

Book Report

The Millionaire Next Door by Thomas J. Stanley and William D. Danko

Prepared by Raakesh Sureshkumar (1218477559)

Money being a better form of barter system with exchange of a pieces of metals and fine wood, its popularity has reached zenith's in the recent centuries though invented long back by the Lydians around 700BC. The Millionaire Next Door is a book that explains the significance of this commodity and its accumulation over a period of time can turn anyone rich. This age is a free age where most of the people are termed to be middle class with a good income to support their families. But, it doesn't mean that all the people with a hefty income are rich. Though some aspects are comparable to the book "Rich dad, poor dad" by Robert Kiyosaki, it was kind of a misnomer for its title. Stanley and Danko have divided the book into 8 chapters.

Meet the Millionaire Next Door:

This chapter focuses on the commonness of the millionaires among us. It states that what we see on the outside about a person may not always be the same as how he / she lives their lives. A person living above their means, tend to fall in a strenuous debt. People in a "higher status" in the society who feel the need to look rich in public gathering have the tendency to loan amount a huge amount of money which may be considered as liabilities in the eyes of an avid investor.

In absolute contrast to this, a person who is actually rich might appear frugal in gatherings. There are a lot of examples in front of us like Warren Buffet, Mark Zuckerberg and Bill Gates who wouldn't want to flaunt their riches in front of the "general public". These modest personalities are the ones who are actually millionaires who spend their lives investing in their ideas and for their growth rather than material goods which are counted as liabilities. In this context, the author tries to imply that such kind of people might even be one among our neighbors who live well below their means, thereby, enabling them to save about 30 % in their monthly income and accumulate wealth that could serve them after retirement.

The author takes examples of lawyers, doctors and actors who tend to maintain their status by showing symptoms of extravagancy. They tend to buy in bigger houses and cars to flaunt their wealth in front of their customers. This is a psychological aspect that aspect enables a person to think that he is better to his counterparts only if he shows uniqueness by spending on material goods that the others cannot possess. These are the kind of people who often fall into debt and hence culminate in their children falling into debt too.

Frugal Frugal Frugal:

This chapter focusses on the thrifty nature of the general public. It is not just a status but a lifestyle all together. It assures that people can tend to a rich life only living a frugal lifestyle. The concept of “Less is more” by the architect Ludwig Mies might be applicable here. People need to appreciate what they have and be content with it. The author talks on the daily needs of the people and how often the people that earn more than the thrice their daily needs tend to spend their remaining sum in a product or service that might not be required for their upcoming near future uses. The authors take into account the flaunting of wealth and the high cost of maintaining social status. They explain that wealthy individuals prioritize financial independence over a high social status. Further, they did not receive sizable financial support from parents, and raise their own children to be economically self-sufficient adults.

In general, we are suggested to live a conservative lifestyle to achieve the status of financial contend. This point is a kind of a niche and is quite redundant in any financial education book that we could find. I personally feel, a new aspect on how to achieve this could have been given rather than providing plain flat statements on to live a frugal life.

Time, Energy and Money:

This chapter talks about the cost aspects to a millionaire. According to the author accumulation of wealth over a significant amount of time is an important aspect. In this chapter Stanley and Danko deep into the aspects of maintain a perfectly balanced financial lifestyle. They bring into it the concept of Wealth index for an individual.

$$\text{Wealth Index} = (\text{your age}) \times (\text{annual pre-tax household income})/10$$

The following inferences can be made from the above formula. *Prodigious Accumulators of Wealth (PAWs)* have a net worth of twice their Index. An *Average* wealth accumulator has a net worth of around their Index. An *Under Accumulators of Wealth (UAWs)* have a net worth of half or less their Index.

Accumulation of wealth is much more important than actually earning is the author's point here. The earning can be in any form in the form of a profession, daily job, investments but what finally matters is the percentage that we save from these amounts. Taxation is another aspect that the authors have into consideration. They have explained on ways to minimize taxes. Along the lines of living frugally and carefully monitoring their expenditures, the study found that the rich are experts at legally minimizing their taxes. Most millionaires structure their financial affairs so as to minimize their annual realized income and maximize their annual unrealized income.

Just like most of the governments in the then contemporary government, the American tax code is designed to tax higher income earners. The millionaires tend to make most of their income from passive investments that are taxed at a lower rate. They spend more time on

financial planning than the average person and are more inclined to make use of trusts for effective tax reduction. While the average high-income, high-consumption household realizes about 90% of its net worth each year in taxable income. Further providing statistics, the millionaires as a whole realize only about 7% of their net worth in income each year — which means only 7% of their net worth is subject to income tax. They believe in a totally different set of traits that lets them sustain their wealth. The first one is the financial education that is the first and foremost as all the drama in the world is finally to earn money to support their families and live the lives of their interest. So, better investments in stock market shares, real estates prove to be good investments according to the authors.

Another statement that the author makes is that “millionaires invest 20% of their income”. So, according to Danko and Stanley the source of income doesn’t matter but the accumulation of the wealth. To think on wealth index, a recent graduate who makes 20 grand would have accumulated 60 grand in a period of 3 financial years. However, for those in their mid-40s and later to meet this metric, they would have needed to save 10% to 15% of their incomes throughout their career, or started later but saved 20% to 25% of their incomes. That's not common, but also not impossible.

You Aren't What You Drive:

This chapter might not seem necessary to many middle – aged investors. But, it sure is necessary for young so-called wealth accumulators who are planning to save to buy their hard earned some on their favorite sports car. The author takes an example of a Mr. Allan being a self-made multi-millionaire and a Prodigious Accumulators of Wealth who has lived in a three-bedroom house for forty years together. This is in direct violation or contradiction to the chapter 1 of this book. Cars and houses are considered to be symbols of status that often tend to distract individuals from their synergy of wealth accumulations. Mr. Allan has to make a decision on buying a Rolls-Royce to which he replies, “Building wealth is not something that will change your lifestyle”.

This has a strong meaning to it in the sense that initially car was just a basic necessity when he had started his business. Just because, he is a multi-millionaire now doesn’t mean that the utility of a car changes from what we drive which takes us between places to a status symbol in the eyes of the common public. In a personal sense, I feel the Berkshire Hathaway chairman, Warren Buffett one of the top 5 wealthiest people in the world has never upgraded from his house that he bought in 1950s and drives an equally modest car.

According to Stanley and Danko, the motor vehicles can be divided based on their utility as personal vehicles, sports utility vehicles, pickup vans and so on. Millionaires buy motor vehicles based on their utility rather than the luxury it provides or its outer looks or its sporting behavior. He explains this by giving an example that “the average American buyer of a new motor vehicle paid

more than \$21,000 for his most recent acquisition. This is not much less than the \$24,800 paid by millionaires”.

I feel that the statistics of the motor vehicle manufacturers are a bit irrelevant to the context here. This can also be seen in the statistics as there is not much disparity in the division between the purchase of cars from the American car manufacturers and Japanese manufacturers. There is a difference of about 20%. The list of German, French or Italian manufacturers might not be visible in the listings as they are more of a luxury or sports car manufacturers which most of the millionaires might not be interested in.

The author writing this article in the Millennial generation period might not have effectively focused on the usage of mobile phones which have become a status symbol in the recent years. A person wielding an iPhone might be considered more sophisticated than another person holding a non-apple product in his hand. People tend to forget the basic necessity of a phone is to make calls and do messages.

Economic Outpatient Care, Affirmative Action, Family Style:

I felt that these chapters are critical. These are related to the younger generation of people who might inherit a huge portion of their wealth from their parents. These are typical especially in immigrant parents who had taken a lot of pain in setting up businesses and growing their businesses into million-dollar deals. But, when it comes to their children, it's a basic psychological mindset to spend lavishly for their children. This reduces the value of money as assets for the younger generation who grow up to depend a lot on someone else as they did during their early years.

In one of the research studies made by Stanley and Danko, it showed that around 66% of America's millionaires received no economic subsidies from their parents other than college educations. Yet despite this, the study data actually showed there was a negative correlation between receiving funds and accumulating wealth — the more adult children received from their parents, the less they accumulated by their own efforts. Some reasons proposed by the authors are insightful and interesting:

Providing cash and assets to adult children sends a subliminal message that the parent doesn't think they will be able to make it on their own. The second reason being, the adult children generally fail to distinguish between wealth they have generated and wealth provided by the parents as a gift. Subsequently the adult children perceive themselves as more productive than they actually are, which can lead to negative household consumption habits. Though, this might not be common practice among the middle class of the society, this could be the main reason for some businesses to shut down just after one generation of prosperity after its ownership has shifted to their respective heirs.

Children may often turn up financially illiterate if they are not assigned financial responsibilities and if they don't understand the value of money in their early age. In the United States, it might seem easier to achieve higher income with good talent than accumulation of wealth. There are equal distractions in the market for buying unwanted commodities when

compared to the income bar set for the typical middle class individual. The economic outpatient care is a point that I find completely valid that has the complete tendency to spoil an adult child whose psychology might indicate that any financial instability would require help from their parents to mitigate the effect. This could be avoided right at an early age.

Find Your Niche, Jobs: Millionaires versus Heirs:

This is a general problem of the aristocrats where the family businesses are generally acquired by their sons or daughter's who go on to make their dad's dream a reality and make it an empire. But in my opinion "An idea cannot be stolen or transferred just by knowledge, its like a seed which germinates and grows the fastest and healthiest in the soil it belongs to". So, though in some cases, the family trend of owning businesses may go on for 2 to 3 generations, it cannot live on forever until the mainstream industry is changed according to the interest of the individual

Later, the authors deal with a list of activities or businesses or services that usually result in an individual success in his or her career. The author affirms this point by stating the following example, Twenty percent of the well to do family in the US are headed by retired individuals. Of the remaining eighty percent, more than two-thirds are headed by entrepreneurs or self-owners of businesses. In America, fewer than one in five households, or about eighteen percent, is headed by a self-employed business owner or professional.

Summary:

I found the book to be quite interesting with interesting anecdotes and impressive statistics. Two of the points that captured my mind were the change in lifestyle that brings along with it a huge change in the wealth accumulation. Spend only for what you need is something that I would like to take as a personal message. Also, investments can become secondary sources of income that can supplement our daily budget. Secondly, the point about the general trend on the children of the wealthy becoming less conscious on wealth accumulation and feeling the need to depend on their parents seems to be valid point and generally evident in the society around us. Also, the statistics provided for this by the authors were quite good.

On the side of a critic, I would say too much emphasis on a single commodity would have been waste of read for many as the commodity would have been outdated by now. By this, I refer to the chapter "You Aren't what you drive". The overall context of the book is to deliver the message that millionaires are not what we think they are, that is, they are mere neighbors who live a frugal lifestyle. This could've been broadened to define, what the millionaires would rather invest their money in, if not for the general material goods that the common public buys. For example, a detailed explanation on market investments and real estate would've been better. This mainly focusses on the entrepreneurial candidates. A huge demographic population of America is still middle class who could use these aspects to improve their financial status.