:

- How broad an area do you cover? (You want someone who's familiar with more than one community.)
- How many properties have you listed and sold in the last year?
- How many investment properties do you own?
- Will you be representing the seller, the buyer, or both?
- Can you assist me with financing?

YOUR INSURANCE TEAM

The basic idea behind insurance is pretty simple: protect what you cannot afford to replace, and cover yourself for unexpected events.

HOW TO FIND AN INSURANCE AGENT

What distinguishes insurance agents from most of your other potential advisors is that they're more likely to approach than to be approached. That's because until a disaster strikes, no one pays much attention to insurance. Ask for recommendations from other members of your team or from business associates. You'll find insurance agents listed in the Yellow Pages, in local newspaper ads, even in concert programs and playbills where their underwriting helps support a local activity. Good agents tend to be exhaustively involved in community activities.

Your business probably won't burn to the ground, your employees probably won't sue you, and you probably won't produce a defective product that results in a class-action suit against you. Still, you need to protect yourself and your investment, and that means getting an insurance agent on your team.

Insurance agents are basically salespeople peddling insurance policies. *Independent agents* represent many different insurance companies and can offer you a wide choice of insurance coverage. *Captive*, or *exclusive, agents* work for just one insurance firm and have more intimate knowledge than independent agents of the coverage that particular firm offers. Some insurance agents are also financial planners. In this case, they should be able to help you with your overall financial plan.

About credentials. The only credential an insurance agent needs is a license issued by the state. There are, however, a few designations an agent can earn that you should look for. *Chartered financial consultants* or *chartered life underwriters* have training that takes between three and five years to complete. *Chartered property casualty underwriters* have training in property and liability coverage. Agents who have earned such designations tend to be more experienced and knowledgeable than merely licensed agents. At any rate, you should obtain the license number of any potential agent and conduct a background check with your state insurance commission.

How insurance agents are paid. Insurance agents are paid commissions by the company or companies they represent. An insurance company with a good reputation and a spotless record will pay lower commissions because its policies are easier to sell. A company with a less secure reputation will pay higher commissions.

What to ask when shopping for an insurance agent. Insurance agents are likely to ask you just as many questions as you ask them. They need to discover your goals and needs in order to tailor a policy to your situation. So go to any interview expecting to provide some basic information about yourself and your aspirations. When it comes time to ask your own questions, don't forget these:

- What is your license number? (If the agent refuses or hesitates to give you the number, walk away.)
- How many insurance companies do you represent? Which of them receive most of your business, and why?
- In how many areas of my financial life are you qualified to assist me?
- How are claims reported to the company?
- Will you be available should I need service, or is everything handled by an adjuster?

WHAT TO DO WHEN THINGS DON'T WORK OUT

Sometimes aspiring business people select advisors and the relationship doesn't work out. Should a marriage prove not to be made in heaven, how will you respond? Will you play the blame game, assigning responsibility for things gone wrong to this advisor who's proven less than satisfactory? Perhaps, in truth, you didn't plan carefully enough in the first place and you selected a poor advisor. People who point fingers don't learn from their mistakes.

If you're in genuine pursuit of financial freedom, you have to take responsibility for an advisor who doesn't work out. This doesn't mean blaming yourself. Blaming yourself is no different than blaming the advisor. In any event, whose fault it is doesn't matter in the scheme of things. Rather than blaming, you should simply part ways with the advisor, admit to yourself that something went awry, and move on. In

FEAR: I've just hired all these expensive advisors. If one of them screws up, it could ruin me.

FACT: Sometimes an advisor won't meet your needs. It's best to dismiss any advisors with whom you're dissatisfied and then move on, without becoming mired in the blame game.

FREEDOM: Those who learn from their mistakes are the most likely to achieve financial freedom.

a fledgling business enterprise, whenever you fall you have to get back on your feet, dust yourself off, and forge ahead. You have to be more like Thomas Edison, who tried 10,000 different experiments before he finally succeeded in inventing the light bulb. In Edison's mind, he hadn't failed 10,000 times—instead, he'd discovered 10,000 ways not to invent a light bulb.

TAKE NOTE

Edison discovered 10,000 ways not to invent a light bulb—and then discovered the right way.

CHOOSE YOUR ENTITY

Presumably you've been building your team, and you now have access to sound legal and tax advice. It's a good thing, because soon you'll be deciding what legal form your business will take.

Every business is operated under the umbrella of one of the following entities: sole proprietorship, partnership, C or S corporation, or limited-liability company. As we learned in Section 2, each entity has advantages and disadvantages in terms of taxes, liability, and owner control. The type of business you set up depends on your present income, your plans and goals, your tax status, and a variety of other circumstances. Which entity is right for you?

Don't forget that the legal form of your business is one of the most important decisions you'll make. The tax code is thousands of pages long and extremely difficult to wade through, yet you won't be able to use that as an excuse if you choose the wrong entity for your business. If you're thinking of setting up a business, do yourself a favor: Hire a good attorney and accountant to advise you in the process of selecting an entity.

LAYING THE GROUNDWORK FOR YOUR CHOICE

Before you decide which entity to go with, there are a number of important housekeeping chores to take care of:

1. Write a mission statement indicating what sort of product/service you'll offer, examine the competition, and start writing a business plan.
2. Begin assembling your team of professional advisors.
3. Take steps to legalize your business. Almost all jurisdictions require some kind of licensure. Check with local, state, and federal agencies to see that you comply, and expect to pay some fees.
4. Register your business name with the state. This will establish you as a bona fide business and indicate whether your name is already being used by some other company.

RICH DAD'S TIP

"One very important point is that you seek out and rely on the careful guidance of expert professionals in choosing the legal form of your business."

CHOOSING A BUSINESS ENTITY

Stumped about which business entity you should choose and how to set it up? In addition to consulting an attorney or accountant, you might try contacting the following organizations:

The Chamber of Commerce Small Business Institute
201 East Dundee Road
Palatine, IL 60067
1-800-429-7724; Internet: *http://www.usccsbi.com*

U.S. Department of Commerce
14th and Constitution Avenue, NW
Washington, DC 20230
(202) 482-5061; Internet: *http://www.mbda.gov*

- To register a trademark, contact this agency.

The Small Business Administration
409 3rd Street, SW
Washington, DC 20416
(202) 205-7701; Internet: *http://www.sba.gov*

- The Service Corps of Retired Executives (SCORE) is part of the SBA and has information regarding permits and licensing procedures. It also provides valuable tips on starting a small business.

U.S. Patent and Trademark Office
Washington, DC 20231
1-800-786-9199

- To register a patent, contact this agency.

Internal Revenue Service
Internet: *http://www.ustreas.gov*

5. Get a trademark or patent for any intellectual property. Be sure to check with a lawyer who specializes in patent law.
6. Scout out a place of business and check local zoning laws. In addition to reviewing any leases with a lawyer before signing,

make sure you have the proper permits for your enterprise, for example, health, fire, and sales tax permits. You are responsible for making sure your business complies with local and state laws.

SOLE PROPRIETORSHIPS

In its purest form, the sole proprietorship is considered by most a no fuss, no muss enterprise. Not surprisingly, about 75 percent of businesses take this form. This is not the business form that Rich Dad recommends. As a sole proprietor all you need do is decide the nature of your product or service, advertise, and start plying your trade. You won't have to deal with complicated legal documents or hire expensive legal advisors. Sometimes paperwork is still required for sole proprietorships, so make sure you check with the proper local, state, and federal agencies and obtain any necessary documents. For example, you may need a business license. If you choose a business name other than your own (called "doing business as," or DBA for short), you'll have to register at the county courthouse. Relatively speaking, the legal matters associated with establishing a sole proprietorship are simple and straightforward, things you can tend to yourself. However, this is a very risky way to start a business.

RICH DAD'S TIP

▲

"The important word in sole proprietorship is sole. You alone are responsible and liable. Do you want your personal assets put at risk if there is a problem with your business?"

IS A SOLE PROPRIETORSHIP FOR YOU?

Sole proprietorships offer people the opportunity to run their businesses as they see fit, with minimal intrusion from the government. You are the owner, and decisions and profits are all yours. The sole proprietorship requires little paperwork and is the simplest business entity to operate. Moreover, if you decide to discontinue your business, no one else need be consulted: Pay off your debts, liquidate your assets, and close up shop.

A sole proprietorship may work for people like freelancers and consultants who want to keep their businesses small and their staffs limited. If you intend to bring in partners or you need investors, the sole proprietorship won't work because it precludes anyone else from owning equity. Nor is the sole proprietorship ideal if you have reason to be concerned about liability. As a sole proprietor, you are personally liable for all the debts your business incurs. All of your personal assets are also at risk because you choose to operate as a sole proprietor. Liability can be a big drawback.

PARTNERSHIPS

Like a sole proprietorship, a partnership requires no special paperwork. It is simple and relatively cheap to start. You and your partner(s) will probably want to operate under a business name, so be sure to register it with the appropriate state agency. There will be a small fee associated with this step.

In addition, you should set up an agreement so that each partner's rights and liability are clearly outlined. Partnership agreement forms can be purchased at stationery stores or provided by lawyers but should be reviewed very carefully to make sure they apply to your specific situation. In any partnership agreement it's important to include the following:

- Date of agreement
- Names of partners
- Type of business entity
- Amount of investment from each partner
- Location of business
- Description of proposed accounting system
- Employee management roles
- Draws, salaries, or bonuses
- Division of profit or loss
- Restrictions on fiscal authority and expenditures
- Duration of partnership
- Plans for altering or dissolving the partnership
- Distribution of assets upon dissolution of partnership
- Provisions for settlement of disputes
- Settlement in case of death or incapacitation

IS A PARTNERSHIP FOR YOU?

Let's say you don't want to run the show by yourself. Perhaps you lack the experience to make a success of your business, or you simply prefer sharing responsibility with others. Then you may consider a partnership. It is often said two heads are better than one, and for some people the additional ideas and enthusiasm generated by a partnership can bring comfort to what would otherwise be a daunting task. Partnerships can also increase the amount of available capital, and new businesses need plenty of that.

On the down side, in a partnership you give up a certain measure of freedom and control. People being people, disputes are bound to occur, causing many a sleepless night. It is also important to remember that business decisions and actions taken by your partner are legally your business decisions and actions, even if you do not know about them in advance. You are obligated by your partnership to live up to all agreements entered into by the partnership. In a general partnership, as in a sole proprietorship, liability rests entirely on the shoulders of the owner(s). Not only are you fully liable for your decisions, you're also fully liable for the decisions of your partner. Once again, your personal assets are completely at risk, but now they're at risk for decisions your partner may make.

TAKE NOTE

For some people, the additional ideas and enthusiasm generated by a partnership can bring comfort to what would otherwise be a daunting task.

CHOOSING THE RIGHT PARTNER(S)

Just as important as the decision to form a partnership is your selection of partner(s). When considering a partner, ask yourself the following questions:

- Are you keeping emotions out of the selection process? Best friends don't always make the best partners.
- Have you taken a careful look at this person's financial history? A poor credit rating could seriously hobble your business.
- What professional talent does this person bring to the partnership?
- Will this person's personal life interfere with business?
- Do you share the same values?

If you don't feel comfortable with your answers, you might want to go hunting for new partners or consider a different entity for your business. A general partnership is not an entity normally recommended by Rich Dad. However a limited partnership can be very useful in certain circumstances. For instance, a limited partnership may be the perfect entity in which to hold certain types of real estate. Your legal and tax advisors are best able to review the applicability of the various types of partnerships to your particular situation.

CORPORATIONS

RICH DAD'S TIP

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"I recommend that, if possible, you at least consider being an employee of your own corporation. C corporations provide the greatest flexibility."

A third and very different choice of business form is the corporation. Unlike the sole proprietorship and the partnership, the corporation is an entity completely separate from you, the person incorporating it. Your company is now an "Inc," and with that designation comes some additional paperwork and compliance issues based on the laws of incorporation unique to the state in which you choose to incorporate. However, the corporation provides a level of protection for you. Because it is a separate entity, it should provide protection for your personal assets from creditors of the corporation. Although you may want to do some of this legwork yourself, you should use a lawyer for much of it.

Though the rules for creating a corporation vary from state to state, there are two basic steps: You file articles of incorporation with the state secretary of state's office or the corporation commission, and you establish an operating agreement or shareholders agreement. The basic document for incorporation can be obtained from the office of the secretary of state. Different states have different names for this document, for example:

- Articles of incorporation
- Certificate of incorporation
- Charter
- Articles of association

Once you incorporate, there are certain rules and formalities that must be observed. For instance, most states require corporations to hold shareholders' meetings and keep updated business records, and some states have special forms for filing this information. Such regulations may seem silly when you are the sole owner of and the only shareholder in your corporation, but it is critical that you comply with the requirements. If not, your corporation could be dissolved and you might end up paying a fine. There are consultants who specialize in assisting companies with compliance requirements. A consultant will make sure all necessary meetings are held and documented, and that all incorporation paperwork is filed with the state. Check with your legal counsel, who may provide this service or direct you to a consultant in your area.

On the bright side, remember that the corporation owns its own assets and pays its own debts. This is the secret of the rich. If, on paper at least, you don't own anything, then you can't lose it. If a party claims injury from your business and sues, your personal assets should be protected.

Before you incorporate, you must decide which type of corporation best fits your needs. In Section 2, we discussed the pros and cons of C and S corporations. Now you'll have to decide which one is for you.

RICH DAD'S TIP

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"This is a secret of the rich: The corporation owns its own assets and pays its own debts."

IS A C CORPORATION FOR YOU?

Here are a few questions to ask before you decide to form a C corporation. The more yes answers you come up with, the more applicable the C corporation is to your business.

- Is your business growing so rapidly that you can no longer handle it alone?
- Do you need to raise more capital?
- Do you want less risk personally?
- Can you visualize sharing control of your business with another?
- Has your business outgrown your goals?
- Would the business benefit from managerial and creative skills that you lack?
- Do you want to offer fringe benefits that are only available through a C corporation?

IS AN S CORPORATION FOR YOU?

As we learned in Section 2, S corporations can be a desirable choice for the start-up small business owner. The income of an S corporation is passed through to the shareholders, who then declare the income on their personal income tax statements. If your personal tax bracket is lower than the corporation's, passing the business income to yourself can lower the overall taxes. Or if you incur a loss at the corporate level, it may be able to offset income at the shareholder's individual tax level. To create an S corporation, you must first follow all the steps required to incorporate (see incorporation steps above). In addition, there are some special rules and regulations:

- An S corporation can have no more than seventy-five shareholders.
- All shareholders must agree to choose S corporation status.
- An S corporation must be incorporated in the United States, and shareholders must be residents of the United States.
- Only one class of stock can be offered.
- You must sign and file IRS form 2553, and elect to be taxed almost as if you were a partnership. This allows you to claim the limited liability of a corporation but to avoid being taxed at the corporate level, since losses "pass through" to shareholders.

LIMITED-LIABILITY COMPANIES

You'll recall that the limited-liability company (LLC) is a relatively new business entity that may offer the tax advantages of a partnership along with the limited liability of a corporation. In some states you must choose how your LLC will be taxed. The process of launching an LLC, which is similar to incorporation, requires more paperwork and is costlier than launching a partnership.

LLCs are now legal in all fifty states, but the laws governing them differ from state to state. In general, to form an LLC you must file articles of organization with your state's office of the secretary of state, as you would for a corporation. As with a partnership, though, in some states you will be required to produce an operating agreement. This agreement can be oral, but you should put it in writing nonetheless to protect your future interests.

IS A LIMITED-LIABILITY COMPANY FOR YOU?

Take a moment to consider exactly what an LLC can and cannot do for you before forging ahead. Do you intend to be the sole owner of your LLC? Then check with your state to see if single-owner LLCs are legal. And don't assume that the label limited liability will eliminate your risk should your company default on loans. Although an LLC generally limits the liability of its members, it may require them to guarantee loans personally. You should also know that transactions outside the state where the LLC was formed may be treated differently by the law than transactions instituted within the state.

Remember, an LLC is a business entity that can combine the tax benefits of a partnership with the limited liability of a corporation. This marriage can be used to your advantage. However, consolidating two sets of regulations can lead to confusion. Make sure you do your homework, learn the rules, and above all, seek professional advice.

MOVE FROM EARN-TAX-SPEND TO EARN-SPEND-TAX

By now you've chosen your team and your business entity. The next step is to devise a tax strategy whereby you, the business owner, will take advantage of the tax deductions allowed for your business—deductions for things you may have been paying for personally, with after-tax dollars. This will allow you to move from the earn-tax-spend model of an employee to the earn-spend-tax model of a business owner.

RICH DAD'S TIP

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"The tax laws were written for the benefit of the business owner. You're paying more in taxes than you should if you don't take advantage of the deductions provided for you."

In Section 2 we learned that the business owner starts out with a gross income, then deducts all legitimate business expenses, reducing net income as much as possible prior to paying taxes.

STUMPED ABOUT WHAT TO DEDUCT? HELP IS HERE...

While a good tax advisor can save you money, as a business owner you'll optimize your savings if you have personal knowledge of tax laws and choices. There are plenty of places to seek help. For example, you can find lots of information on the Internet at these sites:

* Internal Revenue Service, *www.irs.ustreas.gov.* Many IRS publications address the topic of allowable business deductions. You can download them from the web or get them free by calling the IRS Tax Distribution Center at 1-800-829-3676. Some important publications include #334, Tax Guide for Small Business; # 463, Travel, Entertainment, Gift, and Car Expenses; and #535, Business Expenses.
* Smart Business Supersite, *www.smartbiz.com.* This provides free information on how to run your business, including tax-savvy tips.
* Business Toolkit Website, *www.toolkit.cch.com.* Click on Controlling Your Taxes.

Business owners pay for many expenses before taxes—expenses they would have to pay even without a business. With a little creative thinking and proper documentation, a business owner can transform everyday expenses into legitimate business deductions.

WHAT ARE LEGITIMATE BUSINESS EXPENSES?

Legitimate business expenses, according to the IRS, are any "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Here are some common business expenses:

- Fees for tax preparation
- Advertising
- Car and truck expenses
- Business travel
- Retirement plan contributions
- Office supplies
- Entertainment
- Insurance payments
- Professional organization membership dues
- Transportation costs
- Postage
- Business gifts of $25 or less
- Interest

And some nondeductible expenses:

- Penalties for breaking the law (no, traffic tickets incurred while driving to a business meeting are not deductible!)
- Tax penalty payments
- Social club dues or membership payments
- Political contributions
- Professional examination fees
- Gift or inheritance taxes

What about your expenses? Do you require a truck or a car to conduct business? You may have thought of deducting loan payments on your vehicle, but have you also considered deducting

RICH DAD'S TIP

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"Always remember that we may live in a free country, but we don't all live by the same laws. If you want to be rich or get rich quickly, you had best follow the laws the rich use."

the cost of gasoline, oil, and tires? What about any repairs or registration fees? Of course, not every expense will be a deduction. The point is to reconsider all your expenses and determine which might qualify as business tax write-offs. Write down each and every expense you have, no matter how irrelevant it may seem—everything from clothing and childcare to vet bills and home security systems. Then ask your tax consultant which of these expenses would rate as a tax deduction for your particular business entity. The following chart is an example of how some personal expenses can be converted to business expenses:

One of the biggest advantages to business owners is that they can pay for many normal expenses BEFORE taxes. These are expenses that they would have to pay for anyway, without a business. With creative thinking and proper documentation, a business owner can turn these expenses into legitimate business deductions!

Here are some ways others have turned their personal expenses into business expenses:

PERSONAL TO BUSINESS EXPENSES

BEFORE	BECOMES	HOW?
Computer	Business Equipment	Prove the business use. This is easy in today's world — Word processing, spread sheet programs, accounting software.
Internet Service	Utility	Prove your need for business communications by communicating with clients and colleagues.
Cellular phone	Business Equipment/Service	Use your cell phone to call clients, vendors, etc.
Automobile	Auto Allowance	Document how much of your monthly mileage is business related and deduct the IRS-approved standard mileage rate.
-OR-	Business Vehicle	Company owns vehicle and furnishes to employee. Personal use is taxable.
-AND-	Auto Maintenance	Company pays for gas, oil, tolls, car washes, tune-ups, etc.
Meals Out	Business Meals	Note the business purpose of meal and who attended.
Child/Day Care	Provided Child Care	Business adopts plan to furnish child care.
Child's Allowance	Employment for your child — Often tax free to your child	Written job description, time sheet, reasonable wage.
Medical, Vision	Medical Reimbursement	Adopt medical reimbursement plan to pay all medical, vision, dental, orthodontia costs.

PERSONAL TO BUSINESS EXPENSES

BEFORE	BECOMES	HOW?
Magazines	Subscriptions	Prove use for your business or have available to waiting clients.
Art Work	Office Art	Use in your office, and document as business expenses.
Dry Cleaning	Out-of-town Expenses	Dry cleaning expenses are allowed as part of your out-of-town business expenses.
Gym Equipment	Physical Fitness Facility	Establish an on-premise house/office gym.
Vacation	Business Trips	Create business purpose for the trip.
Tuition	Education	Authorize employee/owner education.
Seminars	Education	Authorize employee/owner education.
Furniture	Business Furniture	Where appropriate, prove business need — desk, etc.
Home Costs	Home Office or Business Rental	Follow home office guidelines — measure square footage used for business, track all home expenses for reimbursement.

NOTE: These are available ONLY to business owners, not to employees. Plus, as always, each individual's circumstances vary, so always consult with your own personal tax advisor to see what is applicable to you. Finally, correctly document your expenses and practice good record keeping to make sure you can justify and KEEP these deductions if you are ever audited.

THE IMPORTANCE OF KEEPING RECORDS

It's imperative that you keep complete and accurate records of all your expenses for tax purposes. If the IRS ever comes knocking on your door, you'll have to prove that your deductions are legitimate, and these records will form the basis of your case. There are certain expenses that the IRS will scrutinize carefully. They include travel and entertainment expenses, business gifts, cars, and office supplies and equipment. If you're claiming deductions in any of these areas, be sure to record the who, what, where, when, and how much. Get a business credit card and use it only for expenses you plan to deduct. Write on all receipts the purpose of the expense, for example, a business dinner with a prospective client, whose name should also be recorded. It's a good idea, if you're traveling a lot, to keep a log for business use of your automobile that includes the date, the mileage, and the purpose of each trip. Have a file in your office just for business receipts, and organize it monthly while your memory is fresh.

You should keep most records for at least four years, and ideally seven. Keep all records of investments other than real estate until you sell, and hang on to records of real estate investments for seven years after selling or as long as the cost of the property is used to

TAKE NOTE

Keep all receipts and make sure you record who, what, where, and when; the amount, the time, and the place; and the business purpose of the expense.

TAX FORMS FOR FILING BUSINESS DEDUCTIONS

In addition to keeping good records, you'll have to know which tax form to fill out. Each business entity requires a unique form, as follows:

- Sole proprietorship, schedule C of form 1040
- Partnership, form 1065
- C corporation, form 1120 or 1120A
- S corporation, form 1120-S
- Limited-liability company, form 1065

calculate the cost of a new property, as in a tax-deferred rollover. Copies of business tax returns should be held for at least six years, and longer if possible.

ABOUT TAX AUDITS

A letter from the IRS doesn't necessarily mean you're being audited. There are many reasons for the IRS to contact a business owner. Among other things, you may have failed to report all your income, made a mistake in your calculations (which could end up favoring you), or filed your return late. Should you be informed that your tax return is being audited, you'll have an opportunity to explain the details of your return, and you'll be free to appeal decisions made by the IRS. Don't panic. If you've followed the rules, kept good records, and filed your returns on time, you've probably got nothing to worry about. Remember, the tax laws are made to protect legal business entities and their owners.

RICH DAD'S TIP

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"Don't panic—be prepared."

The IRS has three years, called a *period of limitations*, to audit your return, unless you've underestimated your income by more than 25 percent, in which case the limit is six years, or you're suspected of fraud, in which case there is no statute of limitations. If you're audited, remember to:

- Get in touch with your tax preparer immediately.
- Make sure your records are in order.
- Respond to the IRS in a timely manner. Waiting to answer will only make things worse.

FEAR: The IRS is out to get me. If I claim business deductions, I might be audited.

FACT: The U.S. Tax Code contains laws that protect the business owner.

FREEDOM: You can work within the law to decrease your tax burden.

Step 5:
Enter the
B Quadrant

THE IRS TRINITY: HOW AUDITS ARE CONDUCTED

The IRS conducts an audit in one of three ways. A *correspondence audit* is done by mail. The IRS asks you to post specific records verifying that your taxes have been calculated correctly. Remember, once they leave your hands original records have a way of permanently disappearing, so send copies only. An *office audit* is held in an IRS office, and only specific areas of your return are questioned. Key point: Do not volunteer any information about other areas, which might just open up a can of worms. A *field audit*, conducted in your home or office, opens up your whole tax return to examination. This will go more smoothly if all your records are accurate and in order.

Often tax advisors and preparers represent their clients during audits. In case you do have to show up, remember to:

- Dress professionally, and be calm and businesslike in meetings with the auditor.
- Never lie.
- Keep your answers short and to the point when questioned. Do not offer extra information.

If you disagree with the results of the audit, don't despair. You have the option of appealing.

WRITE YOUR BUSINESS PLAN AND RAISE CAPITAL

Let's take a look at how much ground you've covered in your journey across the bridge to the B quadrant: You've chosen your business entity, built your team, and learned how to take advantage of the tax laws to maximize your profits. That's a lot of ground covered! Now you're ready for the real nuts and bolts of building a business. It's time to draft a business plan and seek funding for your new endeavor.

RICH DAD'S TIP

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"Start with realistic goals, then improve upon or add to the goals as your education and experience increase. Remember that it is best to walk before you run."

RICH DAD'S TIP

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"The business plan is your road map . It should help you define your goals and focus your efforts on achieving those goals."

A ROAD MAP FOR YOUR BUSINESS: THE BUSINESS PLAN

One of the most important tasks as you move forward is preparing your business plan. This is your road map to growth. The first draft is for you, not potential investors. It should enumerate your goals, highlight your weaknesses and strengths, and most importantly, help you zoom in on ways to improve your operation. After you perform additional research and seek out professional advice, you'll produce a more polished draft to present to potential investors. This draft will serve as a resumé outlining your skills and experience and those of your team, a management plan for your business operations, and a tool for tracking your business progress.

GETTING STARTED

Give yourself plenty of time to produce a solid plan. Research takes time, and you'll want the bulk of it done beforehand so that when you sit down to write you won't be repeatedly jumping up to gather more material. Make sure the plan is kept within reasonable limits, less than thirty pages. Bear in mind that other people will be reading this document, and chances are they'll be professionals without a lot of

A BIBLE FOR THE WRITING IMPAIRED

Businesspeople are notorious for not knowing how to write clearly. You don't have to become one of them. Before producing your business plan, read *The Elements of Style* by William Strunk and E. B. White (yes, the author of *Charlotte's Web*). This classic primer on good writing can be found in the reference section at your library or local bookstore. It's a quick read and will give you lifelong tips on how to present your ideas with razor-sharp clarity.

time to spare. Should you have trouble keeping the plan short, revisit your mission. If your mission is clear, it will focus your thoughts and result in a concise presentation.

Just as important as conciseness is clarity. Try not to get tangled in a web of words, and at all costs avoid pompous business jargon. Your best bet is to write in a simple, straightforward style. It's also a good idea not to overdo design elements. Ignore all those clever graphics and borders that your word processing program dangles before your eager eyes. The idea is to highlight your strengths by sticking to the facts and streamlining your presentation. In this way you'll increase your chance of closing the sale with potential investors.

TAKE NOTE

Your business plan should be concise, easy to read, and free of grammatical and typographical errors. Remember, the plan is a representation of you.

HELP IN WRITING YOUR BUSINESS PLAN

You sat down to write your business plan—and stared at the blank page or computer screen before you. Suffering from writer's block? Take heart. There are plenty of resources out there to help you draft your plan. You may need to look no farther than your local library, whose shelves are undoubtedly bulging with business guides containing examples of plans for beginners. Here is just one example of many, a generic plan that might aid you in putting together your own:

Front Matter

Name of business and owner, contact addresses and numbers
Mission statement
Table of contents

Part One: Executive Summary and Exit Strategy

One-page summary of your business
Mention target market and goals
Mention exit strategy

Part Two: Defining the Business

Description of product/service
Description of intellectual property
Expand on market
Economic outlook for the industry
Competition
Business risks
Location
Management team
Expand on exit strategy

Part Three: Financial Information

Funding sources
Capital equipment
Income and cash flow projections for three years
A format for comparing actual to projected performance

Part Four: Supporting documents

Personal materials: resumé, reference letters, credit reports, cost-of-living budget
Legal documents: copies of contracts, leases, letters of intent

Remember, this is a rough guide, not a blueprint. The elements are merely suggestions to help you craft your own plan, one that communicates a vision of your future business and embodies your hopes and dreams in concrete form.

Although you'll be tailoring your plan to the special needs of your business, there are some important points to keep in mind:

- ***Executive summary and exit strategy.*** The most important part of your business plan is the executive summary. Most potential investors read this summary first and decide on the basis of its contents whether to continue reading. It should be short (one page if possible) and should convince them of the need for your business and its potential for success. The exit strategy is critical. Potential investors will want to know how fast they can expect to get their investment back. The typical plan today claims that the company will go public in three years. If you don't produce hard evidence that your management team has experience in taking companies public, this will not excite knowledgeable investors.

- ***Management team.*** Though you may not be able to afford a complete team when you launch your business, see that the plan mentions your future team members as being part of an advisory board. If your team is knowledgeable and experienced, it will improve your chances of attracting investors.
- ***Intellectual property.*** Will you be creating and preserving potentially exploitable intellectual property assets, or erecting barriers to competition by creating intellectual property? Your plan must highlight this competitive edge. For instance, if you've been issued a patent on your product, no other company can produce and sell the same product without your permission. If they see that you have solid intellectual property and that you're protecting it, your investors will be more assured of a return on their investment.
- ***Income and cash flow projections.*** Your income and cash flow projections must demonstrate financial literacy and the ability to manage cash properly. Don't show large overhead expenses and high salaries in your first official business plan. Your revenues won't support them. Potential investors want to see that their money will be used to create value for the business, not to pay high salaries for the management team.

Once you have your plan written, make sure several people experienced in business read it. While criticism is hard to take, it is harder to suffer rejection from investors who have noted all the mistakes of your presentation and none of the potential strengths of your new business. Your business plan is a looking glass to the future—make sure you get it right.

TAKE NOTE

Many ventures, even those that offer strong business plans and a needed product or service, fail because they are undercapitalized.

SHOW ME THE MONEY: RAISING CAPITAL FOR YOUR VENTURE

Cash is the lifeblood of any new business venture. Without sufficient capital your company could crash before it leaves the ground. But raising capital can be a difficult, time-consuming, frustrating experience. Increase your chances of raising capital by investigating all your options.

WHERE TO LOOK FOR CAPITAL

There are a number of options, and it's important to look into all of them thoroughly before committing to a particular plan. Here are some common sources of capital:

- ***Personal funds.*** Most new businesses are funded in part by the owner's personal assets.
- ***Loan or gift from family.*** This is a common source of capital and may come with no, or at least a low, interest rate.
- ***Equity or loans from friends and/or business associates.*** Your friends and business associates are the most likely to support your business endeavors. Getting them on board as investors early in the game will help you obtain additional financing later from the private sector and from "angels" (see below). It will also give you valuable experience in presenting your business plan and "asking for the check."
- ***Banks.*** Bank loans are not usually available for start-up businesses. Most lending institutions are regulated by the federal government and require a good track record before they'll grant a loan. However, the Small Business Administration (phone 202-606-4000) has several guaranteed-loan programs financed through banks. Be sure to check them out. The red tape may seem burdensome, but the end result could be funding for your business.
- ***Angel investors.*** These are wealthy individuals with a passion for boosting entrepreneurial ventures. Most major cities have angel groups that actively seek start-up companies in exchange for equity. Angel groups meet regularly and listen to presentations from hopeful entrepreneurs. If your presentation is successful, you'll find mentors, funding for your business, and equity partners.

Step 5:
Enter the
B Quadrant

- ***Private investors.*** There are many accredited investors looking for new businesses in which to invest. Consult with your attorney and accountant and consider preparing a private placement memorandum (PPM). A PPM will include your business plan and allow you to dictate the terms to a potential investor. It will also give you practice in valuing your business and help keep you in compliance with federal and state securities laws.
- ***Venture capital firms.*** These are professional groups that invest in businesses and help run them. In addition to funding, venture capitalists provide management and operations advice to neophyte business owners. Venture firms today usually prefer investing in an established business ready to move to the next level of growth. You should probably not approach venture capital firms with a start-up business idea unless you and your team have a strong track record of successful business ventures.

TWO TYPES OF FINANCING

In addition to seeking capital for your new business, you have to decide what form of financing you want. Will it be debt or equity financing, or a little of both?

Debt financing is money borrowed and repaid over a designated period, usually with interest. This is an attractive form of financing because the lender does not become an owner of your enterprise. Your obligation to the lender ends when the terms of the loan agreement are met. When negotiating a loan, remember to:

- Set the loan amount.
- Specify a due date and payment schedule.
- Establish the interest rate.
- Discuss loan fees.
- Make sure that prepayment of the loan will not carry a penalty.
- Find out if any financial restrictions are placed on your loan.
- Limit the amount of collateral, if it is required by the lender.
- Try to avoid guaranteeing the loan personally. Many banks will require a personal guarantee by the business owner. Bear in mind that this makes you step outside the protection of a corporation and puts your personal assets at risk for repayment of the loan.

Equity financing allows the business owner to exchange equity, or part ownership, in the company for capital funds. Unlike a loan, these monies do not have to be repaid. That may sound good, but it can be a disadvantage to lose partial control of your company. However, if your company is in need of additional financing, then you may have to bite the bullet and give away some equity.

Whatever source of capital you find (if you're fortunate enough to find it), and whichever type of financing you choose (if you have the luxury of choice), don't proceed with the funding scheme until you've sought the help of a professional investment advisor and an attorney. It is the business owner's job to make the business work, not to be an expert on all financial minutiae. Find good advisors and use them.

NOW THAT YOU'RE IN THE B QUADRANT...

At long last, after all your careful legwork, you've crossed the bridge into the B quadrant. Congratulations! Remember, moving from the left side to the right side of the CASHFLOW Quadrant isn't like changing jobs or professions. It involves a change at the very core of you—who you are, how you think, and how you look at the world. The change is as profound as the age-old story of the caterpillar becoming a butterfly. In the old days you may have thought like an S quadrant type, who doesn't like to delegate work because no one else can do it better. Now, in the B quadrant, you have a new motto: Why do it all myself when I can hire other people to help me do it?

Just because you've realized that business is a team sport doesn't mean you can walk away from your work entirely. Now that you've set up a business, you have to mind it.

RICH DAD'S TIP

▲

"When you move into the B quadrant, you change from an independent operator to a team player."

Mind Your Own BUSINESS

"In the world of business capital, money follows management."

To build successful businesses or to invest in promising businesses, you need to understand the B-I triangle. The B-I triangle represents a company that is solidly managed not just in some but in all areas, from cash flow management to product management. This is the company that will attract money—for in the world of business capital, money follows management. If you're a business owner, what steps can you take to build a business asset that will attract money? The discussion that follows assumes you're an aspiring business owner, but the tips offered should be equally helpful to would-be investors.

OUTSIDE THE B-I TRIANGLE: START WITH THE FRAMEWORK

To attract capital, first you must establish your framework: mission, teamwork, and leadership. Start by asking yourself this question: Does my mission come first, above any thought of the profit in it for me, and am I willing to give it my all in order to keep the company growing? If the answer is a definite yes, then you're ready to assemble your team.

RICH DAD'S TIP

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"Just to make money is not a strong enough mission. The mission of a business should be to fill a customer need. If it fills that need and fills it well, the business will begin to make money."

In assembling your team, look for people with experience and a track record, and be willing to pay for outside expertise that could spell the difference between success and failure. When you don't have the money up front to hire specialists, consider inviting them to be members of an advisory board, with the understanding that once sufficient capital is raised, they will come on board. Another pointer: Don't put together a business plan that's top-heavy with salaries. Nothing turns away investors faster than potential business owners

RICH DAD'S TIP

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"A leader's job is to bring out the best in people, not to be the best person."

who are raising money in order to reward themselves with a fat paycheck. Investors want to see your eyes burn with passion and commitment—not dollar signs.

While assembling your team, you should also be striving to improve your leadership style. One of the best ways to do this is to volunteer more. At your church and at work, volunteer to lead projects. In the typical organization it is hard to find people who actually want to lead. Most folks hide in the corner hoping no one will call on them. Step up to bat. While this won't instantly transform you into a great leader, it will produce feedback on your leadership style. And if you're mature enough to hone your leadership skills in response, you'll develop into a great leader.

A LEADERSHIP LITMUS TEST

- Are you depending on charisma to lead your team? Watch out—leadership has less to do with personal magnetism than with persistence in communicating your mission to your people.
- Do you hole yourself up in your office all day long, poring over numbers rather than getting out and talking with your team? Financial statements are important, but so is mixing with—and listening to—your employees. Watch out for the stuffed-shirt syndrome. The best way to keep abreast of company progress is through informal interaction and ad hoc meetings.
- When it comes to making decisions, do you put off the day of reckoning? Leaders need to be action oriented; otherwise their companies will succumb to paralysis.
- When giving a speech, do you stand stiff as a board and trip over your words? It may be time to brush up on your body language and public speaking skills. Try contacting your local chapter of Toastmasters International, a nonprofit organization that gives members the opportunity to speak and be critiqued by sympathetic peers. If you're developing an Internet business, check out *www.ietoastmasters.org.* Some universities offer courses in communications training. And if money is no object, you might want to hire a media consultant to bring out your latent charm.
- Do you lead by command—telling people what to do, and punishing them if they don't—or by enabling? Leaders who hire talented people and give them space to shine are establishing an atmosphere of trust in which creative ideas will flower. The personal development programs offered by select franchises and network marketing organizations can help develop and fine tune your leadership skills.

INSIDE THE B-I TRIANGLE: CLIMB THE TIERS

With the framework—mission, team, and leadership—in place, you're well on your way to building a strong business. Now it's time to address the five tiers inside the B-I triangle: cash flow, communications, systems, legal issues, and product management. Each is very important and dependent on all the others. A successful business must have all five areas working together. Much as the disruption to a fuel line can bring down a plane, a malfunction in even one tier of the B-I triangle can cause a business to derail in even the best of times.

MANAGE YOUR CASH FLOW

Positive cash flow is essential for a growing company. You might want to start your venture into cash flow analysis by playing the game *CASHFLOW: Investing 101*. This will teach you the difference between actual cash flow and phantom cash flow. Once you start up your business, remember that cash flow management starts on the first day, whether you have an Internet company, a rental unit, or a hotdog stand. Attention to details in the early stages will pave the way for success. Here are some pointers to help you contain and direct your cash flow:

- Call on an accountant, banker, or financial consultant for advice in structuring your cash management system.
- Delay taking a salary until your business is generating cash flow from sales. If you're terribly strapped, keep your day job and start your company part time.
- Review your cash position daily, looking at cash sources and needs for the coming week, month, and quarter. This way you can plan for any large cash need before it becomes a crisis.
- Keep a close eye on your ratio of assets to liabilities. This will enable you to move quickly when money needs to be borrowed.
- Bill customers as soon as your product is shipped or your service provided.

- Require payment up front until credit has been earned by your customers.
- Pay your bills promptly, but ask for extended-payment terms from day one. Ask for extended-payment terms again after you've made several timely payments.
- Keep your overhead to a minimum. Don't purchase anything new—such as a copy machine—until sales justify the purchase.
- Invest your cash on hand to maximize its earning potential.
- Establish tight internal controls over the handling of cash.
- As your business grows, continue to keep a close eye on cash management. Losing sight of cash flow during expansion is a common reason businesses go under.
- Make sure your bank account is reconciled by someone other than the person preparing checks or signing them.

If you purchase a franchise or join a network marketing organization, you may find much of your cash management system already provided. In either case, it's still important to have your own advisors to help you structure your personal cash management system.

Follow your cash from receipt to deposit, from purchase order to writing the check, and have an outside accountant review your system to make sure you have adequate internal control procedures.

RICH DAD'S TIP

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"The ability to run a company from financial statements is one of the primary differences between a small business owner and a big business owner."

THE ABCs OF ACCOUNTING

Let's review what we learned earlier: There are three basic financial statements, and you should know how to distinguish among them. An *income statement* reflects all revenues and expenses for a given period of time. Total expenses are subtracted from total revenues, resulting in the pretax profit. A *balance sheet* shows total assets and liabilities at a specific point in time. An asset is any item of value the company owns, such as available cash, equipment, or property. A liability is any amount owed, for example to suppliers, credit card companies, or the IRS. A *cash flow statement* shows how much is received and how much spent on a monthly basis. This statement, especially critical in the early stages of a business, indicates whether there is enough cash to pay the bills. Whereas the income statement focuses on earnings from operations, the cash flow statement also covers investments, loans and their repayment, and other balance sheet changes.

MANAGE YOUR COMMUNICATIONS

There are two types of communication: external communication—for example, sales, marketing, customer service, and public relations—and internal communication with employees, investors and advisors. Communication can be either written, as in advertising and copy writing, or verbal, as in public speaking and negotiations. The better you are at writing and speaking, the better your cash flow will be, so it's imperative that you make an effort to hone your communications skills.

As a general policy, you should attend at least one communications seminar a year in any of the following areas: sales, marketing, raising capital, ad and copy writing, public speaking, and negotiations. Since raising capital is critical to the birth of a business, the aspiring entrepreneur should attach high priority to effective communication with potential investors.

MARKETING SMARTS

Marketing is a way of letting potential customers know that your business exists. It's important to send a clear message to customers: How will your product or service make their lives easier or better, and what sets it apart from the competition? There are many ways to get this message out. As a busy entrepreneur, you should concentrate on just a couple of marketing methods. The most widely accepted ways to launch a business are:

- **Publicity** (getting the media to mention your business in print or on the air). This is a free—or at least inexpensive—way of getting the word out. If you learn to write positive press releases it will help attract journalists. Remember, however, that you may have no control over what a journalist says about your company. Public appearances and networking with associations and groups that are your intended market are also important ways to bring visibility to your business.

- **Direct mail** (sending an ad package through the post office). This can be more effective than telephone advertising because customers can review the information at their own leisure. To maximize the response, you should seek out a mailing list tailored to your business. You might want to rent one from a mailing list company.

- **The Internet** (creating a web page, using automatic e-mail responses, or joining an Internet mailing list). The Internet is a wonderful way to get your message out to the masses. But don't pour too much money into designing a fancy web page until the number of orders you receive via the Internet can pay for the production costs.

- **Advertising** (paying for space in a magazine or newspaper, or buying airtime on radio or TV). Advertising is expensive. Before you run ads, ask the advertiser what sort of customer response you might expect. Will you get enough bang for your buck?

(continued)

The secret of successful marketing is that it must never stop, and it must adapt to changing circumstances. Marketing is a constant effort, for it is how a business is presented to the intended market. For more information on marketing techniques, you might want to consult Jay Levinson's books from the *Guerrilla Marketing* series.

Marketing is an ongoing part of every successful business. If you stop marketing, the rule of thumb is that you'll see the impact six weeks later in a drop in sales. If you need a boost in sales, communicate to your database. Your customer list should be one of your company's most important assets.

Even more basic than the language of marketing, however, is the language of sales. Sales is what you do one on one, as opposed to marketing, which is sales done via a system. Like it or not, the heart of business is sales, and the person who balks at learning this language is probably not going to make it in the B quadrant. Fear of rejection is what makes people avoid sales. Fear, however, can be conquered with training and experience. You might consider joining a reputable network marketing company, which will provide sales experience and offer a program in communication. By observing how people respond and heeding the lessons, you'll gradually develop the thick skin and speech style so critical to survival in the B quadrant. Like other B quadrant leaders, you'll learn to express passion for your business, whether you're selling a product one on one or selling the company's mission before a convention hall packed with thousands.

FEAR:	I can't do sales. I'm too afraid of rejection.
FACT:	With training and experience, you can overcome your fear of rejection. Once you overcome your fear of rejection, you'll develop a thick skin and critical communications skills.
FREEDOM:	Good communications skills will help you become successful in the B quadrant.

Don't lose sight of the sales talent you may need at the front desk. Your receptionist or telephone operator is the first impression your company may make on potential customers. Every time your receptionist answers the phone or greets a visitor, your company is sending a message.

In every marketing or sales effort, whether spoken or printed, you should strive for three goals:

- Identify a need
- Provide a solution
- Answer your customer's question "What's in it for me?" with a special offer

Consider the example of Frank Woolworth, communicator par excellence. Woolworth splashed the words "5 AND 10 CENT STORE" across his storefront signs and built a merchandising empire out of the public's desire for inexpensive trinkets. *The New York Sun* wrote of him, "He won a fortune in showing not how little could be sold for much, but how much could be sold for little." If you truly are fulfilling a customer need, then you can communicate with passion and create a legitimate sense of urgency. Chances are customers will respond.

Just as critical as external communications is internal communications. You have to keep employees fully informed and engaged in your business. The more they feel a part of your success, the more successful you'll be. There are times when the most effective way to lead is by showing pride in the accomplishments of your team.

COMMUNICATING WITH THE TROOPS

One way to motivate the troops in your company is through hoopla—corny rituals that raise morale by making work fun and participatory. Not long ago at Tupperware, saleswomen would attend a weekly "Rally" and march up on stage during the "Count Up" to the applause of their peers. Badges were awarded based on the previous week's sales performance. The ritual was competitive but also entertaining, and everyone came out a winner. Wal-Mart thrives on the traditions of small-town America: parades, eating contests, and cheerleading squads. At one annual meeting, the Wal-Mart "Shrinkettes" led a rousing cheer: "California oranges, Texas cactus, we think K Mart could use some practice!"

RICH DAD'S TIP

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"A business is a complex network of inter-operating systems. If a single system fails, there's a good chance the whole business will be crippled."

MANAGE YOUR SYSTEMS

A good businessperson supervises all systems simultaneously and identifies weaknesses before the weaknesses turn into system failures. Don't underestimate the magnitude of this job, which covers aspects of your company as diverse as product development, accounting, order processing, human resources, and computer systems. General oversight is especially important when your company is growing rapidly, because you want to make sure that as sales increase, so does your capacity to deliver. At each new level of growth, start planning the systems needed to support the next level of growth, from phone lines to lines of credit.

How do you learn to captain your own ship? One good way to gain experience is through real estate. The average investor who buys a building gets to tinker with most of the systems in a typical business. Real estate is fairly stable and inert, so it gives the fledgling businessperson a certain amount of time to correct things if any one system goes wrong. And learning to manage a property for a year or two teaches excellent management skills. Where can you find a good real estate investment? Look for someone who is a poor business manager and take over. But avoid the temptation to buy a property just because it is a bargain. Some bargains are cleverly disguised nightmares.

Once you're launched, whether in real estate or some other business, you should formalize your operations as much as possible. Although you may already be performing many of the common functions of a business, for example, product development, manufacturing, and inventory, you may not have defined them as separate systems. It's a good idea to record the operations of your different systems in a policies and procedures manual. In creating the manual, you'll inevitably find ways to streamline your operations and improve your profitability. And the manual will become an invaluable reference to your staff. The more you formalize your operations, the more efficient your business will become. You may actually be creating a new intellectual property asset in the process—efficiency systems that can be copyrighted.

If the learning curve isn't for you, you might want to look into buying a franchise or joining a network marketing organization, where many of the systems are automatically provided. You'll receive an operations manual that describes the marketing, communications, and other systems being provided to your business. Such "ready-made" businesses are attractive to many people, as the phenomenal success of McDonald's suggests. McDonald's is the same everywhere in the world—and it's run by teenagers. That's because all the systems are finely tuned and already in place. Good franchises can be relatively headache free.

FOR FURTHER HELP

A good source of information for entrepreneurs just getting started is the Small Business Administration, a federal agency whose mission is to help small enterprises prosper. The agency offers courses, seminars, publications and videotapes to teach people about accounting, marketing and other systems. It also runs a network of regional business development centers. For more information, call 1-800-8-ASK-SBA or click on to *www.sbaonline.sba.gov* or *www.business.gov*. There is also an SBA-affiliated association called the Service Corps of Retired Executives (SCORE) that hooks up experienced leaders with business owners who need advice on running their businesses. You can reach the national office at 1-800-634-0245.

MANAGE YOUR LEGAL AFFAIRS

The best insurance for your business is admitting what you don't know—and finding an expert to help you. You should consult an attorney about any legal aspect of running your business. However, if your cash flow is tight, seek out a lawyer who is willing to give you an hour or two of his or her time, and arrive at the meeting with your list of questions carefully prepared. Or you might convince a lawyer to sit on an advisory board, in which case you're very lucky.

Here are just a few steps you may have to take to prevent legal wrangles later on:

- Register the name of your company with the state. This will establish you as a bona fide business and tell you whether your name is already being used by some other company.
- If you're manufacturing a product and don't want it copied, register the product name as a trademark with the U.S. government.
- If you plan to sell a product for which your state has a sales tax, apply to the state tax commissioner for a resale tax number. You'll be required to collect state sales tax.

- If you're hiring employees, ask the Internal Revenue Service for an Employee Identification Number (EIN) so that you can pay their Social Security taxes.
- Contact your state department of labor and/or employment security and register and request the forms to pay unemployment tax, disability, and state income tax for your employees.
- Check with the Occupational Safety and Health Administration to make sure your offices meet workplace safety laws.
- Depending on the nature of your business, you may need to apply for permits or licenses, for example, to handle flammable materials or food. Direct your inquiries to the state association for your specific field.
- Consult with an intellectual property attorney to make sure you have adequately protected your intellectual property rights.

PROTECTING INTELLECTUAL PROPERTY

A patent gives the inventor of a product the right to prevent others from making or selling the product. A *copyright*, which applies to such things as books, movies, and software, gives the owner the exclusive right to make copies of and products derived from a work. A *trademark* protects a word, name, or symbol that distinguishes the owner's product from other products. A *trade secret right* protects the owner's confidential information—anything from a computer program to the formula for Coca-Cola—from being stolen, but only if it is indeed kept secret. For an excellent introduction to the various protection mechanisms, see *Protecting Your #1 Asset, Creating Fortunes from Your Ideas, An Intellectual Property Handbook* by Michael A. Lechter, Esq.

MANAGE YOUR PRODUCT

Your product—or service—rests at the top of the B-I triangle because it is the expression of your mission. All tiers below support the long-term success of your product and therefore your business and your mission. Be careful when talking with investors not to overemphasize the importance of your product. Experienced investors know that product is the least important aspect of a business. If the triangle's framework and lower management tiers aren't solidly in place, then no matter how stellar the product, it won't succeed.

FOR THE WOULD-BE ENTREPRENEUR...

Want to launch a business, but don't know what kind? First you have to distinguish between *product-based* and *service-based* businesses. The product business makes money by developing, manufacturing, and selling a product, or buying one from another company for resale. Pfizer and Nike are product businesses. The service business makes money by selling a service provided by an employee or a contractor. Examples are your dentist's office or a graphic design company. One thing to keep in mind when deciding the nature of your business: It usually costs less to start a service business than a product business, which may require expensive machinery and equipment as well as lots of employees and office space.

If you can't predict what product or service will fly, take a look at the consumer trends magazine *American Demographics*, or check out the helpful website at *www.americandemographics.com*. This resource might help nudge you in the right direction.

Above all, managing your product or service means developing it. If you're selling a product, then development entails oversight of the manufacturing method and process as well as pricing and bidding mechanisms. One of the most important product-development tasks is to create an atmosphere in which creative ideas bubble to the surface, resulting in a new or improved product. During IBM's most creative period, Chairman Vincent Learson staged "performance shoot-outs" in which designs were worked on by competing groups. As a result, almost all of IBM's innovations during that period were the result not of formal product planning but of inspired "champions" diligently tackling problems. It doesn't matter whether you're in the high-stakes technology business or food catering—encouraging groups or individuals to develop their ideas will eventually result in a better product or service. And it will bring an invaluable side benefit: employees who are dedicated to your business because they have your trust, attention, and respect.

RICH DAD'S TIP

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"There is a B-I triangle inside each of us."

Become an Ultimate INVESTOR

"The rich invent their own money. How? They build companies and sell their shares to the public."

Having worked through Rich Dad's program this far, and after all your effort, you deserve a breather. Give yourself a week or two off, leaving your business in the hands of capable managers. It's time, once again, to assess where you are.

Picture this scenario: You've created a portfolio that outperforms the indexes, bought three investment properties that are generating a positive cash flow, and started your own business, which keeps increasing in profitability. You're financially secure. You're making the children's tuition payments, using passive income for an addition on your house, and thinking of hitting the links at age fifty. But the prospect of whiling away your days on the golf course isn't all that appealing. Though you've worked hard to get where you are, you can't shake a sense that you have unfinished business. It's as if you were walking out on a tied game in the bottom of the ninth. Chances are you have this uneasy feeling because you have achieved your financial goal and need to set new financial goals. Now comfortable isn't enough—you want to be rich.

If this scenario, or something like it, fits you, then don't let the naysayers hold you back. "What's the point of going any farther?" some might say. Back in America's frontier days, that question wouldn't have dampened the resolve of the pioneers. Should you have the skills to make a fortune, it will be your reward for hard work, ingenuity, farsightedness, and perseverance—virtues upon which this country was built. You will have realized by then that money doesn't buy happiness, it buys freedom, not only for yourself but also for others—your heirs, and the people who benefit from your philanthropy. No one has ever denied the truth of that.

How do you expand your wealth? And how do you preserve wealth once you achieve it?

MIND YOUR WEALTH

Keeping a fortune can actually be as difficult as acquiring it. The newly rich sometimes imagine that they've grown smarter or been blessed with the Midas touch. But the newly rich have to mind their assets; otherwise all they've built is a house of cards. Even giants like Donald Trump have had to file for bankruptcy.

RICH DAD'S TIP

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"Poor is eternal, but broke is temporary. If you lose everything and yet you're financially literate, you'll be able to build it again."

HOW THE ULTIMATE INVESTORS DO IT

If you've come this far in the Rich Dad program, you're already an inside investor. Inside investors start their own businesses or buy into existing companies. Although they control management to some degree, they don't necessarily control wealth. If, however, their businesses are well run, inside investors are positioned to expand operations through mergers and acquisitions. They've learned to use their businesses to fund their real estate and paper asset investments. Once they own several entities that can buy assets with pre-tax dollars, their net worth grows exponentially.

The professional team you assemble to start or buy a business is critical to the expansion of its operations through mergers and acquisitions. Only your attorneys, financial planner, and accountant will know your enterprise well enough to advise you properly on how to negotiate the most favorable deal while also meeting legal requirements.

When inside investors extend their control to other entities, they're growing horizontally. Certain investors, however, take a vertical approach. They build businesses, and when those businesses have matured enough they sell them publicly on a stock exchange. The vertical approach turns the inside investor into an ultimate investor.

Ultimate investors create assets where there were none; they make money out of nothing. The ultimate investor spurs the economy in the community where his or her business exists through job creation. Ultimate investors still control their companies though they've sold pieces of them, and down the road if they need capital to expand operations they can sell more shares. This privileged position puts ultimate investors in the company of those elite who are invited to invest in promising companies before they go public. When these companies finally do go public, the ultimate investors are in the advantageous position of being selling shareholders.

HOW CAN YOU BECOME AN ULTIMATE INVESTOR?

Now that you're in the B quadrant, it's time to ask the following questions about your business:

- Is it profitable?
- Do I still enjoy running it, or am I restless?
- Have operations grown too rapidly for me to keep up, or too complex for my level of management skill?
- Is the business going to require a lot of capital funding in the future?
- Is the industry expanding or contracting?
- Am I ready to start another business?
- Do I *really* want to retire?
- Can I afford to pass the business on to children or other family members?
- Are my heirs capable of managing the operation?
- Public offerings are expensive—can my company afford one?

If your answers reveal that you're at a crossroads rather than the finish line, you may be ready to choose the path of the ultimate investor.

This path is not for everyone. Not even Rich Dad pursued it, and he commanded a large financial empire. Ultimate investing requires more than financial intelligence—you must have the stamina to survive the process of going public. In truth, not every start-up will go public. Doing an IPO is very expensive. And for those start-ups that do go public, one's private information is subjected to public scrutiny, under-performing stock may spark a lawsuit by disgruntled shareholders, and company management may be vulnerable to takeover. If you have the mettle to take a company public, however, you have a chance to acquire great wealth.

RICH DAD'S TIP

"When companies go public, ultimate investors don't buy shares, they sell them."

THE COST OF GOING PUBLIC

Funding is needed for more than just the start-up stage of a business. Companies must have tangible net assets of $18 million to be traded on the New York Stock Exchange, $4 million on the NASDAQ. The IPO process itself can run half a million dollars or more, exclusive of underwriting fees.

RICH DAD'S TIP

"You'll never get rich if you don't have the confidence to make a good sales pitch and then ask for the check."

Do you want to take your company public? Then bear in mind the following:

- ***Get a mentor.*** This person should not just train you but also introduce you to elite investor circles. There will always be someone who knows more than you do—search high and low for that special person who will guide you in the ways of your chosen industry. Be ready to devote a few years to the process, for experience is a crucial part of the ultimate investor curriculum.
- ***Learn about IPOs.*** The key to getting rich through an IPO is being able to predict what the market will want in three to five years, which is how long it may take to bring a company to the public. This requires in-depth knowledge of national or global market trends, as well as intuition.
- ***Hone your sales skills.*** To raise capital for a business that you wish to take public someday, you'll have to sell your idea to potential investors. Convincing others that your idea is worth their risk of capital requires self-confidence, honesty, and business acumen. You must be skilled in the art of public speaking, know your subject inside out, and believe in what you're saying. Most important, you must be able to ask for the check at the end of your sales pitch.
- ***Invest in management, not product.*** Because there are no earnings by which to gauge profitability in start-ups, savvy investors evaluate the management team. Even a surefire product won't work if it's mishandled by the management team. Make sure your management team includes someone experienced in going public.
- ***Understand the industry.*** When you start a company, particularly

one you intend to trade publicly, you're dealing with a myriad of unknowns. At the very least, you should familiarize yourself with your industry, everything from competitive pricing to the latest government regulations affecting it.

- ***Keep your focus on the core business.*** Many companies lose sight of their core business during the process of going public, and some end up failing because the principals diverted their attention from running the business to the chore of the going public.
- ***Look for capital.*** There are many sources of capital funding. You can issue a private-placement memorandum (PPM) explaining the investment opportunity you're offering and the terms for participation. A PPM is drawn up by an attorney specializing in securities law and is distributed to targeted investors. You can also approach angels or venture capitalists. They not only fund emerging companies but also often become partners and personal trainers to get the businesses shipshape for an IPO.
- ***Be patient.*** For a pre-determined time after a company goes public, major shareholders and officers are legally restricted from selling their shares of stock. So even if your company makes a bundle, you must be patient about your equity.

LOOKING FOR CAPITAL?

There are many sources of capital funding. In addition to talking with people you've met during your adventures in the B quadrant, you can search the web. You might start with the Venture Capital Resource Library at *www.vfinance.com*. This site offers a directory of law firms, accountants, investment banks, and venture capitalists as well as a link to AngelSearch, a database of potential investors. The Money Tree Survey (*www.pwcmoneytree.com*), compiled by PricewaterhouseCoopers, is a quarterly report of investments made by venture capitalists in businesses at all stages of development. The best source will be valuable referrals from others who have found success through the same process.

BEYOND ULTIMATE INVESTING

If you make it to the pinnacle of IPOs, you will have joined the world of too much money. The most important thing your money will buy is financial freedom. This doesn't mean complete freedom from work, however. You'll still be minding your fortune. The difference is you'll have an army of talented people to mind the nuts and bolts systems of the businesses you've built.

PRESERVE YOUR FORTUNE

Minding your fortune means keeping it. A well-worn path has been beaten by millionaires going to bankruptcy court. How can you avoid that path? As counterintuitive as this may sound, you must reduce income and increase expenses. Specifically, reduce *taxable* income and increase expenses everywhere possible.

Remember Rich Dad's advice not to draw a large salary? That's because a large portion of any paycheck you draw will be eaten up by taxes. Since many of your nondeductible personal expenses are also legitimate, deductible business expenses, you should let your business cover them. You should likewise avoid paying income tax as much as possible. Your business might supply you with a car, for example, or cover the tab when you take a prospective client or investor to dinner. Portions of these expenses are legitimate business tax deductions.

But don't overindulge in business entertainment. You want to spend pre-tax income on expanding your business by creating additional assets. Otherwise you'll may end up frittering away profits on doodads. Unlike a yacht or a diamond necklace, an asset is something that returns money to the income column on your financial statement. Assets lead to growth. And growth should be your mantra. Before you make company profits, plan how you'll use them to acquire or build additional assets, thus keeping your profits out of Uncle Sam's pockets as long as possible. Learn how to have your money work for you.

GIVE BACK

Getting back to the naysayers—some will insist you have no right to want more money, that wealth isn't a worthy goal. Our society sends mixed messages about money. It's considered the root of all evil, yet those who control vast amounts of it are treated like gods. The fact is private wealth has nurtured civilization throughout the ages. The rich have built hospitals, schools, libraries, museums, symphonies, and foundations for world peace. It is to the rich that the Mother Teresas of the world turn for humanitarian aid. While the profligate lifestyles of some have given wealth a bad name, money is the source and foundation of many good deeds.

RICH DAD'S TIP

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"If as you travel the path toward financial freedom you give back to the community, when you finally reach your goal, you'll be richer in spirit."

A HUMANITARIAN HERCULES

By the time he died in 1919, the steel magnate Andrew Carnegie had given $350 million to educational and humane causes. He established 2,500 libraries, the Carnegie Institute of Technology, an endowment for world peace, a fund to reward acts of bravery, a foundation to support higher learning, and an institution for scientific research. This man who had enriched himself turned around and enriched communities all over the country.

No matter how hard you've worked to build your assets, don't forget to give some of your money back. Bear in mind that philanthropy has practical benefits. It reduces taxable income and is a boon to public relations. Far more important, though, it allows you to experience the ultimate power of money. By giving back to society, you have the power to change society. What's the good of worldly riches if they leave you poor in spirit? Philanthropy will make you richer in spirit. And it may cause your name to outlive you.

Charitable giving has become a big business. In 1996 Ted Turner, vice-chairman of Time Warner, challenged his fellow billionaires to start sharing their fortunes. Turner also called on the media to keep track of those who proved generous—and, by omission, those who did not. After he set an example with a $1 billion gift to the United

Nations, others stepped up to the plate, including Bill Gates. The foundation that Gates and his wife Melinda established pledged $750 million to immunize children in developing countries, $1 billion to provide financial assistance to high-achieving minority students, and $25 million for the prevention of AIDS in Nigeria. These are three exceptionally worthwhile projects that came to life because someone had the burning desire to become an ultimate investor.

No doubt this level of philanthropy may be beyond your present means or reality. But it can serve to inspire you. Even before you fulfill your financial dream, start the habit of giving.

RICH DAD'S TIP

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"Believe in yourself and start today!"

FEAR: People will say I'm greedy if I aspire to be an ultimate investor.

FACT: If you become an ultimate investor you'll build a fortune, and with that fortune you can give back to the community. Ultimate investors have built hospitals, schools, libraries, museums, symphonies, and foundations for world peace.

FREEDOM: Ultimate investors who are philanthropists are applauded for their generosity.

AND THINK BIG

In the end, the reward of your Rich Dad journey is not only the freedom that money buys but also the confidence you gain in yourself—for they are really one and the same.

The reason most people stop and turn back from their dreams is that the tiny person inside them beats the person who is bigger. Work daily to be bigger than your smallness. Even though you still may not be good at everything, if you keep on striving your world will change. Never run from what you need to learn. Face your ignorance, your fears, and your doubts. Make mistakes and then learn from them.

A Final Word

Having read this workbook from cover to cover, you've received a financial education that can help you change your approach to money as well as to life. This is my way of giving back, of teaching those who don't have a Rich Dad how the world of money works. Day in and day out, you can choose to be rich. You now know how to draft a financial plan to be secure, to be comfortable, and to be rich. And you also now know that financial literacy and self-confidence will help you achieve your long-range goals.

RICH DAD'S TIP

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"Goals have to be clear, simple, and in writing. If they aren't in writing and reviewed daily, they aren't really goals— they're wishes."

I hope that, in addition to all this, you've learned more about yourself—about your attitude towards money, your avoidance of change, and your tolerance of risk. For when you get right down to it, Rich Dad's program is less about changing the mix of securities in your portfolio than changing the mixed-up ideas about security that keep you living from paycheck to paycheck. I've said it before, and I'll say it again: The old advice "Get a good education so you can get a good job and be secure for life" is obsolete in the information age. Whether you like it or not, the clock can't be turned back. The sooner you learn financial skills for the new age, the sooner you'll take control of your life.

Although you've finished reading this work/study book, you'll want to keep it handy to refer to as you proceed. This is just the beginning. There are many complex lessons to digest—give yourself time to learn and relearn the steps. Remember, I've spent a lifetime learning these lessons. But while it's important to proceed at your own pace, don't use learning as an excuse to procrastinate. Rich Dad would tell you that the best teacher of all is experience. Don't be afraid to make mistakes. Make a mistake, learn from it and go out and try again. You'll never master a financial skill or strategy until you've actually put it to use.

Not everyone will start his or her own business, let alone pursue the course of an ultimate investor. It's taken me years to gather the know-how and courage to scale those heights. No matter what you choose to do, though, you'll be better off tomorrow for having used this program inspired by Rich Dad. If the only change you make is to think twice about buying assets instead of doodads, you'll gain more control of your cash flow and thereby increase your financial options. If you can do that much, you know you can do much more. Go ahead, seize the opportunities out there. Choose to be rich!

Robert Kiyosaki