How Do the Wealthy Get That Way?

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Unless you are in the wealth category of Bill Gates and Warren Buffet, you probably realize that many people are richer than you are. So how did they get that way?

- Did they have the advantage of a large inheritance?
- Was it because they were self employed?
- Could they have married into a wealthy family?
- Were they "penny pinchers" for their whole life?
- Did they have high I.Q.'s?

None of these reasons fully explain the 'millionaire' phenomenon. I have read the popular books on this topic (The Millionaire Next Door, The Automatic Millionaire, Rich Dad, Poor Dad, etc.) I have also reviewed academic studies. But most of my insights come from working with clients for over 30 years, many of whom did become millionaires. These are my observations and conclusions:

1. Wealthy people are made, not born. 80% of millionaires are the first generation of their family to become wealthy. Interestingly, most of the very wealthy families leave a major portion of their estates to charity. Children who inherit significant wealth without achieving it on their own seldom manage money well. A wealthy man told me, "if money comes too easily, it isn't properly respected." A large inheritance can often undermine the character of the recipient because they don't have to focus on adding value to the world. This often happens when parents continue to support adult children.

2. Self-employed people are more likely to become wealthy. Overall 20% of our population is self-employed, while 75% of millionaires are self-employed. This high percentage is largely attributable to self-employed professionals like attorneys and physicians. The others, who are entrepreneurs, are as likely to go bankrupt as they are to become wealthy. Entrepreneurs who do accumulate wealth, as well as the professionals, have other attributes.

3. Most millionaires became wealthy because they picked a spouse who helped them realize a dream. Seldom do people become millionaires totally by themselves. On the contrary, one of the significant obstacles to accumulating wealth is choosing partners poorly, especially spouses. I call divorce "the process of mutual impoverishment."

4. Some wealthy people are very frugal, even to the point of being penny pinchers. Popular writers often glorify this trait as the path to riches, urging readers to forego lattes, drive old cars, and to never move to better neighborhoods. While living within one's means is critical, as discussed below, developing a penurious character is a form of financial dysfunction. Misers never know 'how much is enough' and develop an obsession to save more money. In my opinion this trait is a barrier to good socialization and prevents people from enjoying the wealth they do accumulate.

5. The people that I have seen become wealthy are smart - but not necessarily the kind of "smart" measured by an I.Q. test. They have come to recognize and appreciate their
unique gifts and advantages, and they use their abilities to create value for others. When a high I.Q. is coupled with an expectation that one deserves special treatment, it is a hindrance to achieving wealth.

How much does it take to be wealthy? I think that financial wealth is measured by a balance sheet of assets vs. liabilities rather than an income statement because it demonstrates the resources that can be put to work to create more money. Statistically, only 3.5% of the 115 million households in this country have net assets of over $1 million. 98% of those have a net worth between $1 million and $10 million. The 2% who are 'super-rich' are not addressed in this blog.

I have noted two attributes that apply to most millionaires. The first is that they value education and are generally well educated themselves. As my mother often said, "Investment in education is the best investment that can be made, because it can never be taken away from you!" Education is the strongest predictor of future earning capacity.

A high income alone doesn't make someone a millionaire. There are many athletes, movie stars, gamblers (including lottery winners), and highly paid executives who are never able to accumulate wealth. The reason is that they keep ratcheting up their standard of living to keep up with their income. So when their income drops, they don't have the financial resources to provide the cash flow to maintain their lifestyle.

This doesn't only apply to high-income people; many low-income people stay poor because they live beyond their means. I find that the easiest way to tell whether a new client is living within their means is to examine their credit card statements. If someone consistently carries a balance on their credit cards, they are living beyond their means.

Thus the second attribute of the wealthy is their ability to live within their means. This translates into a life-long habit of always saving at least 10% of their income. Even those who aren't fortunate enough to have a good education can become financially independent if they consistently live within their means and save 10% of what they make starting at an early age.

It's that simple: to help your children become wealthy, make sure they get as good an education as possible, and teach them to save a dime of every dollar that they earn, starting with their first allowance!

This and other financial commentary by Bert Whitehead can be found at http://www.bertwhitehead.com