Book Review: The Millionaire Next Door

Spread out the hammock and pour a big glass of lemonade - summer is here! Over the next several monthly financial columns, I will review three financially related books. These will include *How Rich People Think* by Steve Seibold, *The Total Money Makeover* by Dave Ramsey, and first up *The Millionaire Next Door* by Thomas J. Stanley PH.D. and William D. Danko, PH.D.

If we strive to be like someone, shouldn’t we study what makes that person tick? What do they do? How do they think? How do they act? If you want to run fast, isn’t it prudent to model your workout plan after those of world-class athletes? If you want to be a great Father, shouldn’t you model your behavior after first-rate Fathers? If you want to be a Millionaire, isn’t it prudent to find out how they got there, how to they act, and what is their attitude and philosophy about living? *The Millionaire Next Door* seeks to find the answer to this very question. The answers were quite surprising!

Authors Stanley and Danko wrote *The Millionaire Next Door* in 1996 after years of researching the wealthy in America. They held focus groups and interviews of over 500 millionaires and more than 11,000 surveys of high-net worth or high-income individuals. This 245 page book was full stories and examples of how this wealth was created as well as the attitudes and beliefs of the people that hold that wealth.

The author’s research reveals that wealth isn’t necessarily a measure of our income; it is more a function of what we spend. In defining what “wealthy” is, the authors produced a simple rule of thumb to help determine what one’s expected net worth should be. They suggest multiplying your age times your pretax household income and dividing that by ten. The resulting figure is approximately what your net worth should be which is heavily influence by income and age. Prodigious Accumulators of Wealth (PAW) are in the top quartile of wealth accumulators by this metric and Under Accumulators of Wealth (UAW) are in the bottom quartile. This book focused on differentiating the attitudes and behaviors of PAWs vs. UAWs.

At the time of publication, the average millionaire in America was 57 years old, married with three children and two thirds are self-employed. This group doesn’t buy expensive cars, suits or watches. The most common vehicle driven was the Ford F-150 and many times vehicles were bought used. This group was fairly well educated and puts a premium on a quality education for their children and grandchildren. On average, 20% of PAWs household annual income is invested in appreciable assets. This group spends nearly twice the amount of time making and planning their investment decisions than do UAW. In fact, the authors found there was an inverse relationship between the amount of time spent purchasing depreciable assets like automobiles and the time spent planning one’s financial future. PAWs put a premium on financial security while UAWs relish the status symbols of the stereotypical wealthy.

The authors found seven common factors among those who have successfully built wealth:

1. They live below their means.
2. They allocate time, energy, and money efficiently, in ways conducive to building wealth.
3. They believe that financial independence is more important than displaying high social status.
4. The parents did not provide economic outpatient care.
5. Their adult children are economically self-sufficient.
6. They are proficient at targeting market opportunities.
7. They chose the right occupation.

One part of the book that I found to be particularly revealing is related to financial assistance given to a child by a parent. As a parent, we want our children to do better and be more successful. In their research, the authors found an inverse relationship between financial success and the presence of substantial economic assistance from a parent. More than two-thirds of the millionaires surveyed have received no financial gifts from their parents. The authors concluded that significant economic assistance, or Economic Outpatient Care (EOC) as coined by the authors, weakened the child and when the child became an adult they tended to lack initiative and had a high propensity to spend. The lesson here - Teach your children to fish!

In conclusion, author’s Thomas J. Stanley and William Danko didn’t have any hidden motives or agendas for writing this book. The book simply summarizes their research and lets the reader conclude what behavioral adjustment should be made, if any, if the desired goal is to be a PAW instead of an UAW. This book is highly recommended.

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