RICH DAD® Mini Guides

RICH DEBT POOR DEBT

The Rich Dad Formula for KILLING YOUR BAD DEBT

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CHAPTER 1: THE PROBLEM WITH BAD DEBT

I get asked this question all the time.

"Robert, will your financial education help me? I'm deeply in debt."

My answer surprises most people.

"Probably not."

Let me explain why.

If you are drowning in bad debt right now, there are things you need to do before you are ready for advanced financial education. First, you need to understand why you got into debt in the first place. Second, you need to get out of that debt using a proven system.

Here is what most people do not understand. There is good debt and bad debt. And the difference between the two determines whether you become rich or stay poor.

Good debt makes you rich. Bad debt makes you poor.

Good debt is debt that someone else pays for you. Bad debt is debt that you pay for with your own money.

An example of good debt is a loan on a rental property. Your tenant pays rent. The rent covers your mortgage payment, your property taxes, your insurance, and your maintenance costs. Money flows into your pocket every month.

An example of bad debt is a car loan. You make the payment every month. Money flows out of your pocket.

Another example of bad debt is the mortgage on your home. I know that makes some people angry. But your home is not an asset if you are making the payment. Your home is a liability. An asset puts money in your pocket. A liability takes money out of your pocket.

Years ago, I was nearly one million dollars in debt. One million dollars.

I remember sitting in my small apartment, looking at the stack of bills on my kitchen table. Collection notices. Angry letters. Late payment warnings. I felt sick to my stomach every single day.

My rich dad said something to me that changed everything.

He said, "Robert, this debt is trying to teach you something. The question is, are you willing to learn the lesson?"

He looked at me and continued. "You have bad debt because you made bad decisions. You bought liabilities thinking they were assets. You spent money trying to look rich instead of becoming rich. Now the debt is showing you the truth about your financial intelligence."

That hurt. But he was right.

Warren Buffett, one of the richest men in the world, often says, "If you cannot control your emotions, you cannot control your money."

When I looked back at how I got into debt, I saw a clear pattern. Every bad financial decision I made came from one of two emotions. Fear or greed.

My rich dad made me write down every debt I owed. Next to each debt, I had to write down which emotion caused me to take on that debt. Fear or greed.

It was one of the most painful exercises of my life. But it was also one of the most valuable.

The goal is not just to get out of debt. The goal is to get out of bad debt so you can get into good debt.

By the time you finish this book, you will understand the difference. You will have a proven plan to eliminate your bad debt. And you will be ready to use good debt to become rich.

CHAPTER 2: TWO STORIES ABOUT TWO CARS

Let me tell you two stories that teach everything you need to know about thinking poor versus thinking rich.

The Three Thousand Five Hundred Dollar Dream Car

A few years back, a friend came over to my house. He was excited. He had just bought a car.

"Robert, I got an amazing deal," he said. "I paid only thirty-five hundred dollars for it. Put in another five hundred for parts. Runs great. I could easily sell it for six thousand."

He wanted me to take it for a test drive.

I climbed in. The interior smelled like old cigarettes. The seat had a tear in it. The engine made a knocking sound.

I handed him back the keys and smiled.

"It's a great car," I said.

But that is not what I was thinking.

What I was thinking was this. The car was depressing. I would not want to drive this car to a business meeting. I would not want to be seen in this car.

My friend took the keys back and smiled.

"I know it's not beautiful," he said. "But I paid cash for it. No debt."

As he drove away, thick black smoke poured from the exhaust pipe.

I felt sad for him.

The Porsche Speedster Story

In 1995, I got a phone call from my local Porsche dealer. He said, "Robert, the car of your dreams just arrived."

I drove to the dealership immediately.

There, sitting in the showroom, was a 1989 Porsche Speedster.

Porsche only made eight thousand of this model over three years. Collectors were buying them and putting them up on blocks in storage. If you could find one for sale in 1989, the asking price was one hundred thousand to one hundred twenty thousand dollars.

But this car was not just any Porsche Speedster.

This was Speedster Number One. The very first one ever built. The one the factory toured all over the world for auto shows. After the tour, this car had been stored in a warehouse. It only had twenty-four hundred miles on it.

I walked up to that car like I was in a dream.

The color was perfect. Metallic linen. I opened the door and sat in the driver's seat. I inhaled deeply and smelled the rich scent of leather.

My wife Kim looked at me and asked, "Do you want it?"

I nodded.

She smiled and said, "Then it's yours. All you have to do is find an asset to pay for it."

I put a deposit on the car. I arranged financing with the dealer. And then I went out to find the asset that would pay for my liability.

Using Good Debt to Pay for Bad Debt

Here is what I did.

A little over a week later, I found a mini-storage property in Texas. I borrowed money from the bank to buy it.

The cash flow from that property covered the monthly payment on the Porsche. Every month, the rent from people storing their furniture and boxes paid for my dream car.

A few years later, the Porsche was completely paid off. And I still owned the mini-storage property. It still produced cash flow every month.

I got richer from having an expensive car. Instead of getting poorer, which is what happens to most people who buy expensive cars.

The Porsche is still mine today. The mini-storage property still makes me money every month.

The Real Lesson

Think about these two stories.

My friend paid four thousand dollars cash for a depressing car. That money was gone forever.

I had a Porsche Speedster. One of the most beautiful cars ever made. But my car cost me nothing. Zero. The asset I bought paid for it.

This is what rich dad taught me. Do not sacrifice your dreams. Do not settle for cheap things that make you unhappy.

Instead, expand your means. Get smarter about money. Learn how to afford the life you want without going into bad debt.

Assets buy liabilities.

If you remember nothing else from this book, remember that.

CHAPTER 3: FOUR QUICK MONEY LESSONS

Before I give you the formula for getting out of debt, you need to understand four lessons about money.

Lesson One: Your Financial Statement Is Your Report Card

My rich dad used to say, "Your financial statement is your report card once you leave school."

There are only two parts that matter. The income statement and the balance sheet. Income and expenses. Assets and liabilities.

Rich people build their asset column. Poor people have only expenses. Middle class people buy liabilities they think are assets.

When I bought the Porsche and the mini-storage property, here is what my financial statement looked like.

On the liability side, I had the loan for the Porsche. Bad debt. Money flowing out.

On the asset side, I had the mini-storage property. Good debt. Money flowing in.

The cash flow from the asset paid for the liability.

My assets bought my liabilities.

This is what rich people do. They use assets to pay for the things they want. Poor people use their paycheck to pay for the things they want.

Lesson Two: Who Are You Really Working For?

My rich dad taught me something most people never understand.

He said, "Every time you owe someone money, you become an employee of their money."

If you take out a thirty-year loan, you just became a thirty-year employee. For the next thirty years, you will work to make payments to that bank.

Most people work their entire lives for banks and credit card companies. Their paycheck comes in. Most of it goes right back out to pay debts.

Rich dad borrowed money too. But he did his best to not be the person who paid the loans back.

He wanted good debt. Debt that someone else paid for him.

His favorite way to do this was rental property. "The bank gives you the loan, but your tenant pays it off for you."

Lesson Three: Your Banker Loves to Lend You Money for Both Assets and Liabilities

Here is something most people do not understand.

Your banker will lend you money whether you buy an asset or a liability. Your banker does not care which one you choose.

To the banker, both are assets. The banker just wants to lend money and collect interest.

People who borrow money to buy assets usually end up with more money to buy liabilities. People who only buy liabilities often have no money left over to buy assets.

The richer you become, the happier your banker becomes. Because you keep borrowing more money and paying it back.

Lesson Four: What Asset Does Your Banker Love Most?

There are four primary asset classes you can invest in.

One. Businesses.

Two. Real estate.

Three. Paper assets like stocks and bonds.

Four. Commodities like gold and silver.

Of these four, your banker loves real estate most.

It is very difficult to get a loan to start a small business. It is very difficult to get your banker to lend you money to buy stocks or bonds.

But your banker will loan you money to buy real estate. For thirty years. At a low interest rate.

Why? Because real estate is collateral. The bank can take the property back if you do not pay.

This is the power of leverage. If you invest ten thousand dollars with no leverage and your investment goes up ten percent, you make one thousand dollars.

But if you use the bank's money and buy a one hundred thousand dollar property with that same ten thousand dollars, and the property goes up ten percent, you make ten thousand dollars.

Your return is one hundred percent. Not ten percent.

This is why rich dad said, "Always give the banker what he wants."

But he also said, "Always treat any debt as you would a loaded gun."

Leverage can swing both ways. You can make a lot more money using the bank's money. But you can also lose a lot more money.

That is why you need education. That is why you need experience.

CHAPTER 4: THE 10-STEP FORMULA TO ELIMINATE BAD DEBT

This is the formula Kim and I used to eliminate over five hundred thousand dollars of debt. It is the same formula I have taught to thousands of students.

It works. But only if you work it.

Step 1: Tell Yourself the Truth

You must commit to telling yourself the truth about how much you owe and to whom you owe it.

Sit down. Write down every single debt you owe. Every credit card. Every loan. Every IOU. Everything.

Do not lie to yourself. Do not leave anything off the list.

Face the hard facts.

Step 2: Stop Accumulating Bad Debt

Stop digging.

Put a freeze on all debt. Anything you purchase from this moment forward must be paid off that same month.

Stop adding to your credit card balances. Stop taking out new loans.

If you cannot pay cash for it this month, you cannot buy it.

Step 3: Make a List of All the Debt You Owe

Take that list from Step 1 and organize it.

Include credit cards, school loans, car loans, personal loans, store credit accounts, and your home mortgage.

But do not include debt for investments. If you own rental properties that produce positive cash flow, do not include those mortgages.

We are dealing only with bad debt. Debt that you pay for out of your own pocket.

Step 4: Hire a Bookkeeper

I know you think you cannot afford this. But rich people have bookkeepers. Poor people do not.

Kim and I hired a bookkeeper when we had almost no money. It was one of the smartest decisions we ever made.

A bookkeeper keeps accurate records. A bookkeeper provides emotional support. A bookkeeper forces you to face the truth every month.

Find a bookkeeper. Meet with them every month.

This is not optional.

Pay Yourself First

Before I give you the next steps, you need to add one more piece.

With every dollar that comes into your household, take a set percentage off the top before paying any bills.

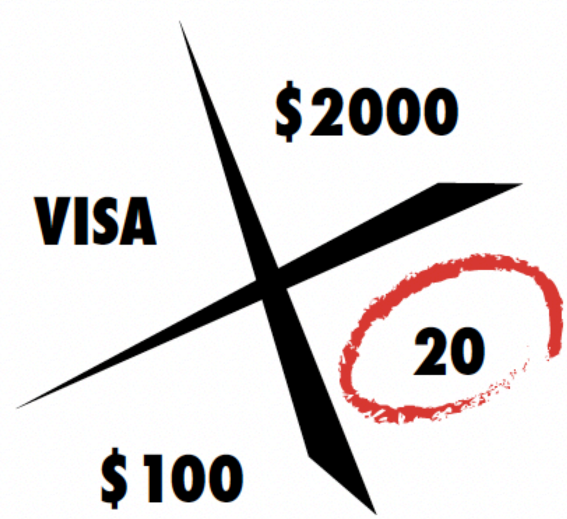
Set up three piggy banks. One for savings. One for charity. One for investing.

Commit ten percent of all income to each piggy bank. That is thirty percent off the top of every dollar.

You might start with only two percent. That is fine. What matters is creating the habit.

Do this starting today.

Step 5: Make a Visual Picture of Each Debt



For each debt, draw a square divided into four quadrants.

Upper left: Name of the debt.

Upper right: Total balance owed.

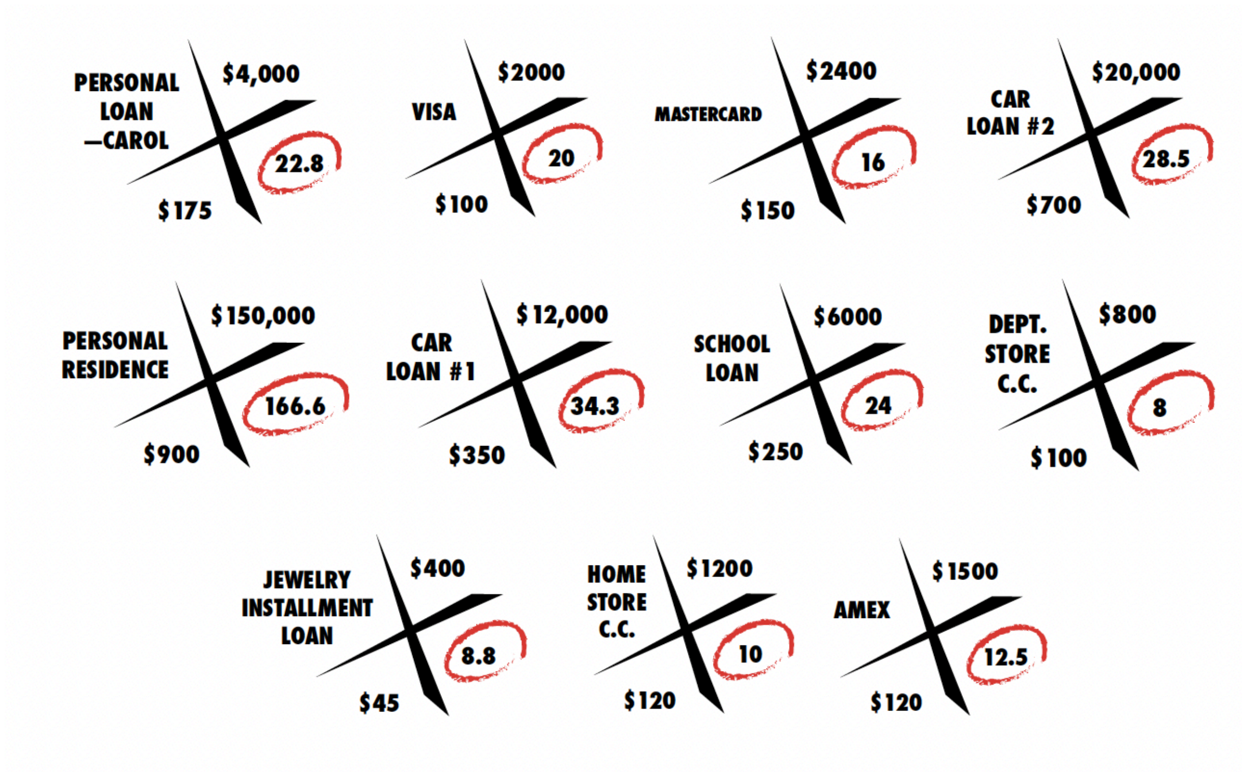
Lower left: Minimum monthly payment.

Lower right: Total balance divided by minimum payment. Circle this number in red.

For example, if you owe two thousand dollars on Visa and your minimum payment is one hundred dollars, you write twenty in the lower right corner and circle it.

That circled number is the number of months it will take to pay off that debt.

Do this for every debt on your list.



Step 6: Determine the Order for Paying Off Each Debt

Look at all your circled numbers.

Find the lowest number. That is debt number one. Write a number one next to it.

Find the next lowest number. That is debt number two.

Continue until every debt has a number.

Why not pay off the highest interest rate first?

Because you need to see immediate results. By paying off the debt with the lowest number first, you pay off your quickest debt first. You see progress fast.

This keeps you motivated.

Step 7: Find an Extra One Hundred to Two Hundred Dollars per Month

You need to find an extra one hundred to two hundred dollars per month. This is in addition to all your regular payments.

Get a part-time job. Sell things. Create a side business. Mow lawns. Walk dogs. Sell items online.

If you cannot come up with an extra one hundred dollars per month, your chances of becoming financially free are slim.

Find the money. Do not make excuses.

Step 8: Pay Only the Minimum on All Debts Except Debt Number One

Pay only the minimum monthly payment on every single debt except debt number one.

For debt number one, pay the minimum monthly payment plus the extra one hundred to two hundred dollars.

Focus everything on debt number one.

Continue every month until debt number one is completely paid off.

When it is paid off, put a big red X through it on your chart.

Then celebrate.

Step 9: Move On to Debt Number Two

Now the formula gets powerful.

For debt number two, you pay the minimum payment on debt number two plus the full amount you were paying on debt number one.

Let's say you were paying two hundred fifty dollars per month on debt number one. The minimum on debt number two is one hundred dollars. You now pay three hundred fifty dollars per month on debt number two.

With each debt you pay off, the amount you can put toward the next debt gets bigger.

This is the snowball effect. Your payments start small but get bigger and bigger.

Continue until debt number two is paid off. Put a red X through it. Celebrate.

Then move to debt number three. Pay the minimum on debt number three plus the total you were paying on debt number two.

Continue this process for every debt on your list.

Step 10: Invest the Final Payment Amount

When you pay off your final debt, you are making a large monthly payment. Maybe two thousand dollars. Maybe three thousand dollars.

When that final debt is paid off, do not stop.

Take that entire payment amount and invest it. Every single month. Forever.

This is where you go from being debt-free to becoming rich.

Imagine having two or three thousand dollars every month to invest. Money that used to go to credit cards and loans.

Now that money goes into assets. Assets that produce cash flow. Assets that make you richer.

This is financial freedom.

The Results

Let me show you what this looks like.

If you have fifty thousand dollars in bad debt and you find an extra one hundred fifty dollars per month, you can pay off all that debt in about three and a half years.

Then you focus on your home mortgage. Following the same formula, with the large payment you built up, you can pay off your home in less than four and a half years.

That means in eight years, you can be completely debt-free. No credit cards. No car payments. No mortgage.

Completely free.

Then you take that massive monthly payment and invest it. Every month. For the rest of your life.

That is how you become rich.

CHAPTER 5: OUR STORY

Let me tell you the truth about Kim and me.

In 1984, we left Hawaii. I shut down my manufacturing business. We moved to California to start fresh.

We ran out of money in three months.

We were broke. For a short time, we were homeless.

A friend let us live in an apartment above her garage.

To survive, we maxed out every credit card we could get. The debt was growing.

We worked odd jobs to pay our debts and eat. We worked sixteen, eighteen hours a day. We were still falling behind.

We considered declaring bankruptcy. Friends told us we should.

But we did not.

We decided to pay the money back. We decided to learn our lessons.

We estimated we had about five hundred thousand dollars in total debt.

We followed the exact formula I just taught you.

By 1990, we were out of consumer debt. We had paid back most of the debt.

It took us about six years.

Today, we are rich. Not just because we have money. But because of what we learned during those six years.

CONCLUSION

Years ago, my rich dad said something I will never forget.

"Robert, when your car is broken, you take it to a mechanic. The problem with your financial problems is that only one person can fix those problems. And that person is you."

Only you can fix your financial problems.

Not your parents. Not your spouse. Not the government. Not a guru. You.

When I looked at my financial statement in 1985, I realized I had failing grades. I was not as financially smart as I thought.

Facing my financial statement was painful. But it was also the best education I could have received.

By facing my mistakes, I became accountable. By improving my financial grades, I learned what I needed to learn to become financially free.

You are at a decision point right now.

You can close this book and go back to your old life. Or you can decide to change.

Whatever you decide, there is a price.

If you do nothing, the price is staying in debt. The price is stress and worry and sleepless nights. The price is staying trapped.

If you take action, the price is discipline. The price is hard work. The price is sacrifice.

Both choices have a price. You choose which price you want to pay.

My hope is that you choose action.

My hope is that five years from now, you are debt-free. That you are investing every month. That you are building wealth.

Start today. Create your financial statement. List your debts. Stop accumulating bad debt. Pay yourself first.

Take the first step today.

You will never feel completely ready. But you can start anyway.

One step at a time. One month at a time. One debt at a time.

Until you are free.

I believe in you. Now you need to believe in yourself.

Go become debt-free. Then go become rich.

You can do this.

Now go do it.