THE BEGINNER'S GUIDE TO

PERSONAL FINANCE

RICH DAD®

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INTRODUCTION

How—and why—the Rich Dad way is different than the so-called financial experts

Personal finance is a big deal. Seems like every corner you turn around in the information age, you run into somebody giving you financial advice.

Personal finance is about more than managing your money so you can meet your financial goals. Rich Dad defines personal finance as the path to financial freedom.

There are many things that go into this, from having your dream house, to having enough money for the kids to go to college, to retiring early… and everything in between.

Unfortunately, most of the so-called financial experts are giving out bad money advice.

In 1997, I published my book *Rich Dad Poor Dad*. With over 32 million copies sold, it is the best-selling personal finance book of all time. But true to my nature, it was contrarian and went against the standard financial advice of the time—the same financial advice that is prevalent today like go to school, get a good job, save for retirement, get out of debt — the list goes on and on.

In this beginners guide to personal finance, I'll share with you the knowledge my rich dad, my best friend's dad, shared with me about money, how it works, and how it can work for you to help you become rich.

We will cover the following topics, which are the foundations of personal finance, but with my take on them, which you won't hear anywhere else.

The Beginner's Guide to Personal Finance

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LET'S GET STARTED.

Chapter 1

THE RICH DAD WAY TO BUDGET

Building and maintaining a budget is an essential element of personal finance success. It is the roadmap for your finances. Most financial experts make budgeting all about balancing your income and your expenses. I prefer to talk about budgeting as a way to generate more income and expanding your means.

Here's how most financial experts suggest building a budget.

First, you list your income (all the money that you earn) and your expenses (every bill you pay for in a certain period of time). Most budgets breakdown your income and expenses on a monthly basis.

Next, the experts suggest you make cuts to your expenses until you have a balanced budget.

My rich dad always taught me it's not how much you make but how much you keep. So while the generally accepted practice of increasing your income is always a good idea, we disagree with limited your expenses. Rich Dad believes you should ultimately work to expand your means so you can expand (increase) your expenses to afford whatever it is you desire.

We'll discuss how you can do that later in this guide.

A. Paying Yourself First

My wife, Kim, and I have achieved success through a simple method called Pay Yourself First. Essentially, this is a way of prioritizing your financial saving and investing, making it an expense item on your budget… the most important one.

Here's how it works. With every dollar that came in, we placed 30% into three accounts, or piggy banks.

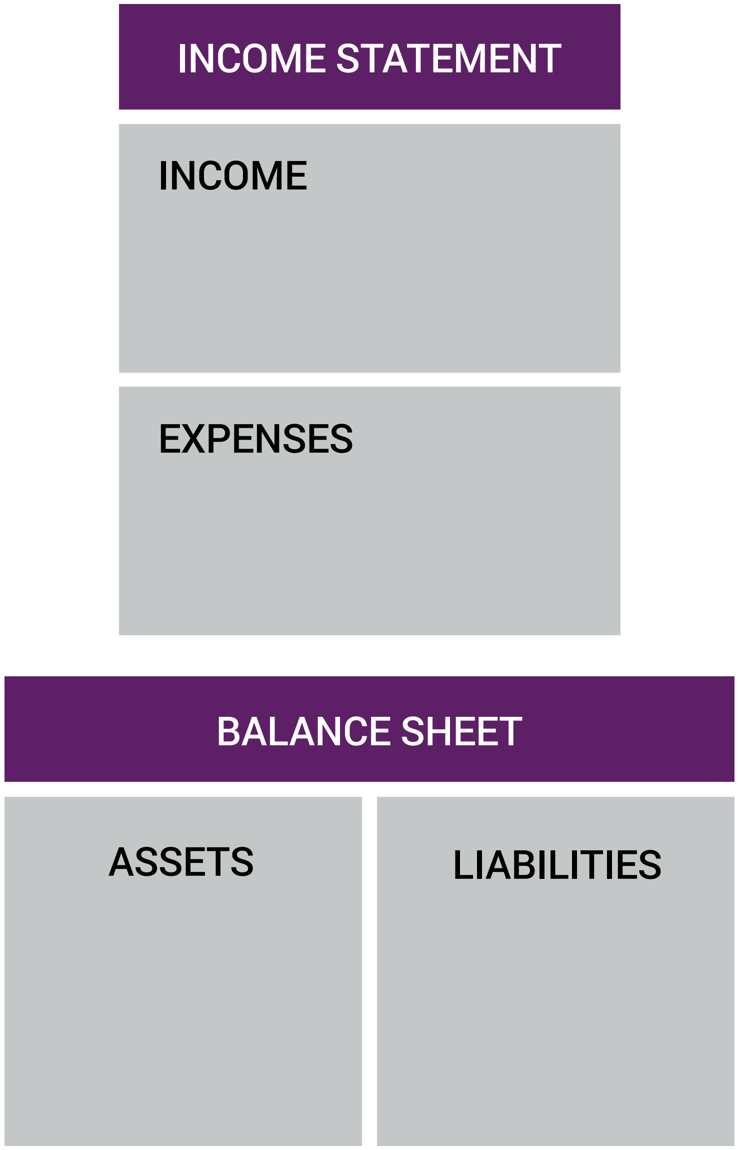
1. **Savings Account (10%)**
   This account is a cushion for unforeseen emergencies.
2. **Investing Account (10%)**
   These funds are allocated for a great investment opportunity, so we'd be ready to make a move once one came to our attention.
3. **Charity or Tithing Account (10%)**
   As the saying goes, "Give and ye shall receive." Another saying we've heard is that, "God doesn't need to receive but humans need to give." Charity is a powerful tool with many benefits to everyone involved.The balance sheet consists of assets and liabilities. Simply put, assets put money in your pocket. Liabilities take money out of your pocket.

Here's how we applied this philosophy in practice. We would allocate 10% into a general savings account, another 10% into our investing account and a final 10% into a charity account. This seems very practical and easy to do, however, like most things in personal finance, it's easier said than done.

B. Budgeting With The Personal Financial Statement

Many people begin to budget their finances using a template spreadsheet that tracks their monthly income and expenses. While this is helpful, it doesn't show you the entire financial picture.

I prefer to show people how to use a personal financial statement. Very simply, here are the elements of a personal financial statement.



The first part of the diagram shows the income statement with two rows labeled income and expenses. This is where most template spreadsheets stop.

My rich dad completed the personal financial statement by including the second part of the diagram, the balance sheet. The balance sheet consists of two columns labeled assets and liabilities.

By understanding the relationship between the income statement and the balance sheet of your personal financial statement, you see the direction your money is moving and whether it is making you rich or not.

i. THE INCOME STATEMENT OF A PERSONAL FINANCIAL STATEMENT

Any money that money that comes into your household flows through the income column of your income statement.

This includes the three types of income:

1. **Ordinary income**
   This includes money you work for such as wages, tips, salaries, and commission from your job or business.
2. **Portfolio income**
   Portfolio income includes profits from the sale of any investments. These are also called capital gains which include the sale of stocks, businesses, and real estate.
3. **Passive income**
   This income includes income from rental properties, limited partnerships in which you invest money but are not actively a participant, and other similar enterprises. Passive income, or positive cash flow, can also come from interest on your savings accounts, bonds, CDs, stock dividends, patent royalties from things you created, patent royalties from books, songs, and other original works.

It's important to note that it's not only how you acquire your income from the three types of income but how you're taxed on the money you make. We'll discuss taxes later in this guide.

ii. THE BALANCE SHEET OF A PERSONAL FINANCIAL STATEMENT

BALANCE SHEET	
ASSETS	LIABILITIES

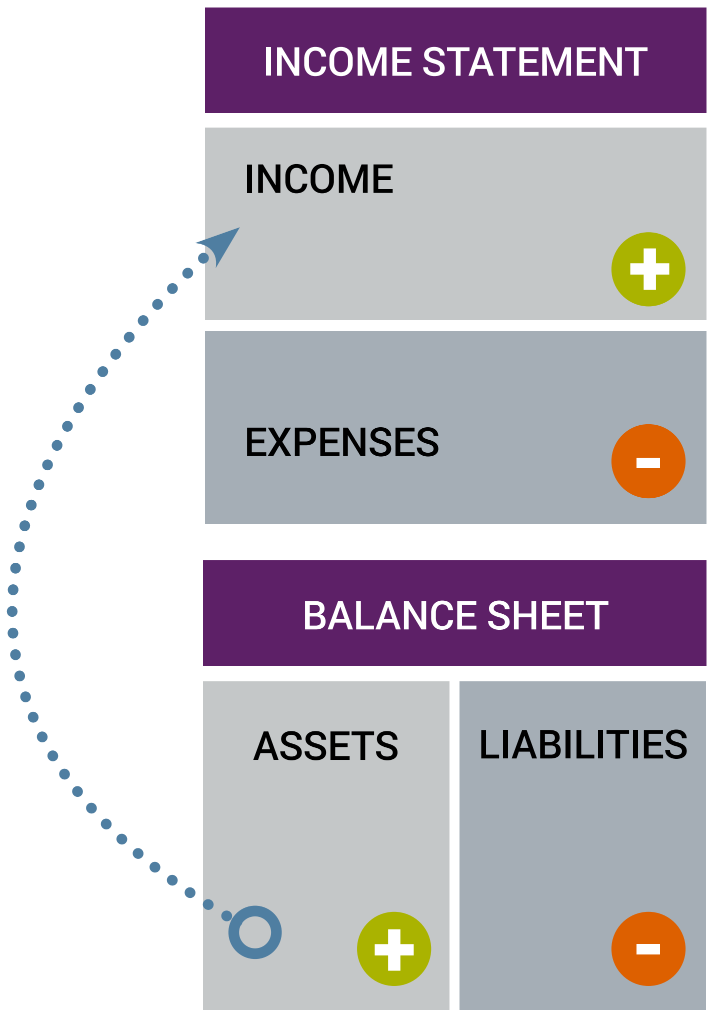
The balance sheet consists of assets and liabilities. Simply put, assets put money in your pocket. Liabilities take money out of your pocket.

ASSETS

The conventional accountant will tell you that an asset is "something of monetary value that is owned by an individual or company." By that definition, your alarm clock and everyday dishes could be considered assets.

My rich dad disagreed. Where most accountants want to classify your shares of stock, jewelry, personal residence, your cars, your mutual funds assets, my rich dad did not. My rich dad didn't believe they had any value until the day you sold them.

Using my rich dad's definition: An asset is something that puts money in your pocket, whether your work or not.

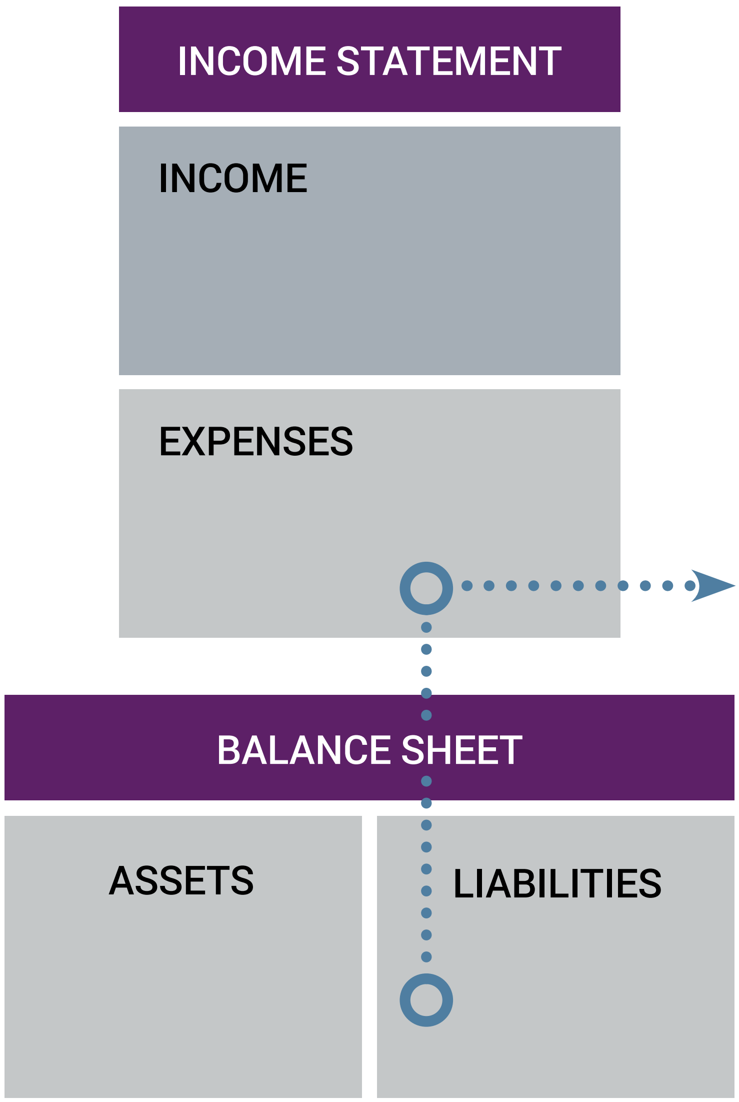


Why is our definition so restrictive? Because your clock or plates won't get you any closer to financial freedom. Purchasing them won't put money in your pocket.

LIABILITIES

To confront the traditional definition of a liability, most accounting professionals will tell you that a liability is "an obligation to pay an amount you owe to creditors, be it an individual or an organization."

Rich Dad defines a liability as something that takes money out of your pocket.



You can see the dilemma. Most people (and bankers) would consider their Mercedes an asset because it has value. However, I would list the Mercedes as a liability because it takes money out of your pocket every month.

"But it's paid for," you contest. The car loan may be paid for, but what about gasoline, maintenance, repairs, and insurance?

The biggest point of confusion I come across with people is when we say your house is not an asset. When I released *Rich Dad Poor Dad*, we received a lot of flack for that, especially when times were booming and people were taking loans out against their homes. It wasn't until the real estate market crashed that people found out they owed more on their house than it was worth that they realized their home was not an asset.

That is why understanding your balance sheet is so important.

People call their liabilities, assets, and vice versa. When the economy turned, many people were faced with that harsh reality.

Simply put, if all you own is liabilities (and that includes your house since it takes money out of your pocket each month), then you will have a hard time getting rich, even if you balance your budget.

If, however, you have assets that produce cash flow each month, in addition to your other sources of income, you will have a much easier time getting rich.

The reason Kim and I paid ourselves first is because we needed that money to purchase assets that provided more and more passive income each month. We then used that income to purchase our liabilities—not our earned income from salaries. That is the simple way we budgeted to get rich, and it is a very different approach than other financial advice.

If you want to use the Rich Dad financial statement for your own budget planning, you can download it here.

Chapter 2

WHY SAVERS ARE LOSERS IN THE RICH DAD PHILOSOPHY

Yes, you read that correctly. I believe that savers are losers. Not personally, but financially.

This may be confusing because I just covered the three piggy banks philosophy where I advocated for saving 10% of your income. However, as I wrote, “This account is a cushion for unforeseen emergencies or special opportunities that improve your life.” It is not something to be relied on for financial security or retirement. It is a last stop gap liquid account only.

Most financial “experts” advise people to save as their primary means of retirement. Saving comes in many forms. You can save money in a savings account with a minimal interest return, put your money into a 401(k) with the hope of some market gains, or put a big portion of your liquidity into your personal home.

Regardless, most financial advisors are big proponents of compounding interest, whereby each year the interest paid on your money includes the previous interest you made before. It is powerful with the right circumstance, mainly high interest rates and frequent compounding. However, most people have low interest rates or infrequent compounding.

Also, most people are not aware of compounding inflation. This simply means that over the same time your savings grows, the cost of buying goods grows as well. Essentially, you may have more dollars from saving, but the buying power of those dollars is less — a losing situation. You need to make money at a much faster rate than inflation to be rich and retire comfortably.

So, by saying 'savers are losers', I do not mean all savers. I mean a certain type of saver. That is, those whose primary financial activity is saving, hoping it will get them rich or prepare them for retirement.

To understand this, it is important to understand another Rich Dad personal finance essential: how to leverage assets to afford your liabilities.

A. Clarifying The Difference Between Assets And Liabilities

Many years ago, Kim wanted a giant 60-foot sailboat. We didn't have the money for it, and we knew it was a huge liability. Rather than simply save for the boat, as many people would do, we wanted to find a more creative and financially intelligent way to afford it.

So, Kim did some research, found out how to contract the boat with a charter company, and the income from the charters covered our liability in the boat. We got to own a luxury liability, and it also became an asset for us. That is winning at money. Saving and then buying is not.

B. Cash Flow vs. Capital Gains

The second Rich Dad personal finance essential to understand in regards to why savers are losers is the difference between cash flow and capital gains.

As we mentioned in the previous section on budgeting, cash flow is income that comes without you working for it from an asset like an investment property, a business, a product like a book, etc. It is called passive income, and it is the lowest taxed income; it is steady and reliable.

Capital gains is income that comes based on the relative price of something going up. You do not recognize a capital gain unless you sell something, and only then does it put money in your pocket—if you were lucky enough to sell at a profit. Capital gains can be taxed very high. I don't dislike capital gains, but they are more like frosting on the cake. If I earn them, I'm delighted, but I don't invest for them.

C. Why investors are the real winners in personal finance

I've said to the dismay of many personal finance experts that your house is not an asset. For these so-called experts, a house is considered your biggest asset. This is because they define an asset differently than we do at Rich Dad.

Remember, our simple definition is if it puts money in your pocket, it's an asset. If it takes money out, it's a liability.

Your personal home is a liability because it takes money out of your pocket. Only if you sell it for a profit does it produce capital gains, again, if you're lucky.

With an investment property, however, you can get income each month in the form of rent, depreciation each year that reduces your tax liability, and all maintenance costs are tax deductible. That is the power of an investment vs. saving, which owning a house is basically a form of saving, albeit with more risk.

Not only that, I can refinance an investment property to remove the equity cash free and deploy it into even more investments in assets. That is a concept called the velocity of money, and it is how to become rich in today's economy, which rewards smart users of debt (investors) and punishes savers of money.

Chapter 3

HOW TO USE DEBT

If you were raised with conventional wisdom surrounding money, you probably just balked at the sentence I just wrote. How could the economy reward people in debt? Isn't debt evil?

The short answer is no. The long answer is it depends.

The key is to understand that there are two kinds of debt: good debt and bad debt.

Bad debt is used to purchase liabilities that do not provide cash flow. These are things like cars, vacations, personal homes, etc.

Good debt is used to purchase assets that put more money in your pocket each month than the cost of the debt takes out. These are things like investment properties, capital investments in your business, investments in product development, etc.

One of the keys to the Rich Dad personal finance philosophy is understanding debt and using good debt to get rich.

Bad debt, of course, should be avoided, as any financial advisor would say. And if you have bad debt, you should pay it off quickly, but good debt is something you should embrace. The reason for this is simple, you can accelerate your return on investment (ROI) by using debt, aka Other People's Money (OPM), to purchase assets. This is because you have less of your own money in an investment, but you still enjoy the cash flow from that asset.

You can learn more about OPM in this blog post that I wrote called, "Rich Dad Fundamentals: Other People's Money (OPM)" In that post I show how you can change your ROI from 12.5% to 50% on the same asset just by using good debt.

Chapter 4

YOUR CREDIT SCORE

The key to using good debt to get rich is having good credit. This is a foundation of any personal finance philosophy and is for us too.

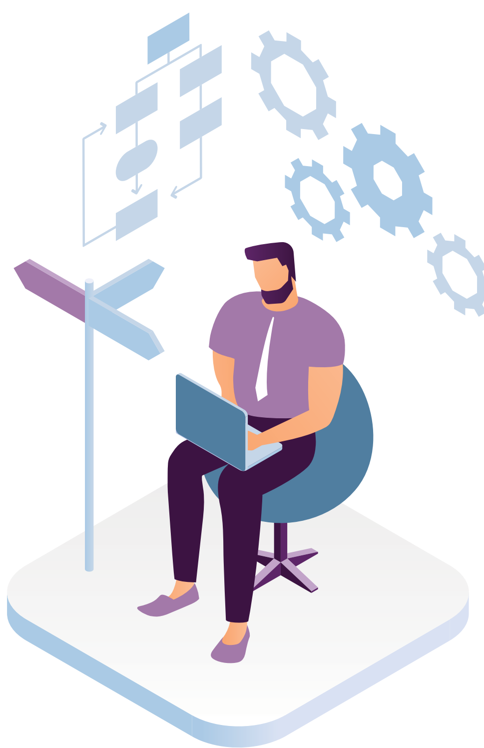
Simply put, the higher your credit score, the easier it is to get debt, better terms on that debt, and insurance to protect your investments.

Credit is scored on a scale between 300-850, and there are four major credit agencies that calculate your credit score. A score above 700 is considered good and anything above 800 is excellent.

According to Equifax, a major credit scorer:

In general, here are the factors considered in credit scoring calculations. Depending on the scoring model used, the weight each factor carries as far as impacting a credit score may vary.

- The number of accounts you have
- The types of accounts
- Your used credit vs. your available credit
- The length of your credit history
- Your payment history



The easiest way to improve your credit score is to reduce your bad debt and to pay your creditors on time (or negotiate with them for extensions as you pay yourself first).

This takes emotional intelligence, as I mentioned before. If you have emotional intelligence, you'll be able to say no to impulse buys for liabilities that will ultimately hurt your credit score. If not, well, you'll probably never get rich.

Chapter 5

HOW YOUR INCOME IS TAXED

I've already spoken to taxes in this guide to personal finances, but specifically I want to share with you the three types of income and the different ways those incomes are taxed.

For most people, they believe paying taxes is simply a part of living in a civilized society. And while that's true, not everyone is taxed the same.

Below, I will explain how the three different types of income are taxed and why.

1. **Ordinary Income**

   As we discussed earlier, ordinary earned income is money you make from your job such as wages, tips, and your salary.

   In an attempt to make things even between the different tiers of society, the government has set up varying levels of how much people will pay in taxes.

   Tax brackets, as they are called, tax people within each bracket at different percentages. For example, in the United States, if you make under $9,525 per year, your tax rate is 10% of your taxable income. If you make between $9,526 and $38,700 per year, your tax rate is 12%. There are varying tax brackets all the way up to individuals that make up to $500,000 per year, who are taxed at a high 37%.

2. **Portfolio Income**

   Portfolio income is made through capital gains.

   Unlike ordinary earned income, portfolio income is a tax on how much money you made on the sale of your asset. The tax rate is determined by how long you held the investment and how much income you made during the tax year.

   For instance, if you owned a rental property for more than a year and decided to sell it, you would be taxed anywhere from 0% to 20%. This would be called a long-term capital gains tax.

   There are also short-term capital gains tax (taxes applied to profits from selling an asset you held for less than a year) and property sales tax which are governed by their own set of rules.

3. **Passive Income**

   Passive income is money that comes in consistently from an asset.

   One of the reasons my rich dad encouraged me to invest for passive income is because of the amazing tax benefits it provides.

   Passive income is taxed at the lowest rate of the three types of income.

   For example, if I own a rental property, I make passive income every month. Not only do I make money through rent, but the passive income I put in my pocket is taxed at a very low rate, if at all.

   The figures presented in this section were for education purposes only. Please consult an accounting and tax specialist for rates specific to your country or state.

Chapter 6

RETIRE YOUNG, RETIRE RICH

Ultimately, any personal finance philosophy would be incomplete without discussing retirement. Everything we've talked about up to this point will position you to retire well, but I want to leave you with a few Rich Dad fundamentals around retirement to wrap everything up.

THE RICH DON'T WORK FOR MONEY

This statement probably comes as no surprise based on what we've talked about so far, but it's very important to understand that a secure retirement is one where money works for you via cash-flowing assets. There is nothing quite as comforting as knowing money will come in each month whether you are working or not.

THE RICH DON'T SAVE FOR RETIREMENT

Most personal finance experts will tell you to invest in a balanced portfolio of stocks, bonds, and mutual funds. The problem with this advice is that these are lousy ways to save and prepare for retirement. Primarily because the companies that help you save in these vehicles charge many hidden fees that eat into your returns. In addition, you have no control over those vehicles, and you take on all the risk while they get all the rewards.

If you are currently enrolled in a company sponsored retirement plan like a 401(k), I advise you to look at the fine print and consult the manager of your company's fund.

You might be surprised to learn how many fees are being taken out of your retirement account every month regardless of whether or not your investments made money.

YOUR WEALTH NUMBER AND RETIREMENT

Here is a simple question for you, “If you (or you and your partner/spouse) stopped working today, how long could you survive financially?”

Sadly, most people couldn’t answer that question off the top of their head. Luckily there is a simple way to determine this, which we call the wealth number. Here is the equation to determine your wealth number:

YOUR WEALTH NUMBER = YOUR AVAILABLE MONEY / YOUR MONTHLY EXPENSES

In this equation, your available money equals the money you have on hand if you stopped working today — not what you make in earned income. Your monthly expenses are your current output each month. This includes anything in your savings and checking accounts, retirement funds, emergency funds, etc.

If your wealth number is 10, that means you have 10 months to live on based on your current money divided by your expenses. If it’s 6, you have 6 months and so on.

Most people, even if they are what would be considered rich, have a finite wealth number. The truly rich, however, have an infinite wealth number. The cash flow from their assets covers their monthly expenses. So, they don’t have to work if they don’t want to. That is the number for the rich when it comes to retirement.

THE RICH USE THE THREE PIGGY BANKS TO RETIRE

A natural question is how much you should put aside each month for retirement. The short answer is 30% of your income, ultimately. But, of course, start with what you can and work your way up if need be.

The long answer is, again, the three piggy banks:

1. Savings Account (10%)
2. Investing Account (10%)
3. Charity or Tithing Account (10%)

Chapter 7

RICH DAD'S PERSONAL FINANCE TIPS

I hope you enjoyed this Rich Dad guide on personal finance. As you can tell, our approach is very different from the conventional wisdom on money, but it's built for getting rich in today's economy, not the one of your parents.

In closing, I want to leave you four simple tips to budget like the rich:

1. Start paying yourself today
2. Complete a personal financial statement once a month and make adjustments as necessary
3. Follow Rich Dad's six simple steps to get out of bad debt
4. Use emotional intelligence to avoid liabilities and save for assets

IF YOU FOLLOW THESE SIMPLE STEPS, you will retire young and rich, just like Kim and I did.