How to Get Rich in Three (Really Difficult) Steps

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" …there is a reasonably predictable way to get rich in America."

Step 1: Ignore Your Parents

Parents around the world typically encourage their kids to get educated so they can get a 'good job.' This may mean becoming a doctor or lawyer, although neither tends to be a path to significant wealth. High-paying professions provide an excellent income stream, but two insidious forces undermine the professional's ability to create significant wealth: tax and spending.

Tax

It is difficult to become wealthy on the basis of a salary alone. Since income is taxed at the highest possible rate, you're left with not much more than 50 cents on the dollar.

Spending

The other problem with having a high income is that it creates a 'wealth effect' that triggers spending. Thomas J. Stanley, the famous author of the research-driven classic *The Millionaire Next Door*, points out that some professionals—in particular, lawyers—spend a large portion of their income to give the impression that they are successful, in part because they do not enjoy much social status from their job. In other words, when you earn $500,000 a year, you buy a Range Rover or send your kids to an elite private school at least in part because you want people to think you are wealthy.


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Step 2: Start Something

Most wealth in America is created through owning a business. Recently, Mass Mutual looked at the proportion of business owners that make up a number of wealth cohorts. They found that 17 percent of people with between $100,000 and $500,000 to invest were business owners.

Keep in mind that there are about 8 million employer-based companies in the United States, meaning that the incidence rate of business ownership (the natural rate at which you find business owners in the general population) is about three percent. Said another way, if you grabbed 100 people walking down the street, on average three of them would be business owners. On the other hand, if you took a random sample of 100 people with investable assets of between $100,000 and $500,000, 17 of them would be business owners, meaning you're over five times more likely to find a business owner in the $100,000 to $500,000 wealth segment than you are to find an employee in the same segment.

The trend becomes more pronounced the higher up the wealth ladder you go. If you look at wealthy investors with between $500,000 and $1,000,000 in invest-able assets, you'll see that the proportion of business owners in this segment goes up dramatically—to 27 percent.

The Very Rich

Among investors with between $1 million and $10 million in investable assets, the proportion of business owners jumps to 52 percent. As for those investors with $10 million to $50 million sloshing around in their bank account, 67 percent are business owners; and for investors with $50 million dollars or more in investable assets, 86 percent are business owners.

Simply put, if you meet someone who is *very* rich, it's highly likely they are (or were) a business owner.

Step 3: Get Liquid

The next step for you as a business owner is to focus on improving the value of your business so that you can sell it for a premium. Just being a successful entrepreneur is typically not enough to become rich. You have to find a way to take the equity you have locked up in your business and turn it into liquid assets.

When it comes to selling your business, the three most common options are:

- ***Acquisition***: This is the headline-popping way some entrepreneurs choose to trade their shares for cash. When Facebook acquired WhatsApp for $19 billion, founders Brian Action and Jan Koum got very rich.

- ***Re-capitalization:*** A minority or majority "re-cap" occurs when you sell a stake in your company (often to a private equity firm) yet continue to run your business as both a manager and part owner, with a chunk of your wealth in liquid assets outside of your business.

- ***Management Buyout:*** In an MBO, you invite your management team (or a family member) to buy you out over time, usually with a mixture of some cash from the profits of your business as well as debt that the managers take on. There are other, less common ways to turn your equity into cash (e.g., an IPO), but the key is turning the illiquid wealth in your business into diversified liquid wealth. The best part about selling a business is that the wealth created is taxed at a very low rate compared to employment income, so you get to keep most of what you make.

You might argue it is better to keep all of your wealth tied up in your business as it grows, but that can be a risky proposition—just ask Lululemon's Chip Wilson or BlackBerry's cofounder Mike Lazaridis. If you keep your money locked up in your business, it also means you may not be able to enjoy the benefits of wealth. You can't use illiquid stock in a private company to buy an around-the-world plane ticket or a ski chalet in Aspen. You actually have to get liquid first.

There are many good reasons to build a business; and for you, wealth creation may not be as important as making an amazing product or leading a great team. But if money is what you're after, there is no better way to get rich than to start and sell a successful business.
