Episode 132 - Your Business is Not YOUR Wealth
Episode Transcription

Paul Adams: These are people that are professionals, like attorneys and CPAs, who have their own practices, these are people that are making hundreds of thousands of dollars a year, no kidding, like this is no joke, regularly, people making over a million dollars a year cannot answer that question. Now, why have the financial industry never taught us to answer that question? Because they don't care if we answer it.

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Speaker 2: Welcome to Sound Financial Bites, where we help you with bite-sized pieces of financial and life knowledge to help you design and build a good life, the knowledge that has been shared from stages at conferences, pages of national business magazines, and clients living across America. Our host, Paul Adams, now brings directly to you.

Paul Adams: Hello, I'm Paul Adams. Welcome to Sound Financial Bites. I'm joined by...

Cory Shepherd: Cory Shepherd.

"The amount of people that have saved for retirement is virtually nil."

Paul Adams: And we are so glad to have you here today. I am so excited about this topic, and let me share with you why. I think it's one of the biggest breakthroughs that we produce when we're working with business owners, and since many of our listeners are not yet clients, and keep in mind, I did say yet, but what I want you to be able to take away today is this same breakthrough we produce for so many of our business owners, when they go through our process. This will be equally applicable to those of you that are not business owners, but I want you to not only key in and focus today, but also stay to the very end. We have a very special giveaway we're beginning, over our next several podcasts. Now, as a business owner, here's what I want you to think about, you've started your business because you want a great deal of financial freedom, you started your business because you wanted autonomy, and you started your business because you wanted to have an income that wasn't an income with that level of freedom and autonomy that you were gonna be able to have working for somebody else. Now, you took a great deal of risk, you may continue to take a great deal of risk, but the difficulty that you will have is that you may not have the right mindset to have ultimate financial independence from that business. And that's what we're gonna cover today.

Cory Shepherd: And right now, every business owner listening is like, "This is what every person says, who's about to try to sell me something. They're walking me down the road."

Paul Adams: Not a single product, we're gonna discuss, nothing that you couldn't do on your own is what we're gonna discuss today. But I remember, when I did a TED-type talk for the Entrepreneurs Organization, here in the Seattle area, it was a nice super-intimate setting, just 12 minutes to cover some of what we're gonna cover today, and the feedback I still get from the people that were in attendance there and how it shifted their mindset around their personal balance sheet, also led to an article in Octane and articles in Forbes Inc, Entrepreneur. We're just gonna bring that to you in podcast format today. But, before that, we do have to hit this week in planning.

Cory Shepherd: So excited about this one. I love this segment that we've added, and this is one of my favorite video clips that we've ever discussed.

Paul Adams: Well, and this is a video clip I got exposed to a long time ago from Ben Stein. I want you to listen for what to listen for, and that is that he's gonna talk about people being financially responsible. We're gonna take just a minute from this clip, a little less than a minute, but what it's gonna show up for you is that he's gonna talk about the amount of debt that people have, and you're gonna hear the interviewer, a guy named Simon Constable, and he's going to say, "Oh, you mean personal debt." And he says, "No, the future liability of your long-term financial security." I'm misquoting him, but you're gonna hear him in just a moment.

"The more successful your business is, the more it may prevent you, unintentionally, from reaching the ultimate financial freedom that you would like."

Cory Shepherd: And just so that you're not distracted from this video, if you think this guy sounds familiar, if you look him up, and he looks familiar, he is, you've seen him before, just think Ferris Bueller.

Paul Adams: Yup, unbelievable actor who plays the same character in every movie, but also one of the smartest economists alive. I would put him right in the same wheelhouse as Thomas Sowell. Ben just does a lot more of that work in the personal finance realm, helping people understand good decisions to make. This is a clip from 2012, and has shaped the way that we teach our clients.

Simon Constable: I sat down with Ben Stein yesterday, and he had some interesting stuff to say about that. Let's listen.

Simon Constable: Thank you very much for joining us.

Ben Stein: Thank you, sir. Thank you, Simon.

Simon Constable: First of all, why would anyone wanna ruin their financial life?

Ben Stein: Well, a lot of people don't really want to, but they do it anyway. And so, I'm telling people how it gets to be done, and maybe if they do the opposite, they'll do better, or if they notice themselves doing the things that are listed in this book, as ways to ruin their financial lives, they will stop doing them, and perhaps rethink their financial lives. So I basically took a lot of the things I do, and I looked into them.

Simon Constable: But some of the things in here... There's also some personal stuff as well, but let's get to, first, the financial stuff. What's the biggest, most important thing that you have in the book, that people should not do if they want to...

"That four percent is enough that it doesn't take so much out in the down years, or as I like to say, because of my country upbringing, 'You just cannot eat your seed corn. You gotta have enough to replant the field every single year.'"

Ben Stein: People should not neglect to make some kind of plan, that correlates assets and liabilities, and matches assets and liabilities. That is to say...

Simon Constable: It's what you owe... And what you owe them.

Ben Stein: Well, no, no, but there's what you're gonna owe when you retire. Your main liability is providing for yourself after you retire, that's your primary liability, and that is an enormous liability, and very few people make adequate provision for it. And it used to be that that was handled by pensions. It isn't handled by pensions, for many Americans, [05:50] ____ civil servants, and so, people have to make a very substantial provision. There's almost no interest paid on bonds or [05:58] ____ deposit. There must be a very substantial amount saved, and most people, or the huge majority of people, are not saving enough. I used to be the spokesman for a group that no longer exists, so I think I can mention their name, called the National Association of Variable Annuities, and... If they exist under a different name... And we had calculations about how much people have saved for retirement. The number of Americans who have saved enough to maintain their pre-retirement style of living is virtually nil.

Simon Constable: Nil, wow.

Ben Stein: Not nil but close to nil.

Simon Constable: Now, one of the other things you've got in the book, 'cause I was flicking through this earlier, it said avoid stocks...

Ben Stein: No, no, no, I absolutely did not say avoid stocks. In fact, stocks are the way to go. I said, avoid trying to pick individual stocks. Stocks are the way to go.

Simon Constable: Alright. Okay. Avoid stock picking.

Ben Stein: Avoid stock picking. Stocks are the way to go, but broad indexes, the Spiders, the Diamonds, the VTI, they're various specific indexes that emphasize high-dividend bank stocks, low beta stocks. There are all kinds of ways to go, but don't try to pick the stocks yourself, unless your last name is... If your last name is Buffett, go ahead.

Simon Constable: Yeah. Well, he's obviously done very well in that.

Ben Stein: Very well indeed.

Simon Constable: Very well, [07:05] ____. There's an amount of stuff in here that's personal stuff, and you say, if you wanna do well, do the opposite of what you're saying here, which is, don't be rude to people. And that's important, right?

"That's what we end up building in our financial lives is a big junk drawer of these separated decisions because we never collected all of the materials with an end in mind; we started building without design."

Ben Stein: Well, what I say is there are two kinds of capital, there's financial capital, that has to be invested very carefully, and you have to try to get a substantial amount of it, not do anything risky with it. And then there's human capital, and that is what you earn, that's what you have, by which you earn a living, show up on time, choose a job that actually pays money, that does not involve just complaining and whining about something, choose a workplace that you find convivial, where you'll find yourself able to do a lot of work, learn all about your job, and your employer, respect your job and your employer, don't flirt with your fellow workers, don't pick fights with your fellow workers over anything at all, if it's at all humanly possible, work the longest hours of anyone in the office, as you humanly can. For most people, the way they acquire financial capital... Most people don't have it left to them, they earn it and they save it. And if you have a good work attitude, and good work ethic, you will acquire financial capital very much more quickly than opposite.

Simon Constable: Of all the things you've got in there, 'How To Ruin Your Financial Life', what's the thing that you regret doing most, that you did to not help your financial self?

Ben Stein: I think I did... I tried to pick stocks for too long, and I should have... If I had started out right away...

Simon Constable: But you were a trained economist.

Ben Stein: You know something? It's interesting, the data about how much better you do, just buying the indexes, as compared to trying to pick stocks, has only become really overwhelming in about the last 20 or 30 years. So when I first got out of school and had a few dollars to invest, that data was not yet overwhelming. It is now overwhelming, and just blows away any contradictory data.

Simon Constable: Great stuff. A nice, thin, light read. Thank you.

Ben Stein: Very, very, very quick read.

Simon Constable: Thank you very much. Ben Stein, thank you very much.

Ben Stein: Thank you, Simon. Thank you so much. Thank you.

Simon Constable: And his new book, "How To Really Ruin Your Financial Life... "

Paul Adams: The amount of people that have saved for retirement is virtually nil. Now, there's two huge distinctions. One is, most people have done no planning, and we're gonna talk about that in some of our key thoughts today, for you to take away. But, bigger than that, not only have most people not saved, but what do we all do? When we look at how we're doing, Cory... Like think about this for a moment, Cory, I'm kind of catching you off guard here, when you think, "Hey, am I good... "

"You may love your business, but your business doesn't love you. In fact, if things go perfectly, your business is planning on leaving you."

Cory Shepherd: Don't worry about it.

[laughter]

Paul Adams: So you ask, "Hey, am I in good shape or not?" Okay. What do you... What do you look to about whether or not you're fit or not fit?

Cory Shepherd: Oh, good shape, not for retirement, for exercise. Well, I would say...

Paul Adams: Yeah.

Cory Shepherd: Can I run a certain distance in a certain amount of time? Can I do a certain amount of pull-ups? Do I look like some definition of I'm in shape?

Paul Adams: And let's stop there, look. How you look, because you look around, how's everybody else doing in this department? Number one, if you wanna have financial security, and you're a family, like the ones we work with, that are between 300,000 and $2 million a year of income, and you look around, you're like, "I got a lot more saved than all these other people." That is not a good comparison.

Cory Shepherd: You're not looking at the right people, right.

Paul Adams: Right. And most people, which we're gonna talk about in a little while, who have even high incomes, do not have enough of a balance sheet to replace that income personally. So you can't even necessarily take it from your other high-income-earning peers. We need to answer this question with metrics, more like what Cory started with, I need to run a certain distance, I need to be able to do pull ups. Well, in this case, with money, we need to know how much it takes to actually be financially independent, have that future in mind, and then be able to put ourselves in a position that our assets are going to match the liability. Now, Cory and I oftentimes talked about this idea, that one day you're gonna create a hand-off. I saw... A friend of mine showed me a cool video clip, we were just at a conference together, and he showed me a clip of his daughter, and she is running a relay, and she's sitting there, waiting, and the other person's running, to hand the baton, and off she goes. Well, that's what we have to do, it's just old us.

Cory Shepherd: And remember that, in a relay race, they actually start running before the other one gets there. We are chasing our future selves, and it's a race to... Yeah.

Paul Adams: Yes. Yes. And that hand-off has to occur, that one day you're gonna hand whatever you've built over to the old you, and guess what? They have... They have to live with that for the rest of their life.

"You have two jobs. You are both the investor in that business and you're likely its chief executive."

Cory Shepherd: And if you drop the baton in the transfer, the race is over.

Paul Adams: Right. Or many people are getting there, and they didn't have the baton at all.

Cory Shepherd: In the first place, right.

Paul Adams: So if you ever watched the sitcom 'How I Met Your Mother', there is a character on there named Ted, who, whenever he makes a bad decision, he's like, "Oh, future Ted will deal with that. That's not a today Ted issue." Well, one day, you've got to hand off that baton to the future you. And did you set enough aside to offset the liability of future you living the rest of their life? And that's what he's talking about, is doing that calculation, what's the net present value of that future obligation, that you have to set aside. To the people listing to this podcast, 401K is not enough, buying products every time somebody proposes to you is not enough. You've got to have principles, and what we're going to take action on, how you're gonna build your balance sheet in the direction you're heading. So the weekend planning today gives us a sense of what the problem is, but those principal things are coming in little tiny sound bites. We're gonna give you something more practical as we go through today. You see, the beginning is you're a business owner, you did it for all the autonomy we talked about earlier, but the trouble is, while you did it for all of this autonomy, the very business that you've built... And the more successful it is... And this is the part we're gonna challenge you with a little bit today, the more successful your business is, the more it may prevent you, unintentionally, from reaching the ultimate financial freedom that you'd like.

Paul Adams: You see, your business, for most business owners, exists on our balance sheet. We put it on a mortgage application, we put it on banks, when we're doing loans for the business, put it on the bank applications. We have this value floating around our lives, or sometimes a friend might just ask, "What do you think the business is worth?" Or we tell our spouse at a time that they're worried because we're low on cash, we say, "The business is worth $8 million, it's fine." All of those things tranquilize us, and when I say tranquilize, I mean like a little drip of morphine. A tranquilizer relaxes you and makes you not as aware of the pain you should be feeling, or the threats you should be responding to. So let's just imagine you're an executive listening to this right now, this already makes all the sense in the world.

Cory Shepherd: And I love that... I love that counterpoint. Like an executive, maybe a owner of an area of a business, they even have a title of like content owner, or strategy owner, or something. They're running their part of the business as an owner, making a good salary, even owning part of the company by getting stock options, and yet, they're not putting... Very rarely do we see any executives putting all of their net worth and future freedom on the one stock of their company. They're usually building assets somewhere else on their balance sheet as well.

"For you, leave today, go do some math, sit down with your spouse, start a new conversation you maybe haven't had before about the importance of building, continuing to build that business, continue to drive your income. And yet, in a disciplined way with strategy, we want you to be able to build your personal balance sheet also."

Paul Adams: Right, and it's often because, in a publicly-traded company, they could see the value of that company change daily, and they understand the volatility of it.

Cory Shepherd: It's un-tranquilizing or de-... It's stimulating, very stimulating...

Paul Adams: Stimulating, yes.

Cory Shepherd: To watch that value go up and down over time.

Paul Adams: Yeah, and you go, "Oh, I can't just depend on that." Well, as a business owner, well, you might only visit your business's value if you're really disciplined as an owner. Maybe you've ordered an appraisal once a year, and then you can say to yourself, "Oh, this is what it's worth." Maybe you do some metric that gives you an idea, quarterly, based upon your EBITDA. Well, then, you've got some sense, but that's only a quarterly move. That doesn't give you real-time volatility, and there's actually only one volatility event when you own the business, as it relates to enterprise value, and that's when you go to sell it. So you could be in a position where you have built a really large asset on your balance sheet, it's called your business, but it prevents you, tranquilizes you from making other decisions.

Cory Shepherd: Well, I was just gonna say, I know what every business owner who's listening may be thinking right now, which is, "My business is the best rate of return that I've had on my balance sheet."

Paul Adams: Exactly right, and probably still is the best rate of return that you will have in your life. And I wanna proposition something to everyone listening, and that is that we're not talking about either/or, which is all too often the case. Let's take some young, hot-to-trot, just went through a bunch of sales call training, they're watching the local business journal for something that happens in cold calling, they're willing to talk to any business owner out there, and they have some... It's a 27-year-old, not that there's anything against 27-year-olds, but it's somebody that doesn't have your level of life experience, telling you that you need to build your balance sheet, not just depend on your business, and you end up in a point... Counterpoint, that's not it at all. This is a both/and, not an either/or.

Paul Adams: The both/and is you need to build your personal balance sheet and build your business and personal in parallel, over time, not one or the other. Now, the other major problem is, for all of you, as business owners, we all had a time early on where the business had to have 100% focus of both mental, physical, and capital resources. I guess that was three, not just both...

Cory Shepherd: Emotional.

Paul Adams: Emotional, yeah. All of the resources it took early on when you're launching it. And as a result of launching that business, it took everything you had. And it's sometimes difficult to now break the habit of what's made you successful so far, to not continue to drive everything you have back into the business. I'm gonna give you guys a little bit of an example. I was speaking to a large group of business owners just about six, eight weeks ago, and, in the audience, were two business owners that had had a highly consequential exit. They had both had nine-figure, low nine figures, one north of $200 million, another one north of $100 million. But really respect...

Cory Shepherd: Just low.

Paul Adams: Just low $100 millions.

Cory Shepherd: Just keep in mind, low. [laughter]

Paul Adams: Yeah. But it is... Now, they're in the audience, and one of them really took exception to what I was saying, because I was teaching like a course, if you will. I gave a talk on the... You can sell your business and retire and four other myths of business ownership. Well, as I was going through the talk, he was... You could see he was agitated, etcetera, and he says, "Well, but that... That means not believing in yourself, and that means I didn't think my business was gonna make it, and if I didn't put everything in my business, I'd have never made it." And I paused and listened to him, and I said, "Here's the thing though, you made it, you got the $100 million exit. Let's think about how many businesses had to start, how many of them just did okay, provided a very nice income for the owner. That's the minority. And the majority were businesses that didn't work out."

Paul Adams: And guys, if you don't... Haven't already realized, as a business owner, I think my participation in the Entrepreneurs Organization has been so valuable, because you get to see a lot of other businesses. You're in a community of business owners, where you're all open or really talking about what's going on. And I'll tell you what, even successful businesses, you have to have a certain amount of success to even be considered by the board of an EO chapter, and even though successful businesses that have already gotten over a million dollars of gross revenue, and enough disposable income and resources that the owner can attend events and pay for the fees to be a member and their membership dues, well, guess what? Even those businesses fail regularly, more often than they ultimately succeed.

Paul Adams: Now, I'm not saying we shouldn't be putting everything we can into your business, not that it's not the best rate of return, but what I do want you guys to be aware of is it may not work out forever. So he's living in his $100 million plus mindset. He's saying, everybody can do it, you need to put everything you got in your business because it did work for him. That's that survivorship bias we've talked about in past podcasts. The guy sitting next to him, in an attempt... 'Cause he and I went around a few times, and... In front of the entire room, it was pretty entertaining, and his good friend said, "In defense of my friend, I gotta tell you, I did everything you were saying, and I had built my personal balance sheet, and I had personal real estate, and I had set aside a lot of investments, and then it was like 10 years ago, he had a complete huge crunch in his business, and he had to use his personal resources, some of them, to be able to put back in the business to save it. And he says that if I didn't do all that... Again, he thought he was talking in defense of his friend... If I didn't do all that, I would not have had my $250 million exit.

Paul Adams: And I was quiet. And I said, "I don't know if you heard what I think everybody else in the room just heard, is had you not concentrated on building your personal balance sheet when the business was going well, you could have never saved your business when hard times hurt, and you would have never had your $200 million plus exit. And you saw both of these guys totally get it in the moment, saw the whole rest of the room totally get it in the moment. So it's not either/or, don't listen to this as either/or, we're gonna give you some principles and why to build your personal balance sheet and your business balance sheet.

Cory Shepherd: So, that was thought one. Second is just the simple calculation and math on how much your business is gonna sell for, and the fact that it will not sell for enough to replace your income.

Paul Adams: Easy way to look at it, look at somebody else making what you're making. So, I'm gonna use an example, but you use your numbers as you're driving in your car, you're at the gym, you're on a run, you make $500,000 a year, adjusted gross income from your business every year, that is your income from the business. If anybody buys your business, that's what they're going to buy. So now, I want you to think about it. Let's say somebody else had that same business. They're making half a million dollars of profit every year from the business, between what they pay themselves as an executive, and what they take out as an investor, via K-1. Well, when they do that, and you're taking those distributions, you go, "Ooh, I'm buying a business that makes $500,000. How many times that $500,000 are you willing to pay for this business?" Now, this is the reason why the average sales price of a business is a little over 2x in the country, because you, as an owner, buying somebody else's business, you don't wanna pay 30 times what they're currently making. You wanna pay something reasonable, you wanna recover it, and so, we're between a single year, if they're in a fire sale situation, their business is not properly structured, to maybe a max of a 5 to 6x of EBITDA, that's it, you're not gonna get an enormous multiple.

Cory Shepherd: I think that's such a great gut check, by the way, Paul. And maybe we went a little fast on that, like just stop and think...

Paul Adams: Yeah, hit it.

Cory Shepherd: How much would you buy a competitor's business for right now? You have...

Paul Adams: If it looked just like yours.

Cory Shepherd: Or whatever it looks like, you wanna... It would fit to join into yours, so you're gonna buy them out of theirs, how much would it make sense for you to buy that for? And it's probably in that multiple that Paul just said.

Paul Adams: Yeah, and think about it, that means... So if you're quote unquote 'going to retire', remember that's what a lot of us, as business owners, have been taught, nobody's taught us the math, but like, "Oh, you build your business, or you sell your business, then you retire, easy math. If you're selling it for six times your annual income, then you've got six years of income. That's it. Or you have a properly-allocated amount of capital that you take an appropriate distribution from each year, and you have a lot less than what you were making before. Let me explain. We've talked about before, in the 4% rule, and we'll put a link in the show notes to our other podcast, you can look for it, but we talk about why you can only take 4% a year. In fact, some economists have even said that it could be lower, but for now, we're gonna stick with four, for the sake of conversation. It's very easy math to do. That means that even if your overall investments, I don't care what you're investing in, commercial real estate, residential real estate, first deeds of trust, or an academically-allocated, globally-diversified portfolio, over time, you will likely get a better rate of return, but it's not a smooth... And up into the right line. That line is bumpy because all of those assets to produce that kind of return are dynamic.

Cory Shepherd: If your portfolio does 8% per year on average, over 30 years, you cannot take 8% per year because those down years, where it goes down 30, and then you also take eight, means it drops by 38, and those kind of losses kill the portfolio all too quickly.

Paul Adams: Yup, it just accelerates the erosion of your capital. You can't take the average out. Now, the other way that that happens, if it's real estate, is you end up with no tenants, or you have large capital expenditures that are required, or there's just a serious lag in the market values. All of those things are, volatility, that are totally normal. We're used to moving money in and out of like savings accounts, those are withdrawals. The asset doesn't change in value. When we are distributing money for our financial independence in later years, it's dis-investing, because we're pulling it out of an asset that can go up and down in value. So we can take 4% a year, even if a portfolio is supposed to average like eight over time, that 4% is enough that it doesn't take so much out in the down years, or as I like to say, 'cause of my country upbringing, you just cannot eat your seed corn, you gotta have enough to replant the field every single year. So you've gone out so far and try to... You probably all made some investments outside your business, that's normal, and people tend to do it out of surplus, but let's go to our person making $500,000 a year, if they want to replace the entire 500,000 a year of taxable income, that's gonna take them $12.5 million at a 4% distribution, to be in a position that the portfolio can maintain for their effective lifetime, because it's a real bad idea to run out of breath... Run out of money before you run out of breath.

Cory Shepherd: Or breath. Yeah.

Paul Adams: It'd be a bad idea to run out of breath at any time, I suppose.

Cory Shepherd: No, really is. So, to scale for your income, the simple mental math is $40,000 of income per million of capital that you have in place.

Paul Adams: So think about that for a moment, every $40,000 you make in income right now, it takes 1 million capital at work to be able to replace it. So if you make $500,000 a year, and somebody says, "How do you feel?" People say, "Oh, I feel like a million bucks." No, you should say, "I feel like $12.5 million, because I listened to this incredible podcast with Paul and Cory, and you should listen to it too. So... But now think about how you've probably collected assets for most people, and we are constantly in awe, and I wanna say amazed, I don't wanna say surprised, and I don't wanna say it in any way that's condescending, but when we look at people's finances, if you ever had an interest in working with our firm, we'll be happy to have a philosophy conversation with you, answer any questions, and then, if you'd like, we don't sell in that conversation at all, but you can apply to become a client. And there's a question in that application, and the question in the application is do you know how much money it will take for you to be financially independent? How much capital at work it will take to be financially independent?

Paul Adams: And I will tell you that it almost never has an answer, and it would be less than one in 20 people applying. And these are not... These are people that are professionals, like attorneys and CPAs, who have their own practices, these are people that are making hundreds of thousands of dollars a year, no kidding, like this is no joke, regularly, people making over a million dollars a year cannot answer that question. Now, why have the financial industry never taught us to answer that question? Because they don't care if we answer it, they care if you buy the next product. No, that's not... They don't care about you. You might be a very nice person, but they don't... That's not their objective. Their objective is to find people with some degree of surplus, and get them to set aside the surplus in the products that they offer. No difference than Mercedes Benz wants to find people with surplus or Tesla wants to find people with surplus, market people with surplus, have them deploy some of their surplus into their products? No different.

Cory Shepherd: And it's the shiny phase 27-year-old with all the enthusiasm in the world, that you mentioned earlier in the episode, Paul, every business owner listening, they probably had that 27-year-old... I was that person, once upon a time, cold-calling over and over enough, that finally you give in and give a meeting. And then they have some cool widget that actually sounds intriguing enough, and you kinda like the person, and you kinda feel bad 'cause they've worked so hard, and so you have a little extra money and you're like, "Great, have at it with some of this." And that happens over and over again.

Paul Adams: Over... In fact, Cory just worked with a super-successful business owner who is in a position that, over time, a long time, trusted relation. We see this all the time, just... I'm thinking of one particular person in my head here, Cory, who had collected from, by the way, a reputable and high quality financial institution, lots and lots and lots of products over time, and they weren't stitched together in a strategy. This is why we no longer follow the model of the traditional financial advising firm. The entire financial industry was built on the Financial Opportunity sales model of the 1960s, like Glengarry Glen Ross style, call people, "I've got a piece of land you should invest it. I've got a stock you should invest in." Yeah. So we've got something really cool that you should transact in, that's financial opportunity sales, that's why we instead borrow from architecture with our wealth design build model.

Paul Adams: The idea is you hire an architect. The architect's job is to get a fee, regardless of what the building costs are, to design a home that you would want to be in for the rest of your life. Well, guess what? With your money, this is the place you are going to live for the rest of your life, or these decisions. But that architect does the blueprint, you and your spouse have said this is what the walkway should look like, the archway going in the front door, this is what we'd like the staircase to be like, these things in the backyard for our children and grandchildren, they architect all of that with you. And then, when you're done, you pay them a fee, they hand you blueprints, and you have some choices.

Cory Shepherd: And granted, the architect does keep cost in mind. That's part of what you're paying for.

Paul Adams: Yes.

Cory Shepherd: But them helping you optimize those costs doesn't relate to what their fee is, and that's really important.

Paul Adams: Exactly right. And then you have the builder, and the builder... You can do it a couple of different ways. You could just go to Home Depot, get a bunch of sacks of concrete, bunch of two by fours, start building that home, based upon that design. You could go to a long-time friend, and we all have that long-time friend that's in the financial business, but you're like, "Oh, I went to college with him, and, boy, they killed a lot of brain cells. I don't know if I want them to be the one making all my financial recommendations." So, you wanna implement with them because of that friendship. That's great. The architect will make sure that the contractor is putting in place what needs to be put in place, but, in our case, we're like a design build architecture firm. Clients can make the choice, if they would like, that we can help them build the actual strategies and tactics required to be able to implement the design. Now, here's the problem, I said all that because I wanted to stand in contrast of what we all do, and what we all tend to do, to keep this architecture metaphor going, is that we just buy materials to build that out of surplus. We just have extra and we buy it.

Paul Adams: This would be the equivalent of trying to build a house by just having extra money, going to Home Depot, and getting lumber when you can. Better yet, people show up and sell you pieces of material. Like, "Here's a cool staircase." You're like, "That sounds really good." And then you grab a couple of... You got a pack of two by fours. And I think I'm gonna need shingles at some point. And you get those, and you start collecting them. And here's the thing, if you were to take the transmission from a Ferrari, if you were to take the wheels from a Lamborghini, if you were to take the interior from a Cadillac, and put it altogether, you don't have one awesome car, you have a pile of garbage. That's what we end up building in our financial lives, is a big junk drawer of these separated decisions, because we never collected all of the materials with an end in mind. We started building without design, hence why our design-build model. Let's pause for a moment, hear, from Cory, about Sound Financial Group.

Cory Shepherd: At Sound Financial Group, we are committed to continuing to bring you Sound Financial Bites. Hello, my name is Cory Shepherd, President of Sound Financial Group. If you are finding value in these weekly podcasts, and they are making a difference in the way you think about money, then think about what kind of a difference could be made if you engaged one of our advisors to help you look at your personal finances. So what would the next step be? Send an email to info@sfgwa.com, with philosophy in the subject line, and we will coordinate with you to have a conversation with Paul, myself, or one of our other advisors, to share with you our philosophy of money. No one is going to close you on that call. No one is going to make you an offer to become a client. The only thing we allow our advisors to do in that call is teach, and the only thing we allow you to do is ask for an application. While we don't accept everyone who applies to work with us, we are committed that any Sound Financial Bites listener who wants to go deeper has the chance to expand their thinking and walk away with new education and resources around money. So even if we find out we aren't right to work together, our team will absolutely take care of you in that call, and make sure that you have access to resources that might be of help to you.

Cory Shepherd: And welcome back to Sound Financial Bites. You've got Cory and Paul here, talking about why a business owner needs to diversify from their business, under their personal balance sheet. And that is our third thought. Then I wanna kick off with this very simple idea, you may love your business, but your business doesn't love you. And, in fact, if things go perfectly, your business is planning on leaving you.

Paul Adams: Yes! That is such a great metaphor.

Cory Shepherd: Best situation is a Dear John letter that you helped your business write.

Paul Adams: Hopefully, with a large check. Let's get that straight, like we want a Dear John letter with a check, which, by the way, I'm just thinking, when Dear John letters show up, which I guess they're now like "Dear John" Instagrams or Snapchats.

Cory Shepherd: Texts, yeah.

Paul Adams: Yeah, but if it had a check, in this case, a Venmo payment, of... With more than two commas, that would be fine, but we don't have that necessarily guarantee that we have to build wealth in both balance sheets. We have to build our business, our business has to be built to sell. And think about this for a moment. And I think about this a lot for my fellow Entrepreneur Organization members, if you're listening from across the country, how many things are brought into our EO chapters that give us amazing things to have our business totally doped out, daily huddles, weekly status checks, dashboarding, all of it. And you know what? Even in an organization, like, I would venture to say, the Vestiges, the EOSs, the Gazelles, the Entrepreneurs Organization, nobody talks about how is your personal balance sheet doing, because it's all about building your business, which is fine, there's nothing wrong with that, but it is worth an acknowledgement that nobody is really talking about, we have to build both. And even when we shape the business properly, to be transferred to our personal balance sheet, it's only gonna give us about six times our annual income.

Paul Adams: Now, I touched on it earlier, but I wanna give one additional note on our 6x sale, for a person making $500,000 a year, 6x would be a great exit. By the way, one big problem, anytime we hear of somebody's exit, and oftentimes, they don't ask about how much, but we know they got several million dollars and they're really happy, and rumors float around, they likely didn't get enough to be done. It would take a huge exit, like 32x, which happens rarely, they're called unicorns, and people exit in a way that gives them more than enough to have the capital at work required. But if you sell for 6x, for your 500,000 person, that's $3 million. Now, $3 million has gotta be taxed. Well, just to keep the math round and be friendly with the taxes, I'm gonna say you end up with two and a half million after.

Cory Shepherd: First time I've heard friendly and taxes in the same sentence.

[laughter]

Paul Adams: So two and a half million, where we invest it, as capital at work, take a 4% distribution. By the way, this assumes we didn't have any extra debt to pay off, anything else. $100,000 of cash flow, you went from making $500,000 a year to 100,000. It is the biggest thing that most business brokers and MNA experts run into, is that these business owners do not know, do not know how much capital it is going to take for them to be financially secure, and that's the reason why a lot of sellers will fall out of a transaction, is near the end, is when they start doing this math. They built the business for 30 years, and only near the very end do they do the math to say, "Oh my gosh, I am not going to be able to be okay for the rest of my life. And there's one other thing that happens, though, is that people feel like, "Hey, I get my business on auto-pilot." It's going really well. I only go on one day a week, or now I'm a board member, and my team is really running this thing, and that's given me all the financial independence I want. Well, consider that things change. And if you've been a business owner very long, and you hang out with other business owners, there are things that can happen in that business that draw you back in.

Cory Shepherd: Like auto-pilot is not a permanent setting on a business.

Paul Adams: That's right, yes. Well, and think about auto-pilot with aircraft, that auto-pilot... We've had some tragic losses of life recently, and the early investigators are saying that it's as a result of the auto-pilot systems malfunctioning, and people not taking off of auto-pilot properly. Now, if that happens to you in your business, like, here's the thing, a plane... If you've ever been a pilot, a plane is constantly trying to kill you and your passengers. It's just you, as the pilot, that is preventing this. Your business is constantly trying to bankrupt you. It's only your job, as the CEO and pilot, that has put you in the position to keep it from going bankrupt, keep it profitable, keep it airborne, auto-pilot temporary setting, because regulations could suddenly change in your industry, which requires... You have to go back in. You have a new competitor, comes in the market, and that new competitor is suddenly like recruiting your employees and eating away your margins.

Cory Shepherd: Or, speaking of employees, it doesn't take a competitor to have a key employee leave, or a major partner or key employee get injured, disabled. They don't have to choose not to wanna work with you... They might... It might not be anything happening to you or your business, just a thing that happens to someone involved with your business.

Paul Adams: Yeah. One of those key people get hit by a bus. You went from being an investor only in that business, to now being the key executive again. Could be a big legal entanglement. All of those things put you right back in your business. And the thing is that, when you get deployed right back into your business, you're not in the position to have had the value you once had, because, now, if you needed to sell it, you're selling a business that's going to be sold to an owner-operator, where, prior, you could have sold it to an investor.

Paul Adams: So, here's where we want to land today. First, we want you guys to walk away, just doing some very simple math, and that is, just for starters, don't even worry about your future ambitions, how much of an income you want in your old age, all that, that's all well and good, just start with this, take what you're currently earning, take that 500,000 and divide it by 0.04, that's 4%, and it gives you that 12 and a half million dollar number. So you're gonna take what you're currently earning, the lifestyle you enjoy, the life you and your family have become adapted to, and say, "I'm just gonna divide that by 0.04." And that's gonna give you the capital at work that's required. That way, if you ever apply to become a client of ours or anybody else's, you at least have a target for your capital at work. How many people are saving money for the future? How many people would say, "I wanna be financially independent?" How many people have a 401K, an investment? They bought something from Morgan Stanley. Whatever they did, no [41:42] ____ advisor doesn't matter. And when it all comes down to it, they actually don't have a destination they're operating toward.

Paul Adams: We would never do that in our business. You don't run a business without an annual objective, a profit objective, but we do it all day long in our personal lives. And, second, you have two jobs. You're both the investor in that business and you're likely its chief executive. So, if you're the investor, that's one kind of income. And, for all the reasons we've talked about, with like Michael Michalowicz's 'Profit First', 'E-Myth', you want to be able to make sure that you are paying yourself properly as an executive, so you can see if we're actually gonna get a decent rate of return as an owner. And then you need to take some of that executive comp, and some of that owner comp. I would not necessarily say to anybody listening that what you should do is not expand your business or not take that next great opportunity instead of putting it on your personal balance sheet. That's not this either/or. What you have to do is just take 20% of what you have in the business, and have that 20% of gross that you take out of the business already, modify your lifestyle, and modify your compensation from the business in a way that allows you to set aside 20%, and then go buy assets. Cory, anything else you'd have them leave with today, in a mindset of what it's gonna take to... Not a different mindset. This is an... Your mindsets are great. That's why you've had this success... An additional mindset on top of anything else you'd want them to kinda leave this meet with.

Paul Adams: So, I'm just picturing most of the folks listening, really smart people, business owners. If you haven't done the math before, you might already have an inclination that if you went and did that math, you might not like the number that you see, it might be hard to see this big number of capital that you need for the first time. And we've been insulated and inoculated from the knowing. And here's what I'll tell you, as unpleasant as it might be to know now, the not knowing all the way into the future is gonna be worse. So it might be hard for a while, getting yourself into the knowing phase right now, but you will be so much happier for it over the long-term. So there might be a little fear of doing that calculation, do it for yourself, rip off the band-aid, experience the pain for a little bit, 'cause the pain now will be so much less than the pain in the future, if you never do it.

Paul Adams: That's it. You'll go through... I would rather all of our listeners, Cory, go through that cognitive dissonance of wrestling with the amount of capital it requires, and closing that gap, than to live with the actual despair of what it's like. And this is very real, guys. I'm not meaning to be ending this on anything but a high note. But, for real, there are many business owners out there. My wife's grandparents had an amazing,

amazing, amazing, amazing business, and, along with that business, was a 60 plus foot yacht.

Paul Adams: They had... All of the family would come over, and they were known as the rich grandparents and patriarchs of the family, and they had a pretty exceptional life, they had a place in Mexico, more than one house in the US, and this huge yacht. And what happened was it all came apart, some health issues, some industry change, and everything on their personal balance sheet was things they were already familiar with buying. He knew how to buy a boat, knew how to buy houses, but hadn't built a balance sheet. And because they didn't build a balance sheet, they live in Mexico, not in like a big, lush house, they live in Mexico, South of San Felipe, in a campo, which, a campo is like a whole bunch of American expats without enough money, who bought a bunch of trailers on leased land, near the ocean, and live off the grid on a... And this would be a really cool place if it was your second home, and you had the funds to be able to fly in and out, and maybe it's a retreat, and that would be wonderful.

Paul Adams: That's not the retreat, it's their full-time thing, 'cause they had to put themselves in a situation where they could live on little enough money to have a decent lifestyle still. That happens more often than you know, and the business owners that were like... I was killing it. I was making $700,000 a year, and this and this and this, and then this thing happened, and I'm flat broke. You don't know that. You just know the guy who's in his 60s now, who is a diligent employee or manager for somebody else, which is okay. And it's also okay that businesses will sometimes not work out, but what's not okay for me is that you'd have to live forever in the future of not having faced that cognitive dissonance that Cory is talking about. So I'd much rather you guys wrestle with it now, and have great future outcomes, than to just forfeit wrestling with it now, and I'll deal with it later. Unfortunately, that later is closing in on all of us much quicker than we might realize. Okay. With that, let's talk about the special giveaway that we're gonna be talking about in the podcast for the next couple of three months, we've got a new experiment, we think it's gonna be a lot of fun.

Cory Shepherd: Very exciting. Revolutionary.

Paul Adams: Is we want to gather a qualified business owner or high-income earning executive. If you're one of those people between 300,000 and $2 million of income, we charge a fee upfront for the work that we do, but what we are willing to do is to take a family all the way through our planning process, and putting them in a position where we will take you all the way through just like any client would. We're going to record every meeting. Granted, we're only going to use first names, we may even change first names, and all of this stuff, to protect the innocent, but still dealing with your life, your numbers, and much like you may hear about some of these podcasts, where somebody talks a little bit about a therapy session somebody's going through, and then you actually hear that little chunk of the therapy session. That is what we're gonna do for... We're gonna start with a family, we'd love to make it a regular podcast feature, but allow all of you to look in on what happens when we're dealing with somebody else's balance sheet, and what it looks like when it's not you, so you can learn more.

Paul Adams: One of the things that makes Cory and I so good at this is how many financial situations and conversations we get to be in every day. Well, we wanna share some of that knowledge with you, and we want to take that special family that's willing to let other people learn from what you are going to learn go through our process and be in a position where you won't have to pay or, ultimately, pay for our engagement fee from going through that process. There's gonna be releases, all this stuff, our compliance team is gonna work on it, but we wanna give you the gift of being able to see somebody else go through the process. In return, we're gonna make sure that there's no out-of-pocket cost for that person that goes through our planning process, who is willing to give that gift to the rest of you. So if you know somebody who's thinking about engaging an advisor, you are a current client of ours, or maybe, as a listener, you're somebody that's been on the verge of wanting to talk to us or not, I would encourage you, info@sfgwa.com, let us know, say, I'm willing to be a guest on the podcast, we will know what that means, we will get in communication with you, and have an initial conversation about what it would be like to go through our process, and give that gift to a bunch of other listeners.

Cory Shepherd: And now, for the featured review. And I'm super-excited about the... Oh, did you have anything more to say about that, Paul?

Paul Adams: Well, I was just gonna say, as a reminder to everybody, with these featured reviews, when you do a podcast review, take a screenshot of it, send it to us, and we will send you a copy of Michael Michalowicz's 'Clockwork', we'll send you a copy of 'Sound Financial Advice', or we'll send you a copy of Cory's book, 'Cape Not Required'. We know some of you, as listeners, have already gotten some of these books. Let us know which one you don't have already. Give us a review on iTunes. It really helps not just us, but it really helps all the other people that are not getting this kind of financial advice, because they're listening to the like sugary, three minutes before the next commercial break, not long-form content, not giving people the opportunity to really learn the strategies, thinking, mindsets, and philosophies that put them in the best position to have financial security for the long run. So, our featured review, drum roll... But we don't really have a drum roll. So...

Cory Shepherd: Wait, I thought I was reading this... Are you reading this one?

Paul Adams: How about you read the title, and I'll read the body. Are you good with that?

Cory Shepherd: Well, I'm super-excited about this one, 'cause I...

Paul Adams: Then you read this one.

Cory Shepherd: Because they sent this one to... That's all... That's all... Yeah, I'm just super excited 'cause I got a chance to talk to this person. She did email us...

Paul Adams: And to the entire audience, let me introduce Cory Shepherd on the feature review.

Cory Shepherd: You can read the title, you should read the title then.

Paul Adams: This is a podcast you must listen to... Now.

Cory Shepherd: If I had to choose only one podcast to listen to for financial information and resources, this is hands down the one I would choose. If you are not listening to every single episode, you should really rethink all of your life choices. Guys and gals, this information is pure gold, and it's free. Why they don't charge for this, I have no idea, but I'm sure happy about it. While I'm not what they often describe as their ideal client, making top percent income, I will be one day, and listening to each episode gives me little nuggets of valuable information in order for me to get there. Why wait until you have a problem to get the answers? They are giving away your entire lives' financial cheat sheet before the test. Start listening ASAP. I'm so grateful to Paul and Cory for bringing us this amazing content week after week. Have I mentioned I love this podcast. And that's Melanie H, business owner. Melanie, thank you.

Paul Adams: And what I think and... At least the feedback we get of our regular listeners, is often something like that, like they actually think that we should be charging for it, but that's not our purpose, we know that not everybody's gonna be able to engage us, we know not everybody is gonna have the mindset to engage us, but we want to be able to make a difference for you in your life. Melanie, from me as well, thank you again. She's, I think, in Florida. She's like on the other side of the country too, which is another gift of why we do all of our stuff by Zoom meeting, our clients are across the country. And the great thing is that this is somebody who heard me as a guest on another podcast, ended up starting to consume our podcast, has become a huge fan. We're super-excited to send you some stuff, Melanie, and really encourage all the rest of you to do that. For you, leave today, go do some math, sit down with your spouse, start a new conversation you maybe haven't had before, about the importance of building, continuing to build that business, continue to drive your income. And yet, in a disciplined way, with strategy, we want you to be able to build your personal balance sheet also. And, as always, we hope that this podcast has been a contribution to you being able to design and build a good life.

Speaker 2: I want to acknowledge you for taking the time to tune in to Sound Financial Bites. You stopped long enough in your busy day to reflect on your finances, and your future to help you design and build a good life. Please take a moment to subscribe to this podcast, and follow us on social media. You can find us on Facebook and LinkedIn. If you have a topic you would like to hear us discuss, please send us a note on Facebook, LinkedIn, soundfinancialbites.com, or email us at info@sfgwa.com. Be sure to check out the show notes for links to any resources that were covered in each episode. For our full disclosure, please check the description of this episode, the description of this podcast series, or you can visit our website. Make it a great day.

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