Nightingale Learning Systems

The Power of Passive Income

WORKBOOK

The Power of Passive Income

Don't Work for Money, Make Money Work for You

Your Travel Guide

Nightingale Learning Systems

IMPORTANT

To begin — Please save this workbook to your desktop or in another location.

How can you get the most out of this writable workbook? Research has shown that the more ways you interact with learning material, the deeper your learning will be. Nightingale-Conant has created a cutting-edge learning system that involves listening to the audio, reading the ideas in the workbook, and writing your ideas and thoughts down. In fact, this workbook is designed so that you can fill in your answers right inside this document.

For each session, we recommend the following:

- Preview the section of the workbook that corresponds with the audio session, paying particular attention to the exercises.
- Listen to the audio session at least once.
- Read the text of the workbook and complete the exercises.

In addition to the exercises and questions, we've created an "ijournal" to make this an even more interactive experience for you. At the end of this guide, you can write down any additional thoughts, ideas, or insights to further personalize the material. Remember, the more you apply this information, the more you'll get out of it.

After each session you are asked to create a map of your journey. Make your map colorful and interesting. Using simple images can be very powerful. Get a piece of paper and markers, crayons, or colored pencils ready.

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The Power of Passive Income Introduction

Hello, and welcome to *The Power of Passive Income: Don't Work for Money, Make Money Work for You*, Nightingale-Conant's hands-on guide to maximizing your income, minimizing your stress level, and getting the absolute most from every moment of your life – financially, emotionally, and even spiritually.

That's a very ambitious goal for any audio program, so as a way of getting started, let's look for a moment at what getting the most from your life really means. It's not any easy thing to put into words – so perhaps thinking in terms of a visual image will help. For many of us, life and career are like a battle, a zero sum game with a winner and a loser required. This is certainly a dramatic image, but it's one we're going to move away from in this program. Instead, I'd like you to think of our time here as a journey, and one that reflects the larger journey of your life as a whole. Like any journey worth making, ours has a clear objective – which is the secret of financial freedom.

How to Use this Travel Guide

As with any journey, having a guidebook can help make the trip go more smoothly. That's why we've created this travel guide to help you on your journey to financial freedom. When you're taking an actual trip somewhere, you don't just get in the car and go – you research your destination and plan your journey. That's what this travel guide will do for you!

At the beginning of each section of the guide, you'll find key ideas from each session of the audio program. We call this part Need to Know Before You Go.

Then, the second part of each section is filled with exercises to help you plan your journey to financial freedom. We call this part Your Travel Planner.

Finally, at the end of each section is a page called The Map. The idea is that you'll create a map of each of the routes to passive income that interest you. You don't have to include every type of passive income, only the ones that appeal to you. By the end of this program you'll have created your own personalized map to financial freedom!

We recommend that you **take a look at each section of the guidebook before you listen to its corresponding audio session.** This way, your mind will be primed to absorb the information. Then, **after listening to the audio session, come back and complete the exercises** in this guidebook. Finally, if you're really committed to accelerating your pace, **listen to the audio one more time**. Our research shows that the more often you hear something, the more deeply embedded the ideas become in your mind.

Are you ready to start your journey to financial freedom? Let's go!

Session 1: Your Map to The Power of Passive Income

Need to Know Before You Go

Imagine that you are searching for a secret in an alien terrain that includes many obstacles but that also includes trails and little-known passageways that bring you closer to your objective. With that in mind, you can think of this program as a map – a map that can help you in several different ways. For example, this map will identify the obstacles that stand between you and your goal. You'll see how to climb those mountains and ford those rivers – or better yet, how to avoid them altogether. At the same time, your map will disclose the quickest and most efficient routes to the source of true wealth in the fullest sense of that word. These routes are the different kinds of passive income we'll be discussing throughout the program. In your life in the real world, you may choose to follow just one of them, or you may choose to explore all of them – but please listen and learn what each one has to offer. They will all help you attain the goal that you seek. To find them, just follow the map that we're now beginning to unfold.

Trading Hours for Dollars

Over the course of a year most Americans spend more time working than they do in any other activity. You may spend a day at the beach with your family, or you may even go on a two-week vacation, but in the overall context of your life, those are just interludes. On the whole, day in and day out, month after month, most people are hard at work. What's more, the percentage of our time that we spend working has dramatically increased over the past two decades. Compared with the way we used to work, and also compared with other nations of the world, Americans are workaholics. We may not like it, or we may have never even stopped to think about it, but that's the way things are in the 21st century.

Of course, if we're going to talk about work, we need to know exactly what work means – and for most people the definition is really very clear. It doesn't matter whether you're a brain surgeon or a carpenter, a taxi driver or a trial lawyer; the fact is, work is really a matter of trading time for money. True, sometimes the trade is better than others. Some people get a lot of money for their time, while others get less. But those differences are superficial compared with the basic unifying fact: most of us are selling our time and the effort or skill with which we fill that time. It's that simple.

But there's a problem. None of us have an unlimited amount of time to sell. In fact, everybody has exactly the same amount of time. The only difference is how much we can sell it for. Over the course of a lifetime – by getting a good education, by developing a unique skill, and especially by working very hard – we can increase our income. But sooner or later, we reach the limit. Sooner or later, we're as good as we can be at our chosen profession. Sooner or later, we're charging as much money as the market can bear. And sooner or later, we just can't work any harder.

If you've reached that point, or even if you can just begin to see it looming on the horizon, this program is going to be amazingly beneficial for you. You'll learn proven, practical ways of earning income beyond the limits of the clock and the calendar. Instead of selling your time and talents to whatever buyers you can find, you'll have buyers looking for you at every moment of the day. That's the real meaning of the term passive income, which you'll be hearing again and again in these sessions.

The Power of Active Income

But it's not really the income that's passive at all. The income is very active – as active as you can make it. You are really the passive element in passive income, because all you have to do is collect. In fact, once you really get your passive income routes in place, collecting income can literally be all you have to do. True, it will take some time and effort to get there – listening to this program is part of that – but you really can achieve total self-sufficiency from passive income. Lots of people are doing it, and you can too.

Huge numbers of people don't know that passive income even exists!

The amazing thing is, huge numbers of people don't know that passive income even exists. If you're one of those people, you work hard for your money, and in order to have more money, you think you may have to work even harder. Since there's a good chance that's how you see things right now, I'm going to ask you to make a radical change in your perceptions – let's call it a paradigm shift. It's more than just changing the way you earn money or gain income. It's a transformation in the way you see money itself. It's seeing wealth and success in entirely new ways.

How Much Money Is 'Wealthy'?

Right now, for example, I suspect you see wealth in terms of a dollar amount. Mr. Smith has $20 million, so he's wealthy. Mr. Jones is $20,000 in debt, so he's the opposite of wealthy. But in order to get the most out of this program, I'm going to ask you to take the price tag off wealth. Instead of thinking in terms of thousands or millions or billions, we're going to be talking about freedom and fulfillment and creativity. That doesn't mean you're not going to be making more money – because you definitely are. However, you're going to make it because you've learned how to see money very differently than before.

The Whys Come First

In the sessions that follow, we're going to be asking and answering a lot more "what" questions than "why" questions. For example, we're going to talk about what you can do to start an online business, or what you'll need in order to develop income from real estate. But here at the start, there are a few why questions that need to be answered. Once you've got those answers in place, the tools and tactics of passive income will be a lot more effective.

So ask yourself **why you want more income.** For a lot of people, that may seem like a foolish question. Wanting more money is just hardwired into us, isn't it? It's like the old saying: You can't be too thin or too rich. But if you think about it, money is never really an end in itself. The desire for wealth is something different from just wanting to hold a lot of bills in your hand. For some people, money means access to material possessions, whether it's a big yacht or a fine watch or just a nice house to live in. For others, wealth means security. It's not having to worry about how they're going to pay the mortgage or fund their children's education. All those things are very worthwhile expressions of wealth.

For the purposes of this program, however, I'm going to suggest a slightly different way of thinking of wealth. At least initially, your goal in creating passive income will not be the same as the other financial objectives you set for yourself. In one word, what we're going to achieve here is freedom – freedom from the need to keep earning more, working harder, and trying to sell your time to the highest bidder. The passive income routes you create are going to relieve that pressure. Once the pressure is relieved, you'll have much greater freedom to make key decisions in your life – both financially and in every other area.

Wealth = Freedom

Right now, you may be in the position of having to take every assignment that comes along. For good reason, you may be unwilling to think about making a job change or a career transformation – because you're worried about missing a paycheck. In your heart you may still have larger financial hopes and dreams, but right now you're in bondage. You're tied to the time-for-money framework, and within that framework your options are very limited. Creating passive income will take you outside that box. Bondage will be replaced by freedom. Instead of just meeting your financial needs, you'll begin to make your own financial choices.

It's great to have lofty long-term financial goals – but it's going to be hard to achieve them if your single income stream goes to just maintaining the lifestyle you have now.

Passive income routes will give you the liberty to pursue your goals more aggressively. It's certainly true that the passive income ideas we'll be talking about can themselves become major income sources – but initially they are sources of freedom. They'll give you the freedom to look at the big picture of your financial life, to see the opportunities, and to act on them immediately.

By now you're probably starting to see that the concept of passive income is a major viewpoint shift. Within the time-for-money equation, most people spend their whole lives trying to achieve a big income. They think a big income will make them rich. But a big income is worth very little if expenses are just as big. People who are still working harder and harder to sell time for money are not really living the life of wealthy individuals, no matter how big the numbers are.

Parkinson's Law

This leads to a second shift in viewpoint. We've said that our initial goal for passive income is financial freedom. If you're like most people, this is a goal that will be attained incrementally over time. You may not be able to quit your day job immediately – you may not even want to quit it – but as your passive income increases, your dependence on your day job will decrease. Ultimately, of course, passive income can liberate you from needing to work at all. You may still choose to work, but that's very different from needing to.

But here's the point: whether this happens will depend not only on the amount of your passive income, but on how you spend it. To help understand this, there's a very well-established principle of workplace behavior called Parkinson's Law. This states that the time needed to complete a particular task will expand to fill the time available. If people have a two-week deadline to complete a report, the vast majority of them will take two weeks to do it – not because they need that much time, but because that's how much time they have. If they had a week to do the report or if they had a month, they would get it done in that time too.

We live in a mindset of instant gratification

For the vast majority of people, spending works the same way, or almost the same way. If we have a hundred dollars, we find ways to spend a hundred dollars – or maybe a hundred and ten dollars. We live in a mindset of instant gratification, so as soon as we have the means to gratify ourselves, we do it. But if you can get out of that mindset, it's actually possible to start building wealth even with a significantly lower income. You're going to learn how to do that in the sessions that follow.

Paralyzed by Debt

But before we go any further, it's important to address an issue that affects millions of Americans in the 21st century. Here's how one entrepreneur described this, and I don't see how it could be put any better. She said, "When I learned about passive income, I was immediately eager to get started. But there was a problem: I didn't have any working capital – and I mean not any. In fact, I had over $20,000 in credit card debt. I knew that, obviously, that was going to make things very difficult. So the first order of business was get out of that hole."

Consumer debt – credit card debt – can paralyze you financially even if you're totally up to speed in every other way. You can be motivated, intelligent, creative, and everything else, but if you're having to service debt every month, you're not going to have the small initial investment capital you need. You don't need a lot of assets to create passive income, but you do need some. You can't afford to be paying credit card bills with money that could be going toward your financial freedom. Passive expenses are just as real as passive income – and credit card debt is the ultimate passive expense. So let's take a quick look at how to get rid of it.

The first step is a bit of honest self-assessment. Many people feel so bad about their consumer debt that they actually don't know how much they have. They'd rather not think about it, so they just pay the bills every month and put it out of their thoughts. That's not the way to make credit card debt go away, however. So start by determining exactly how much you owe. Frightening as that may seem, you'll actually feel better once you have a dollars-and-cents figure to deal with. If it's any consolation, you can be sure there are millions of people who are in exactly the same boat. Well, you're going to get out of that boat, starting today.

Getting Out of Debt Takes Time

One of the challenges of consumer debt is that it can get started quickly, but getting out of debt can take time. You can put a thousand dollars on your credit card in just a few seconds – then you can be stuck with that debt for months or years. The truth is, beating debt is a gradual process, and it can seem especially slow at the beginning. But have faith. Signs of progress will begin to appear, and gradually they will begin to multiply. And remember: as you get rid of your passive expenses, your options for passive income will start to open up. Even if you don't realize it at first, you'll already be closer to the freedom that passive income represents.

When you're first beginning to attack your debt, it's important to eliminate as many unnecessary expenses as possible. In other words, the best way to build passive income when in debt is to get rid of passive expenses. This means eliminating whatever is taking your money each month while you sleep, including interest payments on credit cards, car loans, and any other recurring bills you might have. For the moment, you will want to organize your lifestyle so that your monthly expenses are at the absolute minimum. Think of this as a tactical maneuver, not a permanent condition. Because if you follow this plan, the day will soon come when you'll get everything back and more – plus, you'll really be able to afford it.

The best way to build passive income
is to get rid of passive expenses

We're not going to spend a lot of time on debt issues, because the facts are pretty straightforward. There aren't really any secrets, and the solution is just common sense. Cut back or eliminate your credit card purchases, transfer high-interest debt to lower-interest accounts, and try to pay at least twice the minimum balances each month – starting with the highest-interest debts. Think of this process as a test of your commitment to success. As your debt shrinks, your working capital will grow. Before you know it – in months, not years – you'll have the nest egg you need to really build passive income.

It Doesn't Take Much to Start

If you'd like to have an exact figure of what it will take, $5,000 is more than enough. Once you have that amount of money to build passive income, you're really ready to go. Assuming you're at that point now, keep in mind the principles we've discussed. First, the erroneous belief that wealth is based on a dollar amount. Second, the injurious tendency to spend everything we have, whether it's on consumer purchases or consumer debt. These principles affect not only our day-to-day experiences in the retail marketplace, but also our investment behavior.

When people start saving for retirement, it's not unusual for them to set a goal of $1 million. They keep putting money into a 401(k) or some other investment vehicle until they reach the $1 million target. Then several different things can happen. A certain number of people will think they have so much money that they start spending the principal. They may not spend very much at first but it adds up. There's a kind of self-sabotaging mechanism in this. Something similar often afflicts lottery winners, because studies have shown that many winners end up spending their jackpot in two years or less.

The Principal of Principle

But suppose an individual doesn't spend the million dollars that's accrued over the years. Well, even if he or she keeps it in dividend-producing stocks or treasury bonds, the payout is relatively low. If you choose a conservative strategy, which is what most advisers would recommend, you could expect to earn about 5 percent annually. That's approximately $4,000 per month. It's not an inconsiderable sum. It can definitely help achieve the kind of financial freedom we're talking about. But if all you've done during your career is fund your IRA, that freedom has probably come at the price of many decades of bondage. In this program we're going to show you how to do considerably better than that, and without increasing your risk.

A key piece of information in passive income is the amount of money you need to live without working.

A key piece of information in passive income is the amount of money you need to live without working. Clearly there are two factors to consider here: how can you maximize your income, and how can you manage your spending? If you have very extravagant tastes, the amount of money you need will obviously have to be larger. You just need to be aware of that fact. It doesn't mean you have to live in a cardboard box in order to benefit from passive income, but you shouldn't expect to be buying private jets either. Anyone who tells you different is not being honest with you – and one thing we're going to be in this program is honest.

Income Greater than Expenses

Very simply put, **our ultimate goal is for your passive income routes to be greater than your expenses.** When that happens, you're free to do anything you want with your time, and your bills will still be paid. Needless to say, you're also free to keep working in order to become really wealthy if you so choose. But you don't <u>have</u> to do anything. That's the objective – and you will achieve it when you start using the tools you'll gain in this program. I'll have more in a moment.

Leveraging Money

In creating passive income, there's one word you should always keep in mind. The word is *leverage*. In financial terms, leverage is the ability to multiply an asset without increasing your investment or your risk. This is especially important for people who are building passive income without much capital at the outset.

There are lots of ways to do this. Later in the program, for example, we'll be looking at opportunities for real estate investment. Bestselling authors like Robert Kiyosaki and Bob Allen have done great work in showing how passive income can be developed in that area. As they've pointed out, it's possible to buy a $100,000 house with a down payment of only $5,000. That means you can leverage $5,000 into control of a $100,000 asset. If the house appreciates 5 percent per year, you'll recover your investment after only 12 months, and then you'll continue to get $5,000 for every year that follows.

But that's not all. There are a number of other variables that can work for you in real estate. Suppose you're able to buy a single-family rental property for no money down, and you find a tenant who pays enough rent to cover the monthly expenses. You may not make much profit in terms of cash flow, but there's also a good chance that the house will increase in value – and by the end of a year, you'll have paid down part of the mortgage. Through the power of leverage, you've gained significant assets with no investment except your signature.

Leveraging Time

Time can also be leveraged, just like money – and since freeing your time is one of our major goals, knowing how to do this is a key skill. There are several ways that time can be leveraged. For example, you can hire an employee, or maybe even more than one.

There are many other low-tech options for leveraging your time and money, but the high-tech options may be even more exciting. When you understand the strategies and tactics of passive income through the Internet, you can have dozens of income routes with almost no expense, no employees, and very little time at the keyboard. This will be our focus in the next two sessions. But first, let's go to Your Travel Planner.

Your Travel Planner

Before you begin your trip – Where are you now?

What is your current job? How many hours per week do you spend working? What rate are you selling your time for?

What are some ways you've used to increase your income? Describe the classes, skills, promotions, or other avenues you've explored to make more money.

How much money would you need to be wealthy? Write down the specific number you've had in your mind.

Why do you want to become wealthy?

What would having that amount of money give you? What are the qualities of life that you would have if you were wealthy?

How much debt do you have? Make a list here of every single debt you have – credit cards, car loans, student loans, mortgages … everything. Don't think of this as a comment on your character; you're just writing down the facts.

What are your passive expenses? Do you really need two newspaper subscriptions? Are you paying hosting fees for that website you've been meaning to build? Take a look at your monthly expenses and see if there is anything you're not using. It's easy to free up several hundred dollars a month just by doing this!

What do you spend your money on? Do you eat out too much? Buy ringtones for your phone? Video games? What purchases are you making that eat up your money?

How much money do you need to live on each month?

Do you have extravagant tastes, or do you enjoy simple pleasures?

The Map

To begin creating your map, think about your starting point. Where are you now? Create some sort of visual depiction of your current state. It might be a drawing of a prison, which represents debt - or it might be an "unhappy face" to represent your current emotional state. Jot your where-you-are-now symbol on the top of a large sheet of paper and leave the rest of the page blank. You'll fill in the rest as you go along.

Session 2: Building Passive Income on the Internet, Part One

Need to Know Before You Go

As you follow our map to financial freedom, you'll find there are many routes to your destination. There are many ways to build passive income – but all of them depend on a conceptual shift you'll need to make as soon as possible. You'll need to start thinking in a fundamentally new way about money and how to get it. This is especially true for our topic in this session and the one that follows – in which we'll be discussing the many income-producing opportunities that are available on the Internet.

Internet Businesses Are Different – But Not Completely!

Since online businesses didn't even exist until a few years ago, there's obviously been a learning curve involved for anyone who was used to traditional business models. But part of that leaning curve includes a very important fact. Yes, Internet business is new and different in many ways – but in some ways it's not nearly as different as you might think. Knowing what's unique about online commerce is only useful if you also know what's not unique. In fact, that's also true of passive income as a whole.

Five Basic Differences

Right now let's take a look at exactly what this means. I'm going to introduce five basic differences between passive income and the traditional time-for-money model. As you listen to them, ask yourself where you stand with respect to each point. There are several different possibilities. For example, you may already feel completely comfortable with the passive-income philosophy. Or you may need to get beyond your present mindset, which may require some creative thinking on your part. As we mentioned in the opening session, accurate self-assessment is very important. Then, after we've looked at the five points, we'll see how they connect to our topic in this session, which is creating passive income online.

1) Passive income works best when you first focus on what you know and what you love. The traditional model, on the other hand, focuses on what the marketplace wants to buy.

2) Passive income means that the amount of money you make is not tied to the amount of time you work. In the time-for-money model, if you work six hours you get paid for six hours.

3) Under the traditional model, you should try to work as hard as you can – because the harder you work, the more money you'll make. But one of the most important objectives of passive income is to work as little as possible. Since there is no direct connection between your amount of passive income and the time you work, freedom from work itself is a logical goal.

4) Time for money means there is a limit to the amount of income you can generate. Depending on your line of work, this may be higher or lower, but there's always a limit. A corporate lawyer might make three hundred dollars an hour, but there are still only so many hours in a day. But there is literally no limit to the money that can come from a successful passive income business.

5) In the traditional time-for-money paradigm, the goal is retirement after an extended working career. It may be 20 years or 30 years or even longer than that, but the plan is to build up enough capital so you can stop working. The returns from that capital may come to you in the form of a pension or as payments from a retirement fund. But the money that you've accumulated is going to be supporting you.

With passive income, the goal is to stop working as soon as possible, if you so choose.

You may want to keep having a full- or part-time job, but you won't need one in order to meet your expenses. You'll be supported by the revenue sources you've created – not by the fixed income of pensions or retirement funds. In fact, your passive income routes should be the opposite of fixed. Those routes should be growing continually broader and better paved. They should provide the way not only to financial freedom, but also to more options and opportunities in every area of your life.

I Want to Be Wealthy – Or Do I?

One of the most interesting things about financial success is the way people have mixed feelings about it – feelings that they might not even know they have. Sure, we all say we'd like to be wealthy – but underneath the desire for wealth there's often a certain degree of unconscious conflict. Do we think rich people are good people? Very often we don't – and whether we realize it or not, most of us would rather be good than rich. And if there's a sense that a person has become rich without having earned that wealth through honest labor, the negative ideas we attach to wealth become even stronger. Yet here we are talking about how passive income can bring revenue without your doing any work – and what a good thing that is.

Work Is Rewarding, and Other Beliefs

Have you ever really explored your beliefs about money and how to get it? If you're like the vast majority of people, those beliefs didn't come to you by choice. Instead, over the course of many years you absorbed the pre-existing beliefs of our society. One of these is the idea that "work is its own reward." Another is the general scarcity consciousness of "there's not enough" and/or the fear consciousness of "disaster could happen at any moment." The bottom line is, you may have grown up with the idea that "money is dangerous," or even "money is evil." If that's the case, chances are, you're not going to bring a great deal of money into your life. But no matter what your beliefs are or where they come from, you have the power to create new beliefs to accomplish your financial goals.

You have the power to create new beliefs to accomplish your financial goals.

Please don't misunderstand. I'm not saying you need to work through a moral crisis in order to feel okay about some extra income. But you should understand how radically different this is from concepts of wealth that are deeply ingrained in our society. Consider the idea that "work is its own reward," for example. Basically, this means that people benefit from hard work whether or not they make any money from it. This may be very true in terms of an individual's spiritual development – but work is definitely not its own reward when it comes to someone's financial standing.

Working and Passive Income Are Inversely Proportionate

With respect to passive income, we can make an even more extreme statement. In mathematical terms, this extreme statement can be made in just a few words: <u>work and passive income vary indirectly</u>. In other words, if you spend a lot of time working, your passive income is likely to be low. But if you spend very little time working, your passive income is probably high and getting higher. So for our purposes here, you'll want to embrace the idea that **hard work is not the way to success.** You'll need to really feel comfortable with that.

Replacing False Beliefs

One of the most widespread beliefs is that **making money is very difficult**. It's too hard and complicated for the average person. You've got to be a genius like Bill Gates. But the truth is, millions of people have become wealthy, and millions more are going to in the very near future. You can be one of them. If you <u>want</u> to do it, you <u>can</u> do it.

There are also many people who tell themselves that they **don't like to think about money**. They might enjoy having more of it, but they don't really want to focus on it. They tell themselves that maybe, if they don't really concentrate on it, wealth will come into their lives all by itself. But in reality, we all have to think about money whether we want to or not. And the less we have of it, the more we have to think about it. We all have to pay the electric bill, pay the mortgage, put our kids through school, and spend money on a thousand other things.

So remember: the income routes you'll build with this program aren't ends in themselves. They're vehicles for setting you free in a financial sense. Once you're free, you can stop thinking about money altogether if you so desire. Or you can think about it more than ever, and in completely new ways. But the choices won't be forced upon you. You will make your own decisions about the place of money in your life.

Another common belief is the opposite of the idea that making money is hard – or that it requires special abilities. This is the idea that **wealth happens by chance**. It's a matter of being in the right place at the right time. You just have to be lucky – and if you're not lucky, there's nothing you can do about it. But would you say that the top individuals in any field got there just because they're lucky? Does a baseball player hit a home run just because he was lucky enough to get a good pitch? Does a poker player win a world championship just because he got the right cards? It's true that chance plays a part, but you've got to be able to make the most of the chances that come your way.

It can definitely be useful to think of making money as a game, but there's more to it than just rolling the dice. The game of making money is challenging and fun, and it becomes more fun once you learn how to play it well. And the amazing thing is this, you can even teach the money-making game to play itself. That's really what passive income is all about.

As you can see, there are lots of mistaken beliefs about money, and they've led many people astray. So as we move ahead in the program, keep the following facts about money in your thoughts. These are not just beliefs; these are the truth.

Money is Good

It's not wrong or unspiritual to want to earn money without working hard for every penny. Your prosperity does not detract from anyone else's. The world is a place of abundant opportunities, and we should be grateful for the chance to put those to work. Wanting to be financially successful is not wrong. It's perfectly natural. And since you are a good person, you will put your money to good use. So the more money you have, the better the world will be.

Your prosperity does not detract from anyone else's.

Internet Business 101

There are two basic ways that successful businesses get started in any field, and Internet businesses are no different. The first way involves a couple of people sitting down at the kitchen table and trying to think of a great way to get rich. For some reason, this is rarely done by a single individual. It's usually people who have known each other for a while and who know each other's strengths and weaknesses. Google, for example, was started by two friends – Sergey Brin and Larry Page – who understood the moneymaking potential of a dominant search engine. Internet search engines weren't their favorite hobby. Instead, search engines were the vehicle they wanted to use for building wealth. And it really worked!

But it usually doesn't work. For every Google jackpot, there are millions of brainstorming fools who got nowhere. I know that sounds like a severe statement, but it happens to be true. That's why it's usually a red flag when someone says, "I've got a great idea that's going to make a lot of money." If the only reason it's a great idea is because you think it's going to make a lot of money, you're probably wrong on both counts. It's probably not going to make a lot of money, so it probably isn't a great idea either.

Which brings us to the second way businesses get started, and it's a much more encouraging picture. Unlike the scenario we've just discussed, this one usually involves just one person. It begins with that person asking a few of simple questions: What am I really interested in? What do I know about? What do I care about? What do I <u>love</u>?

At the outset, the answers you come up with are less important than the positive energy you attach to them. If you're really interested in the career statistics of 19th-century baseball players, that's great. Make a note of it. You may think that nobody else could possibly care about who played first base for Mudville in 1886, but you'd be surprised. There are probably at least ten thousand people who are as interested in old-time baseball as you are. But what's different now is, you can find out who those people are. You can connect with them almost immediately. And there's a good chance that you can translate that connection into passive income. It might make you rich someday, or it might not. But what it can certainly do is assist you in meeting your financial responsibilities. That means greater freedom for you to concentrate on other things – and remember, freedom is our first goal in creating passive income.

Use the Internet to Research Your Passion

Here's how to go about it – and this is where the Internet comes in. Once you've identified your unique interests, you can start searching for every possible link to that interest out there in cyberspace. You can see if there are any clubs of baseball fanatics who like to play games in 19th-century uniforms. You can search for people who have an interest in baseball statistics, which is actually a huge demographic. You can see which websites touch on your interest, even if it's only in a very minor way – and then you can get ready to access the members' database.

Unique, Not Big

For the moment, we're going to emphasize the uniqueness of your interest, not the scale of it. A hundred years ago, Henry Ford wanted every family in America to own a Model T. Much more recently, Bill Gates said that Microsoft's goal was to get a personal computer into every home in America. Those were big ideas. Big ideas are great – and they can be very profitable. But they're also harder to come up with, and they're more complicated because your potential customers are more diverse. You may have to work harder to find the common interest. In fact, you may even have to create an interest where one doesn't exist initially. You can find people who like old-time baseball, but people needed to be taught to like personal computers.

In any case, **the fact that your idea may begin on a small scale doesn't mean it can't make money**. And your idea may actually be much bigger than you think. So once you've identified your interest and done some Internet research on it, you're ready to start building on that. You're ready to make the connection between what interests <u>you</u> and what <u>other people</u> find interesting. There are times when it's easy to make that jump, and other times when it's more difficult. But one thing is certain: the more sharply focused your idea is, the easier it is to translate into some level of passive income.

Internet Business 102

Making money on the Internet has been the dream of many people in recent years – and for most people it has pretty much remained a dream. To see why that's happened and to see how you can be different, here are several things to keep in mind. First, an overall strategic point. With any innovation, there is a cycle of interest that goes through several phases. For example, when motion pictures first became available early in the 20th century, audiences were entranced simply by watching a horse run on the screen. But things quickly got more complicated. People wanted to see stories and they wanted to see movie stars. They also wanted to see color photography. As soon as color pictures appeared, black and white seemed like ancient history.

In the same way, when the Internet first started it was amazing that it existed at all. Emailing and instant messaging seemed like miracles. But the same thing happened to the Internet that took place with motion pictures, and in a much shorter time. The technology that seemed so remarkable at first was quickly taken for granted.

Less Is More

What can we learn from this in terms of building passive income on the Internet? Does it mean you need to build an elaborate website with all the bells and whistles in order to attract attention? At first glance, that might seem to make sense. After all, if people want excitement, shouldn't you try to give it to them?

Well, the answer is no – for two reasons. First, unless you have an unlimited budget, you will never be able to build a website that excites your audience simply from a technological perspective. By this time we've just seen too many websites to be thrilled by another one. So this is a situation where the "less is more" rule definitely applies. As we begin to explore making money on the Web, we're going to minimize the technical issues. We're also going to minimize the costs – first because cutting expenses is usually a good idea, but also because putting money into website technology just doesn't bring returns. There are many ways – through Google, Yahoo, and Microsoft – that you can build a blogspace that will completely fulfill your needs. More important, it will also fill the needs of your potential customers.

Who are Your Customers?

Now you're ready to start identifying exactly who those customers are. We're going to identify them using three different categories – an objective measure, a subjective measure, and a third classification that we'll call "ECB," or expected customer behavior. Let's look at these three categories in order.

Basically, the objective measure refers to anything you can say about your customers through numbers. For example, are you able to determine what age groups are most interested in what you have to offer? If we return to the old-time baseball concept for a moment, males over the age of 35 or 40 would probably form most of your Internet viewers. That just seems intuitively right, although if you feel like researching that information, there are ways to do that. You can find out how many people have visited websites devoted to your interest. You can also find out how many people have done Web searches for phrases like "early baseball" or "history of sports." But that kind of research is usually not effective in terms of cost and time.

Chances are, you yourself are probably your best source of objective information about a specific interest. Most of the people who share your interest are probably much like you. That's especially true if you've found a very specific interest, as we suggested. There may be millions of people who follow NFL football, but a lot fewer are interested in what baseball was like a hundred years ago. And remember: that can work to your advantage. Even if there are only a thousand people in the whole country who share your interest, if you can get them all to send you ten dollars a year, then you've got a significant amount of passive income.

Subjective measures of your potential customers are those that aren't expressed simply in numbers. They're generally understood anecdotally, or in combination with a numerical analysis. For example, during presidential election debates, almost every candidate for the past 30 years has worn a red tie. It's just something that voters want to see, and it goes beyond objective categories of age, income, or geographical location. Focus groups show that both men and women respond more positively to someone in a red tie rather than a blue one. It's just a gut feeling that people have. It's totally subjective. But it's a fact, so why fight it? All the candidates wear red ties.

It's important to be aware of the subjective issues of your potential customers. For instance, in every field of interest there are certain phrases, certain names, and certain ideas by which people recognize each other. We can call it *jargon*, although that word may have a negative connotation. It's really just a set of beliefs that a group of people share, and that provides the starting point for a possible relationship. If you want to bond with someone who likes motorcycles, for example, you might want to mention the classic Indian brand of motorcycle that was popular in the 1940s. As soon as you bring that up, a motorcycle enthusiast will know that you have a certain level of interest. But if he or she mentions the Indian motorcycle and you have no idea what it is, it's clear that your interest is less deep. So think about what those subjective touchstones might be for your potential customers, and make sure that you put them to use.

The final element in your customer profile concerns the beliefs that a customer has of you, your website, and any product or service you will provide. This final element also includes the beliefs you have about your customers. All of this can be referred to as ECB, or expected customer behavior. And regardless of what kind of a passive income business you intend to create, I can give you three very specific pieces of information about expected customer behavior right now.

First, if you expect anyone to pay you $20 or more through your website, that expectation is very misplaced. Web customers just aren't going to do it. But there's another side to this coin. Web customers also expect that you will in fact ask them to spend $20 or more – so if you refute that expectation by asking for less, you have a good chance of making a sale.

Second, if you labor over your website or blog in the expectation that visitors will explore every corner of it, you will be disappointed. Even if Web visitors are passionate about a particular topic, the vast majority of people stay on a site for less than five minutes, and often less than one minute. That's another reason why a simple, well-organized website is better than a more elaborate one. So put your best information up front, show the visitor what you have to offer, and make responding to that offer as quick and easy as possible. That's definitely the most efficient route for building passive income.

Finally – although it's true that elaborate websites are a mistake – there is one aspect of a website that you need to take very seriously: **You must update your website as often as possible.** Ideally this should be done every day, or every two days at the outside. This is probably the single most important fact you need to know about a website business of any kind. Visitors quickly learn how often a site is updated, and they will return accordingly. That's another reason why blogs are so much better than more complicated sites. It's easy to update a blog on a daily basis. Because some blog sites prohibit selling, you may have to have a link to a very simple website – but this is not always true.

The few minutes you spend updating your site are the absolutely essential foundation for building passive income on the Web.

We'll have more to say about this and other aspects of Internet business in the next session. We'll also look at experiences of people who were exactly where you are now on the map toward financial freedom – and we'll see how they arrived at exactly where you want to go. But first, let's update Your Travel Planner.

Your Travel Planner

To uncover your subconscious beliefs about wealth, think of someone you know (or know of) who is wealthy, and describe that person here:

What positive traits did you describe? What negative traits did you describe?

Write down some of your beliefs about money, wealth, and work. Examples include “Work is its own reward,” “Wealthy people are selfish,” and “Money should come from hard work.”

What is your opinion of someone who got wealthy without earning the wealth? This might include marrying into money, inheriting large sums of money, or winning a lottery.

How many hours a week do you work? Are you comfortable with the idea of working less for more money?

For the following beliefs, give one example of when you have seen that it is true, and one example of when it was false:

Making Money Is Hard.

I Don't Like to Think About Money.

Becoming Wealthy Is About Luck or Chance.

Next, write a sentence about why each of the following statements is true for you:

Making Money Does Not Have to Be Hard.

Having Enough Money Frees Me from Thinking About Money.

Becoming Wealthy Is About Maximizing Opportunity.

What are you really interested in? What do you know about? What do you care about? What do you love?

Now, put this guide aside for 15 minutes, go online, and spend some time researching your passion. After 15 minutes, write some of your findings here:

Who are your customers? What objective measurements are there about them? (demographics, numbers, statistics)

Who are your customers? What are the subjective qualities of your customers? (personality traits, preferences, jargons, ideas)

What are your ECBs (expected customer behaviors)? Do you expect them to buy your products, read every page of your website, etc.?

The Map

Time to work on your map! If you think that developing an Internet business is an interesting route to passive income, map your route to success. At the top of your map page under the symbol of where you are now, jot down words or a symbol that will represent the start of your Internet business, and at the bottom, words or a symbol that will show the goal of your Internet business.

In between the start of your route, at the top of the page, and the goal of your Internet business, at the bottom of the page, give some tools that will help you down your path to your goal. You might like to depict these as an express lane or a GPS. Also jot down some of the obstacles you might face. Negative beliefs, misperceptions about money, and false expectations of your customers are examples of obstacles. You might enjoy depicting these obstacles as holes, rocks, land mines, or sand traps.

Be sure to leave room on the page for other passive income routes that you might want to follow as well. (Turn to the map on page 118 of the guide for a sample map, if you need one.)

Session 3: Building Passive Income on the Internet, Part Two

Need to Know Before You Go

In this session we're going to move ahead on our trail toward passive income on the Internet – and we'll also be hearing from some people who have already arrived at our destination. With them, you'll see both the obstacles and the opportunities of Internet business. As you'll discover, the Web is a new and unique way to develop passive income – but as in any other business, you've still got to put the customer first.

When I decided to start an online jewelry business, I already had my own line of inexpensive but sophisticated jewelry. I had rings, earrings, and necklaces. These were pieces I'd developed over a period of years. I was confident that there were large numbers of buyers for them – but so far I had only sold at art fairs and flea markets. I knew the Internet was going to be a very different game. I knew everything about my product, but I knew almost nothing about the electronic marketplace.

So I got a few books about website design and Internet marketing. They were useful, but what really helped was understanding my own likes and dislikes when I make a purchase. In thinking about it, I was surprised that I basically looked for the same things when I bought online or when at the mall.

For instance, I really dislike waiting in line. I may spend some time walking around a store to find something I like – but once I've found it, I want to complete the purchase as quickly as possible. That means I don't want to wait very long for a salesperson to check me out, and I really don't want to run into some sort of technical glitch. Even in really big stores, it's amazing how often I'll hear, "The computer is down." When that happens, it's just a chance for me to change my mind about even making the purchase in the first place, and I'm sure other people feel the same way.

I realized that I felt the same way about shopping online, but even more so. It seems like everything gets compressed on the Internet. You want it all to move very quickly. You might spend 20 to 30 minutes wandering around a store, but the average time on a website is a tiny fraction of that. People just want it to happen really fast and efficiently.

When it doesn't happen that way – especially when they're actually completing the purchase – they don't just get annoyed, they actually get scared. They worry about what's going on with their money. If they've a credit card number and the whole buying process suddenly gets stalled, they don't know what to do. They're wondering if they should click on the "submit" button again, but they're also afraid they might get double billed. You don't want that sort of thing to happen if you intend to develop repeat business – and repeat business is the absolute foundation of passive income on the Internet. And what you really don't want is *for the buyers to do something that's much easier than walking out of a store. You don't want them to click "cancel" with their mouse and exit the website. If that happens, you've lost a sale, and you can also be sure they're never coming back to your site.*

Tips to Keeping It Simple

This raises a key principle. In an earlier session, we saw that less is sometimes more when it comes to online income. Try to keep your site as clean and simple as possible – and make this especially true of the payment process. More than half of all buyers cancel at the last minute, during the final process of entering their personal information and receiving approval. That 50 percent figure goes even higher if you ask for any additional information. Most often, people disconnect because of the slowness of the process. If they've gotten this far, they want to buy your product, but they're frustrated. So you've got to make it easy for them.

You can do this by **linking your site to a payment service that will process the billing**. Many such services are available, and it shouldn't be hard to find one that's right for you. Think about online purchases that you've made that have gone smoothly – especially when the billing has been outsourced to a payment service. Then contact the website and get a referral. This should be no problem, especially if you identify yourself as a satisfied customer. You might even be able to create a linking relationship with that site. We'll have more to say about linking in a moment.

If you choose to handle credit card payments yourself rather than through a payment service, be sure to **include some text about the security of a purchase**. By federal law, customers have the right to dispute credit card charges if they don't get what they were promised. They can also dispute any unauthorized charges that appear on their credit cards – all of which have zero liability policies. That means card holders pay nothing for unauthorized use. Federal law requires that online orders be shipped by the date promised. If no delivery time was stated, the order has to be shipped within 30 days. Late shipment means customers can cancel the order and get a refund. They also have the right to reject merchandise if it's defective or was misrepresented. Make this safety information available to your customers. It builds confidence in your business.

Many of the most successful Web businesses **offer free delivery** with orders above a certain amount. But this doesn't mean that the delivery is really free. If you offer free delivery, you can and should build the delivery cost into your price – but now you can use the powerful word *free* in your offer. And you'll be surprised by the number of people who increase their orders so that they can get free delivery.

A **no-questions-asked return** policy is also a good idea, and you should feature this prominently on your site. Once again, this is a real confidence builder – and the fact is, very few people actually return a purchase if you give them what they expected to receive. Once or twice a year you may have to eat a return that may not be legitimate – but as a cost of doing business, it's definitely worthwhile. In fact, one of the best ways to build good will is to treat someone well when he or she makes a return. Very often you'll quickly get a new order from that same customer.

You may also want to offer **discount coupons for return customers.** Once you've gotten buyers' Internet addresses, start sending emails with information on how they can get a lower price on their next purchase. Make these offers time sensitive. That means the order has to be placed by a certain date or the discount will expire. At the time of their initial purchase, be sure to alert your customers that they'll be getting these discount offers in the future. This will make it less likely they'll treat your emails as spam.

A good way to present discount coupons is in an email that you send to confirm a first order. This is a chance to **start building long-term relationships with your customers**. After all, the buyers have just sent you money for the first time. Even with all your assurances and protections, there's bound to be a little uncertainty. Don't ignore that. Thank them for their order, and thank them for their trust. Use that specific word, *trust*. Then include the discount coupon – it's usually a number they can enter with their next purchase. And finally, make sure that you fill the order promptly and completely.

The online jewelry business we've just heard about can be very successful – but in terms of passive income it may not be the ideal enterprise. That's because of the fulfillment issues that simply can't be avoided. For example, the purchases will need to be inventoried, boxed, shipped, and possibly insured. It can get complicated. Wouldn't it be much easier if buyers could just download a ring or a necklace right into their homes? Maybe that kind of teleportation will happen someday. We aren't there yet – but there are definitely some great ways to streamline delivery issues. To see how this can work, let's hear from another Internet entrepreneur:

> *I always liked to take wildlife photos, but I never gave it much attention. Part of the reason was the cost, and also because of the time that was involved. In the days before everything went digital, there was the cost of the camera, the cost of the film, and the cost of the developing process. All those costs had to be paid before you even had anything to look at. But as we know, everything changed when digital cameras came on the market.*
>
> *For me, digital photography was a really wonderful innovation, both personally and professionally. On a personal level, I had always been interested in taking pictures, and now the hassle factor was hugely reduced. And from a business perspective, I realized that digital pictures were the ideal product to market on the Internet. That's because the delivery process was entirely electronic. Buyers could preview the images I had for sale, pay for them with a credit card, and then download them instantly.*
>
> *At first, I was amazed at how simple it was. I was able to build and maintain a very functional website for about $50 a month. I also had no trouble setting up credit card payments. I had some interesting wildlife photos that I had taken in Yellowstone, and I offered them for sale on my website for a few dollars each. Once again, there was a pleasant surprise. It took only a few days to make my first sale. When that happened, I really felt as if I had stumbled upon a moneymaking machine. And I was actually right about that. The Internet really is a machine for finding multiple routes to passive income. For me, the problem was that I didn't really know how to operate the machine yet. After making three small sales in the first week my site was up, I didn't make another sale for more than a month. I had more to learn than I thought.*

Intellectual Property

There are several important points here. First, if you want to create passive income very quickly, Internet marketing of photos or other forms of intellectual property has many advantages. You can avoid all the issues of creating and shipping a physical object such as a piece of jewelry. And whether you realize it or not, **you almost certainly have the raw material for creating intellectual property right now.**

Everyone has a story to tell – so it's just a matter of putting your story into a marketable format. There are people who have written about how they got out of debt, for example – and there are even people who have written about how they got <u>into</u> debt. If you're a parent, you can tell what you've learned from raising your children. You can write about fly-fishing or firefighting, cooking or carpet cleaning. You can even write about writing – and if you can't write, it's easy to hire someone who will write for you. Just put a small ad in a local college newspaper. For very little money, you can hire an English major or a journalism student to help you.

As you're getting started, don't be intimidated by the technical aspects of Internet marketing. You don't have to be a computer genius to have a perfectly good website. A quick Google search will give you many sites for website creation that include the ability to accept credit card payments.

That's the good news – but there's also the other news. It's not really bad news, but it does address some real facts of website business. A moment ago we heard from an entrepreneur who had a few quick sales of his photos. But then he hit a dry spell – with no sales and a diminishing number of visitors to his site. Why did that happen? And why does it continue happening to Web entrepreneurs, even when things seem to go well at the beginning?

A Step-by-Step Method for Building an Internet Business

To answer these questions, we're going to introduce a step-by-step method for building an Internet business that will consistently generate passive income. Quite simply, these are the moves you need to make. They don't cost a lot of money, but they do require a commitment on your part. You need to commit some time, and you need to commit yourself to learning what you need to know. By making that effort at the beginning, your biggest task in the future will be keeping track of the money that's coming into your site.

You need to commit some time, and you need to commit yourself to learning what you need to know.

Step One: Give Your Customers Instant Gratification

Essentially, any business is a system for serving the needs of clients or customers. A website business is a system for serving those needs with the amazing speed and efficiency that technology has made possible. Regardless of what physical product or intellectual property you're selling, here's the first thing you need to understand: **people want things to happen fast on the Internet**. You're selling instant gratification, and you've got to provide that before anything else.

The buzzword for this in website business is "shallow." The shallowness of your site refers to the number of clicks that are needed to perform a certain function. The fewer the clicks, the shallower your site will be. Keeping your site shallow is extremely important, especially in the buying function. Earlier we mentioned how customers dislike waiting in line in retail stores. Well, they really don't like waiting on the Internet. So when you select a program for building your website, make sure that the checkout process is as quick and efficient as possible.

Step Two: Create Some Energy on Your Site

Assuming your site operates quickly and correctly, what else do customers like on a commercial website? People want to feel some energy from the site. They like to see some pictures. They like to see color. They like to see graphics that are creative without being overwhelming. If you've done a good job of setting up your site, providing these enhancements will cost you next to nothing.

What nobody likes on a website is a lot of text in a bland format. Online customers usually don't make a purchase on their first website visit – but **they'll come back if the visit was good** – which means interesting, entertaining, and quality-driven. A good visit means more seeing rather than reading. Good is wanting to see everything that's on your site today, and wanting to come back tomorrow to see more.

Step Three: Update Your Content

This is a really crucial point. Potential buyers will come back to your site if their first visit was good – but what will they want the second time? They'll want it to be good again, but **they'll also want it to be different**. They won't want to see the same thing all over again. So you've got to continually update your website. In fact, *continually* isn't a strong enough word. You've got to <u>constantly</u> update your site. Nothing is worse than a site whose last update was three months ago – and it's amazing how often that happens! If customers feel that you've ignored the upkeep of your site, they'll suspect you might ignore them also. When that happens, the mouse goes click. So keep your site up-to-date.

There are two very easy ways to make sure your site always has something new. The first is by **adding a website forum,** which is an area for customers to provide comments and feedback. Be sure that your site builder program includes the ability to add a forum. You may find that the same two or three people account for most of the comments, but that doesn't mean that more people aren't reading them. As customers become used to buying online, they feel at home using forums and they exchange information freely. So this is a great way to build a sense of community into your site.

Another easy way to keep your site current is by **adding a blog**. This will also let you bring some of your own personality into the site. It will give visitors the sense that they're doing business with a human being and not just a machine. The word *blog* is actually a contraction of *web log* – meaning a diary or journal that appears on an Internet website. Right now there are millions and millions of blogs, and some of them are hugely influential – politically, culturally, and commercially.

As a Web entrepreneur, having a blog on your site is an opportunity to do some really valuable things. It lets you bring your personality into your business and give it your own flesh-and-blood identity. Creating a blog for your site doesn't have to take a lot of time. Sometimes an entry can be just a link to an interesting newspaper article or website you discovered. Blogs are a rapidly evolving medium, and there's a lot to learn about them. To see how they're evolving, visit http://blogsearch.google.com. You'll be able to see blogs on every possible topic.

Beyond what you're selling and how you sell it, blogs and forums provide value-added content for your site. Marketing jewelry, books, or nature photos can be your front end, and you should provide excellent value and customer service there. But you'll sell a lot more of your product if people come to your site even when they don't need to buy what you're selling.

Once you get into a rhythm with your website, there are lots of other options you can explore. You can offer subscriptions to a weekly or monthly email newsletter, for example – or you can create a members area on your site with discount coupons and other benefits.

When you make the effort to add value to your site, people will start coming just for that value – but all those people will become buyers in a very short time.

Besides creating passive income, a Web business is a chance to create real online relationships. Your website can express your personality and your creativity as well as sell your product. Making this happen is really the fun part of Internet commerce. It's a way to make friends as well as make money. Building passive income doesn't get much better than that.

Step Four: Use Reciprocal Links Get Customers to Your Website

We've seen how you can create and build confidence in your Internet business, and how you can deal effectively with customer service issues. We've also discussed the critical need to keep your site updated. But one other major concern needs to be addressed. Suppose that you have a website that markets a cookbook that you've created using old family recipes. You've done a good job of keeping your site shallow, and you have a steady flow of buyers. You've done a great job of setting up an efficient website, but you're still limited by the number of customers who actually find and visit it – and as we'll see in a moment, making your site findable on the Internet is no simple matter.

Fortunately, you can actually get other websites to solve this problem for you. **One solution is called reciprocal links** – and knowing how to use them is absolutely essential for a website business. It's really very simple. First, do a search for websites that serve the same customer base that you're interested in. Look for sites that are very similar to yours, but also find sites that are related to your topic but not identical. If you're marketing downloadable birthday cards, for example, you should look at sites that are somehow related to birthdays, anniversaries, or any kind of greeting card.

A reciprocal link means that you agree to put a link to another site on your own – and the other site agrees to do the same thing for you. So if you're selling jewelry, you should want to link with other jewelry sites. But you should also link to sites that aren't exclusively about the product you're selling – for the simple reason that this will expose you to a lot more potential buyers. There are only so many people who go on the Internet to find and buy jewelry. But perhaps more people would buy jewelry if they found out it was available when they visited a local news site, or a fashion site, or a site about love and marriage.

Your goal is to create a network of sites that are willing to exchange links with you. Always be alert for complementary sites that are willing to exchange links. As you begin your search for appropriate sites on Yahoo or Google, put yourself in the mind of your potential customers and search for the phrases they would use. Once you find some sites that your customers would be likely to visit, start gathering the information you'll need in order to exchange links. For example, you'll need to identify the owners of the site so you can contact them directly. To do that, just go to www.godaddy.com, a major domain registration site. When you type in the website address you're interested in, you should see the owner's contact information if it has been made public.

Your initial contact can be through an email, but a follow-up phone call is more likely to yield positive results. So try hard to find a contact number on the site you're interested in. Your initial email should be personal but also very professional. Don't put anything in the subject line that seems like an ad or an offer. Instead, just write "request for further information" or "some questions." In the text of the email itself, mention the owner's name, the name of their business, and the benefits of exchanging links with your site. Keep it crisp and brief. Wait a day or so, and then make a phone call to the recipient of your email.

When you speak to the owner of your prospective link, start by complimenting the owner on his or her site and use this to introduce your own Web business. Explain your site, and emphasize how your link will go hand in hand with his or her business. Explain the benefits of exchanging links, and respond to any questions the person might have. When the owner agrees to exchange reciprocal links, email your html code and ask that he or she do the same.

For your link to be most effective, ask that it be placed on the exit page of the site you're exchanging with. The exit page is the last page that is seen by a majority of visitors to the site. Usually it's the home page, so request that your link be visible at the bottom of the home page if possible. If there's a links page, your contact should be placed there as well. And of course you'll want to have a links page on your own site too.

Creating reciprocal links will also give you more visibility on the Yahoo and Google search engines, because sites are indexed by the number of times they appear as links on other sites. Creating links is probably the number one thing you should do in order to bring customers to your site.

The fact is, **most people return to the same websites 80 percent of the time they're online**. They may occasionally surf the Net, but mostly they just look at the sites they've visited before. That means it's difficult to get new people to visit your web page. But if those people go to their favorite site and see a link to your page ready and waiting for them, you're in a much better position to gain them as customers. The more links you have, the more traffic you get; and the more traffic you get, the more passive income you'll receive.

We've now spoken at some length about passive income routes on the Internet. A good website business is definitely one of the best ways to generate revenue, and it's also the most contemporary. But it's far from the only pathway that our map will reveal. In the next session you'll learn why stock market investment continues to be a very reliable path to financial freedom – provided you find the right path and stay on it. But first, let's continue with Your Travel Planner.

Your Travel Planner

How will your business deliver “instant gratification”?

What ideas do you have for making your website easy to use?

What elements will you include to keep your content fresh?

Take 15 minutes and go online to research companies that might be interested in reciprocal links. List them here:

The Map

If developing a successful Internet business appeals to you, and if you haven't already done so, mark on your map your route to success. Using words or symbols, jot down some of the tools you'll use and roadblocks you might encounter.

Session 4: Building Passive Income from Stocks, Part One

Need to Know Before You Go

Our previous two sessions explored pathways toward income on the World Wide Web. In a sense, we were talking about investing in yourself through the Internet business that you create. We've seen how a relatively small investment in a website can have a consistent payoff. Later in the program we'll return to the concept of self-investment – but in the next four sessions we'll be looking at passive income from some other very important sources.

Specifically, we'll be talking first about the stock market and then about real estate. Both of these are proven vehicles for successful investment, and especially for the creation of passive income. By putting some time, some thought, and a comparatively small amount of money into stocks or real estate, you can definitely bring greater financial freedom into your life. But it won't happen by itself. Knowledge and discipline are essential – and those are two elements we're going to emphasize in the next few sessions.

Similarities and Differences Between Stocks and Real Estate

Stocks and real estate have some basic similarities, but they're also very different kinds of investments. For example, suppose you get a mortgage on a piece of rental property. Your actual ownership of the property may be very small, depending on the amount of your down payment. If the cost of the property is a hundred thousand dollars and you put ten thousand dollars down, you own 10 percent of the property. The rest belongs to the lender. When rent is paid by the tenant, you can use that income in a number of different ways. You can spend it, or save it, or reinvest it to pay down your mortgage and own a larger piece of the property. In some ways the stock market is very similar. When you purchase shares in a company, you now own a small percentage of that firm. If the shares pay dividends, you can spend, save, or reinvest the income – just as you can in real estate.

Those are the similarities between stocks and real estate, and now here are two important differences. First, real estate is <u>real</u> in a way that stocks are not. A house is something that you can see with your eyes and touch with your hands. You can even live in it! **But stock ownership is much more symbolic.** As tangible evidence of your investment, you get nothing more than a certificate – and usually not even that. Most likely a receipt from your broker will be the only evidence of your purchase. Of course, both a real estate deal and a stock purchase are legal and binding business transactions, but the symbolic nature of stocks has some important psychological effects.

An even more important difference between stocks and real estate involves the liquidity of the two investments. Simply put**, it's a lot easier and faster to sell your stocks than it is to sell real estate** – and for many people, it's also a lot more exciting. This leads us to the first key principle of stock market investing: you need to have a plan and you need to stick with it. Before you make your first stock purchase, you must know what your goals are and you must not lose sight of those goals. In this program, our goal is to create a passive income so that you can achieve financial freedom. Our goal is not to make a quick buck or to make lots of exciting stock trades every day. The fact is, you could have the best trading strategy in the world, but if you don't stick to your game plan, it will be worthless.

The first key principle of stock market investing:
you need to have a plan and you need to stick with it.

Once you have your strategy clearly in mind, you need to think of it as a machine that runs all by itself for a stipulated period of time. You can watch it very closely, but you can't interfere with its operation. Does that sound like a difficult thing to do? The answer might not be as easy as you think. To see why, consider the following example.

Imagine you had created a software program for betting on horse races over the Internet. You have tested this program against the results of hundreds of horse races going back many years, and you know that over the long run it will generate a positive return. But the program bets only on a select number of races, and it also bets only on the favorite in each race. So the return is relatively small – between 10 percent and 15 percent. Of course, a consistent return of any amount is very unusual in horse racing, where almost everyone loses money. And 10 percent to 15 percent is also quite good compared with what you would get from a bank. So you should be happy, right? Not many people can say that they've beaten the races.

But suppose a few days go by, and you notice that the program is not making a profit. At first you're not worried – but as the losing streak continues, you start to get a little worried. What if you made a mistake in the program? Or what if the research you did on past performances wasn't as accurate as you thought? To make matters worse, suppose that while your bets on the favorites were losing, all the long shots were coming in. You've been risking your money in the hope of making 10 percent, and now other people are winning at 10 to 1 or even 30 to 1. Under those conditions, do you think you might be tempted to deviate from your game plan? Do you think your fear of loss might overcome your confidence in success?

Now let's look at another possibility. Suppose your betting program performs exactly as you expected. Week after week it's generating a 10 percent or 15 percent profit. You don't feel fear in this situation, but you might start to feel a bit of greed. You might start wondering how much more money you could be making if you started placing some side bets on long shots. True, you had planned to be very conservative with your passive income returns – but now you start thinking about all the money you could make if you took just a few chances. And then, when those chances don't pay off, you decide to take some even bigger chances in order to recover your losses.

I think you can see where this leads. **Fear, greed, or just the desire for action may cause investors to abandon what could have been very successful strategies**. Far too often, experienced investors get so caught up in the day-to-day performance of their portfolio that they lose sight of the big picture of making long-term profits. The desire for constant action is probably responsible for more stock market losses than any other factor, especially since trades can now be made literally in a matter of seconds.

If you have a solid investing plan, you need to go on automatic pilot. Pull away from the emotional urge to win on a day-to-day basis and look at the big picture. Of course, this assumes you have a solid plan – and that's no small assumption. In a moment we'll look at some strategies that investors use to create passive income from stocks. You'll find out why some strategies work and others don't. There's a good chance this will help you make some money, and there's an even better chance that it will keep you from losing a lot more.

The Golden Rule (of Stock Investing)

The golden rule of stock market investing is very simple. **Know why you're in the market in the first place, and know why you're making any individual trade.** Since we know that our purpose is to create passive income, we can concentrate on the second part of the golden rule. Since many investors are not sure why they bought a stock in the first place, if the price suddenly falls, they're not sure what to do next. On the other hand, if an investor knows why he or she made the purchase, the decision to sell, hold, or even buy more won't be based on day-to-day price fluctuations. Suppose, for example, that you bought 10 shares of Microsoft. If your buy was based on a justifiable expectation that the price was about to go up in the short term, you might want to sell if the price goes down instead. You might conclude that what you expected was based on wrong information. But if you bought Microsoft because you believed it was an undervalued stock, and if the conditions have not changed, you might actually want to buy more – because now the stock is even more undervalued.

Investment Strategies

Right now, let's look at several investment strategies with the plusses and minuses of each. You'll see very quickly why some are better than others – but once again, don't be too quick to pass judgment. It's easy to fall into stock investment traps, and it's not always easy to see the really solid opportunities.

The Brother-in-Law Strategy

> *Last Saturday my brother-in-law called me with a tip on a great stock. He heard about it from his neighbor, and then he checked out the company on the Internet. It sounded like a chance to make some money – but I would really have to act fast. The stock was going to start going up as soon as trading started on Monday, so every minute I waited was potentially going to cost me money. Fortunately, I was able to immediately open an online trading account so I could get in as quickly as possible.*

I think you can see the dangers in following the brother-in-law strategy. But **please notice how the Internet is brought in to validate what might otherwise be an obviously foolish course to follow**. In fact, today the Internet can actually take the place of the brother-in-law, or the neighbor, or the conversation you overheard in a restaurant. For some reason, what people read online can cause them to instantly take action, even if it's something they would never do otherwise.

Never let the Internet – or your brother-in-law – be the deciding factor in a stock market decision.

Try to get as much information as possible from a variety of sources, not just over the backyard fence. Then follow the stock for a period of time. See how it reacts to changing financial news. Pay special attention to the volume of trading for your stock. After all, if no one is buying it, the price can't go up. If you're still interested in the stock after several weeks, and you're sure it fits into your strategy of creating passive income, then you're ready to make a confident purchase.

People who buy stocks based on information about a specific company, independent of the market as a whole, are called "value investors" or "investing in fundamentals." Let's hear from one of them now:

The Value Investing Strategy

> *When I decide to invest in a company's stock, I base my decision on facts about that specific company. I'm investing in the inherent value of the business, as expressed by its proven ability to make money right now – not at some point in the future, but in its most recent annual report.*

Most people define value investing as the process of searching for stocks with a low ratio of price to book value, or a low price-to-earnings ratio. In contrast, stocks with a high ratio of price to book value, or a high price-to-earnings ratio, are growth stocks – or if they're not growth stocks, they could also be called just plain bad investments.

The Technical Investing Strategy

The opposite of the value investor is the so-called technical investor. This is someone who pays less attention to the fundamentals of a specific stock than to the up or down trends of the entire market at that moment. Technical investors were once called chartists, because their main activity was making and studying charts of stock prices. Today this is usually done on a computer. Many different programs are used to reveal patterns in the past performance of the market. The hope is that those patterns will carry over into the future.

It would be fair to say that the three kinds of people we've just discussed – the so-called brother-in-law investor, the value investor, and the technical investor – make up the majority of individual stockholders. But there are also many variations of these three categories. For example, there are technical investors who study trends of the Dow Jones Industrial Average, and there are others who chart the interest rates set by the Federal Reserve. There are fundamental investors who buy stocks when a company's earnings have reached a new high – while others will sell for the same reason, figuring there's nowhere to go except down. And an increasing number of investors combine the different methods into their own personal style.

Whatever approach you take, the most important thing is knowing why you bought a particular stock. If you bought it on the recommendation of your neighbor, be happy about it and recognize that this is why you made the purchase. It's a good idea to actually write down your reasons for making a buy. Tell the reason to your spouse. Tape it on your bathroom mirror. Keep a journal. But whatever the reason, don't kid yourself.

Have a strategy, stick with it, and accept responsibility for whatever it brings.

Before we go any further, here's one more key point about everything we've talked about so far. We've always been talking about individual investors – that is, people who decide for themselves which stocks they're going to buy or sell. In a very real sense, the strategies used by individual investors are less important than the fact that they are indeed individuals. Why is this so important? It’s because **the real heavy hitters in the stock market are not individuals but pension funds, banks, insurance companies, and other billion-dollar institutional investors.**

Sometimes these institutional investors are called elephants, and that’s only partly because they’re big. Think of a swimming pool. If an elephant steps into the pool, the water level is going to rise. Well, the same thing is going to happen when an elephant-size institutional investor makes a huge stock purchase. The price will go up. By the same token, if the elephant gets out of the swimming pool, the water level goes down – just like the price of a stock goes down when a big mutual fund unloads it. Compared with the elephants’ influence on stock prices, the effect of an individual investor is more like that of a mouse – or even a gnat.

So what does this mean for you as an individual investor? To answer this, we need to look back at a point we made at the start of this session. We spoke about the differences between investing in stocks and real estate, and the fact that stocks are a much more liquid investment tool. If you want to buy or sell a stock, you can do it in less than an hour. If you want to buy or sell a house, you may need a year or more. Because of the huge effect that institutional investors have on the stock market, **there’s a strong argument for simply buying shares of a big mutual fund.** Because if you can’t beat them, why not join them?

Mutual Benefit

On the route toward consistent passive income, a good mutual fund is a great place to start. The administrators of the fund will do all the work for you. They will make all the decisions about when to buy and when to sell. All you have to do is collect the quarterly dividends. It sounds very simple, and it actually is. There are only a few small complications. First, buying a mutual fund does not entirely eliminate you from the decision-making process. **You still have to decide which mutual fund to buy** – and since funds can do better or worse, just like individual companies, there’s no guarantee you’ll get the results you hoped for. **With many funds, there is also a minimum investment required**, and sometimes there is a **penalty for withdrawing money** before a certain amount of time has passed. To some extent, both of these requirements run counter to what may have originally attracted you to the stock market. You may have liked the fact that you could get into the market for 50 or a hundred dollars, but now the fund tells you that you have to invest thousands. You may also have appreciated the fact that you could quickly cash in your investment at any time, but now the fund may charge you for doing so.

As you can see, the seemingly intelligent choice of investing in a mutual fund may come with some frustrations. But if you’re the type of person who wants to invest in the stock market in the first place, there’s one more big problem with mutual funds. Simply put, they’re boring**. Months and years can go buy with very little change of any kind.** True, a major goal of our program is to free you from spending all your time at work. But many stock market investors crave action. Never making trades can seem like more work than making them.

Consistency Is Key

To build passive income from the stock market, we need to look for consistency above all. We need stocks that will pay a worthwhile dividend regardless of whether the price goes up or down. Does that seem like a lot to ask? It shouldn’t – because many stocks fit that description. Since they’ve always brought a good return on investment, there’s reason to believe they always will. They’re like good singles or doubles hitters on a baseball team. You can win a lot of games with them. They may not hit as many homeruns as Babe Ruth – but as everyone knows, Babe Ruth also struck out more than any player in history.

You can't afford a lot of strikeouts when building passive income is your goal.

Once again, this is a matter of psychology. Much of our society is built on instant gratification. Highly motivated people are trained to have high expectations of themselves. They want a lot, and they want it right away. This includes stock market investors, who generally expect far too much – and who also expect it far too soon.

Let's use an analogy to make this clear. As everyone knows, predicting the weather is very difficult. You read the forecast for tomorrow, and you learn that there's going to be rain. But then the sun shines for the whole day. This happens because the weather is a chaotic system – and the shorter the time frame, the greater the chaos will be. If you're watching droplets of water slide down a window pane, you can reliably predict that the droplets will eventually reach the bottom, but you can't predict how long it will take them to get there, or how many twists and turns they'll take along the way. There's long-term reliability, but there's also short-term randomness.

In the same way, we can make a distinction between weather and climate. If you live in Chicago, you can be sure that the month of January will be colder than the month of July. That's a matter of climate. But you can't be sure that the 10th of January will be colder than the 11th. Once again, the more you compress the time, the more room you make for confusion.

At the time of this recording, Warren Buffett is one of the all-time most successful stock investors and also one of the wealthiest people in the world.

Warren Buffett has a very simple definition of investing: it's laying out money now to get more money back in the future.

But what is the future? Is it tomorrow, or is it 10 years from now? Needless to say, both are the future – but we need to focus on the long-term future in order to reap the immediate but small-scale gains that define passive income.

To see why this is so important, let's get some historical perspective. Specifically, try to think of all the many things that happened between the years 1964 and 1981. There was the first moon landing, the war in Vietnam, the Watergate scandal, the arrival of the Beatles, the very different presidencies of Jimmy Carter and Ronald Reagan, and much more. There were also many changes in the economy, including runaway inflation and the gasoline crisis of the 1970s. Still, Gross Domestic Product in the United States – that is, the volume of all business being done in the country – rose by 370 percent. The overall sales of the Fortune 500 companies multiplied more than six times. And what happened to the stock market? Well, on Dec. 31, 1964, the Dow Jones Industrial Average stood at 874. And on Dec. 31, 1981, it stood at 875 – a move of exactly one point. If you had bought a mutual fund that was indexed to the Dow, you might have been quite a frustrated investor. On the other hand, if you doggedly held on to your fund shares until the time of this recording, you might be the very opposite of frustrated – because as of today, the Dow is close to 14,000.

By now you probably see how different segments of the economy seem to operate independently of each other. You'd think that a metric like the Dow Jones Industrial Average would keep pace with the Gross Domestic Product, but it didn't happen. The same kind of disconnect also happens within individual industries.

The automobile business is a case in point. During the 20th century, cars had an incredible effect on every aspect of American life. At one time almost 20 percent of our total work force was in one way or another employed in the automotive industry. If you had known all this in the year 1900, you would have thought that you had found the key to the mint. Just invest in the car business, and you couldn't miss.

But let's look a bit closer. It may surprise you to learn that more than 2,000 American makes of cars came into being between 1900 and 1999 – and virtually all of them failed. At the end of the 20th century, only GM, Chrysler, and Ford were still making cars in the United States. So if you had picked a car company as an investment at the beginning of the century, the odds are overwhelming that you would have lost your money – despite the fact that cars literally transformed our way of life.

Regarding this, Warren Buffett once made a very insightful comment. Instead of betting on the success of car companies, an investor in 1900 would have done much better betting on the failure of horse-drawn carriages. There were 21 million horses in the U.S. at the start of the 20th century, and at the end there were less than a quarter of that number. So while it's true that only a few car companies made it through the century, virtually all the buggy whip and carriage companies went broke. But did anybody think of betting against the carriage makers – "selling short," as it's known on Wall Street? Apparently not, because they'd have gotten so rich that we'd certainly know who they were.

The bottom line is, picking stocks as an investment can be exciting – but it's also very much a matter of chance, even for the most sophisticated buyers. If your primary interest is passive income, the best course is to look at the dividend histories of some companies and mutual funds. Then put your money into the strongest ones. Use the income to buy the financial freedom that is the goal of our program, while perhaps reinvesting a portion of it as well.

On the other hand, if you want to balance passive income with a need for some excitement and action, that is also a legitimate choice. As we follow our map toward financial freedom, you might want to take the scenic route! But you'll be a lot better off if you avoid the wrong turns that millions of independent investors make every single day. You'll learn how to do that in the next session, but first, let's fill out Your Travel Planner.

Your Travel Planner

What are your reasons for entering the stock market?

What investment strategies appeal to you? Have you ever bought a stock based on a recommendation or on value investing? How did that turn out?

Do you have any mutual funds or pension plans?

Take 15 minutes and go online to research mutual funds you might be interested in.

What is your investing personality? Are you comfortable with consistent returns, or are you impatient for "home runs"?

The Map

If stock investing appeals to you, jot down some of the tools you will use to get you to your stock investing goals and some of the roadblocks you might encounter. See the sample map for ideas.

Session 5: Building Passive Income from Stocks, Part Two

Need to Know Before You Go

Now we're going to adopt the viewpoint of a rather more active investor than you might expect in a program on passive income. **But remember: passive income is not an end in itself. The real destination of our journey is financial freedom** – and if you decide to exercise some of that freedom by investing in stocks, you'll find valuable information in this session. And if you're not inclined toward becoming actively involved in the stock market, you can still generate passive income from stocks by buying dividend-producing securities.

Long-Term Errors

As we're going to see, sometimes the key to doing something right is not doing something wrong. That's why our focus in this session will be the most common mistakes made by independent investors – not only in buying stocks, but also in selling them. We'll start with some long-term strategic sources of error, and then we'll home in on the tactical mistakes that are made many thousands of times every day.

As we begin, it's important to understand that this session will be much more than a list of everything that can go wrong. Each of the mistakes we'll be discussing has a positive flip side that can translate into profit. **For example, the first and perhaps most common error is investing without a clear goal in mind.** It's easy to say, "Well, my goal is making money" – but that was also your goal when you sold lemonade on the corner, and the stock market is a much more complicated game. So think carefully about what you want from your investments, not only financially but emotionally. If your main interest is consistent income and security, are you ready to completely turn your money over to a mutual fund manager? If you want to retain more control, how much risk are you willing to take on?

As you define your goals, be sure to attach a time frame. Be clear about how long you'll give yourself to accomplish the goals, and when you'll want to re-evaluate them. For instance, if a year goes by and you're not happy with your mutual fund, don't just let it keep going by force of inertia. On a certain date, plan to take another look at what an investment is bringing you. Is it accomplishing the goal you bought it for? Or maybe your goals themselves have changed. If that seems to be happening, make sure it's not because you've gotten bored with your goals and your plan for attaining them.

Patience is one of the true keys to investment success.

If you lack patience, you'll change direction too frequently and for the wrong reason. Many investors take a short-term view – even though they tell themselves they have long-term objective. In the end, knowing your goals could mean making frequent changes in your portfolio – or perhaps making changes only rarely. The main thing is to make every decision a conscious one, and that starts with deciding what you really want to accomplish.

In the process of defining their goals, many investors focus on what the market might do, and they don't pay enough attention to how that will make them feel. **Not allowing for the emotions that market cycles cause is our second big mistake.** When things are going well, it's amazingly easy to believe you're a financial genius. And if you actually are a financial genius, it's even easier to think that you're the master of the universe. This was what happened several years ago to a stock market fund called Long-Term Capital Management. It was founded by a number of truly brilliant academic economists who felt that they had a foolproof method of stock market investing. For a while the system worked great, and it attracted billions of dollars of investors' money.

The problem was, almost any system would have worked great at that time, because the market as a whole was in a hugely bullish phase. But when the momentum shifted, the fund managers found it difficult to come down from the high they'd enjoyed for several years. They'd come to love that feeling, so anything else seemed intolerable. What's more, the investing public had enjoyed believing in the existence of these invincible financial geniuses. In the end, the failure of Long-Term Capital Management was such a shock that it almost caused a full-scale market crash. And the reason was very simple. The overblown optimism investors had felt very quickly translated into overblown fear. Unrealistic emotions have a way of doing that – so be aware of your feelings, and make sure they're in sync with reality.

Investing in the latest fad or speculative trend is mistake number three. A great example was a stock called Pets.com. This company sold pet supplies over the Internet, and it was the poster child for hype during the dot-com boom. Even Jeff Bezos, the CEO of Amazon, confessed that he had invested in Pets.com, and he admitted that it was one of his biggest mistakes. What happened to Jeff Bezos happened to a lot of people. They got carried away by the publicity – and by a stock price that grew daily – at least for a while. Within nine months of its first appearance on the New York Stock Exchange, Pets.com was worth nothing.

When you see a rocketing stock price and all you hear about is this hot new company, think of this as warning signs, not buying signals.

Here's an easy way to remember that advice. Unless you're driving a car, right now put the fingers of your right hand straight out and together. Then hold the hand in front of your face so you're looking at the palm. On the extreme left of your hand is your little finger, your pinky. This can represent the price of a stock when it first comes to your attention. It's pretty low, so you're not very interested. But look what happens next. There's your ring finger, representing a significant rise in the stock price. Now you're watching more closely. Lots of people must be buying this stock. Maybe it's a real trend, something you wouldn't want to miss. In fact, the next time you check the stock price it's even higher, just like your middle finger is the longest one on your hand. You decide not to wait one more moment. You buy the stock at its all-time high because you're convinced it's going to keep going up. After all, it's done nothing but go up since you first started watching it, right? But look at the next finger on your hand. It's your index finger. It's shorter than your middle finger, and this symbolizes a decline in the stock price. How could this happen when there seemed to be so much upward momentum? You're a bit worried at this reversal, but you don't want to be a wimp. You decide to hold on to the stock and wait for the trend to turn positive again. Except now look at your thumb. This is a sudden and precipitous drop in the stock price. At the sight of this, all the excitement you felt just a little while ago suddenly turns to gloom and doom. You're so miserable that you sell the stock even though it means taking a huge loss.

Could it be that the length of our fingers represents some sort of divinely given message about stock market investing? We don't need to answer that question, but there's no doubt the sequence we've just described is exactly what happens to a vast number of independent investors. It's exactly what happens when you let trend-spotting take over your stock picking – and to make it even worse, most people don't even learn from their mistake. Maybe that's why we were given two hands.

Since we're talking about the dangers of trendy investments, a related category of stocks bears mentioning. **With their low prices, penny stocks look like attractive bets – but there are several very serious problems with this type of investment.** First, you are betting that the price of the shares will rise, which for the purposes of passive income is always a bad idea. Second, in order to have even a chance of making money, you need to be trading a high volume of shares, which means the transaction fees will be high. And penny stocks are also more susceptible to fraud and manipulation. Your transactions may be perfectly legitimate, but you shouldn't ignore the fact that there have been many white-collar crime convictions in the world of penny stocks.

Be aware that, in the age of the Internet, getting hooked by trends is easier than ever. We touched on this a bit in the last session, when we spoke of the brother-in-law strategy of investing. The Internet is like the ultimate brother-in-law investment guide. It's full of information, and well-designed websites can make even foolish ideas seem convincing. But the Internet won't pay you back if its advice goes sour. It can be a good source of information, but treat it like your brother-in-law, not your daddy.

More Stock Market Traps

When publicly held companies are profitable, they are obligated to share the profits with stockholders through quarterly payments called dividends. The more shares you own, the bigger your quarterly check will be. Dividends are a great way to build passive income through stocks. But as you look for investments that pay solid dividends, be sure to have a long-term perspective. Many **inexperienced investors go hunting for dividends** in order to get a quick return on their money, and this is almost always a mistake.

Here's why. When a stock is about to pay a dividend, the news is not a surprise to well-informed investors – including the big institutional funds. As a result, the amount of the anticipated dividend is almost reflected in the stock price before the dividend is paid out. That means you're paying more for the stock, and the increased price will of course detract from what you net out through the dividend. In other words, **shopping for dividends means you're overpaying.**

It's good to have dividend stocks in your portfolio – utility stocks are especially reliable – but they're not the only way of building passive income. **Unless you're 100 percent risk averse, a mixed portfolio makes more sense.** Some of your stocks will almost certainly pay a dividend, but a few others might not do so for a long time, if ever. But if you do your research and buy carefully, you may get some blue-chip stocks of the future at bargain prices. If and when those stocks do pay dividends, that money will be pure profit. It won't have been already built into the price you originally paid for the shares.

A similar mistake to hunting for dividends is giving too much weight to earnings reports – especially just before a new one is about to come out. As with dividends, the market will anticipate what the earnings report is going to show. That positive anticipation will be built into the share price, probably long before you even think of buying it. So even a really good earnings report is unlikely to catch anyone by surprise. Since most companies meet or beat expectations, this isn't news to anyone except real newbies in the market. Even if you are one of those newbies, don't make it obvious by buying into a positive earnings report.

In fact, you might be better off looking at a company that doesn't meet its earnings expectations. Do some research on why this happened. Does it look like management can rectify the situation? If that's your impression, the stock might be a good long-term investment. Meanwhile, the stock price will likely go down, which could create an even more attractive opportunity.

Always be aware that "high" and "low" are relative terms in the stock market. Three hundred dollars a share may seem like too much for a stock, while $3 might seem like a bargain. But we have to put the price in context. What are the basic strengths and weaknesses of a company? Are these accurately reflected in the stock price, or is the market making a mistake? And the market doesn't make too many mistakes, at least not for very long. Just because a stock price is low doesn't mean it's a good buy. And, conversely, just because the price is high doesn't mean it's a bad buy.

The mistake is not knowing that "buy low; sell high" is really shorthand for "buy stocks that are undervalued and sell stocks that are overvalued."

In the end, there's a good chance that the price you see for a stock is exactly what that stock is worth. So don't assume that a stock is selling way too high or way too low. A much better assumption is that the millions of investors who are behind that price have seen something that you've missed.

Some small investors try to simplify these matters by just following the lead of a well-known stock market guru. The guru may be a writer or TV personality, or a large-scale investor like Warren Buffett. While a lot can be learned from people who have made millions in the market, your goals and motivations are bound to be very different – and you won't attain those goals by copying anyone else. **The problem is, mirroring someone else's moves doesn't allow you to develop a real strategy of your own.** Warren Buffett's investment strategy, for example, has obviously worked well for him over many years – but it's based on holding on to certain select stocks for very long periods of time. Aside from making him a lot of money, this is the approach that makes him comfortable. But are you going to be comfortable just because he's comfortable? Moreover, Warren Buffett would be a very difficult model to follow, because he very rarely makes a move. You'd probably want to model yourself on someone a bit more active, so you'd need to research the different stock market personalities. But if you're going to be doing that kind of research, you might as well just research the stocks themselves and make your own decisions.

A better course is to strike a balance between ignoring and imitating the stock market wise men. You can certainly follow what some of these investors are doing – if only because they have the influence and the money to influence markets. But following in this sense means paying attention, not copying. Learn everything you can, but definitely learn to think for yourself.

Along the same lines, chances are you have friends with their own ideas about investments. Listen to what they have to say, but **don't take anyone's advice at face value**. That isn't to say their advice might not be good. They could be right. But find out where your friends get their information. If they have a broker that has made them a lot of money, ask for a referral. If they have their own strategy, ask them to teach it to you. You may decide to reject it, but you may also learn something in the process.

Sometimes friends also invoke the wisdom of others, and frequently it's their stockbrokers. There are people who begin every sentence with, "My broker says..." Well, who is this broker? Is he a stock market expert? That's quite possible. Does he have an agenda of his own? That's also quite possible. Essentially, a stockbroker is a salesman. He's trying to sell you his services, which can come into play only when you buy or sell a stock. And with a broker, there's always one question that's very difficult to answer: If he knows so much about the stock market, why is he working for a brokerage house instead of playing in Warren Buffett's weekly bridge game? That may be an unfair question, but no one has the power to predict the future, although we sometimes would like to believe differently.

Many of the investing mistakes we've been looking at so far can be summed up very simply. Many people, especially men, make the basic error of confusing investing with sports. That's why people talk about "playing the stock market." They root for their stocks just as they root for their favorite teams. They idolize their favorite market gurus just as they love a great pitcher or quarterback. It all becomes very emotional – especially when a stock starts going down. We ask ourselves, "Are we going to abandon that stock just because it goes into a slump? What kind of fans would that make us? Wouldn't there be something really disloyal abut that?"

If you have thoughts like those, remind yourself that you're not a fan – you're an investor. **Being an investor is partly an emotional experience, but it should never be a sentimental one**. Success is a relative term when it comes to investing. Ideally, we think of success as making more money. But sometimes it's about losing less. If a stock goes into a decline and you can see a good reason why that's happening, you may need to cut your losses. A smart investor not only knows when a stock is in a tailspin, but immediately takes action to let it go. By the same token, a stock that is obviously undervalued shouldn't be overlooked.

A flip side of this is unwillingness to sell a stock that has gone up because you're afraid that it might go higher. Unfortunately, there is no easy answer for this. **The best course is to examine your own motives.** Are you tempted to make a move because of fear? That's usually not a good idea. Or are you tempted by greed? Are you going to let yourself feel disappointed in a small profit, because you're imagining the big one that might get away? There are so many ways to talk yourself into or out of almost anything – especially when it comes to investments. But what you really need is this:

Stay disciplined, don't be greedy,
and don't be scared either.

If you become emotionally attached to your stocks, you'll end up paying with losses. Part of the reason good investors fall prey to this trap is that they put so much work into finding the "right" stock. They read books on investing, devise stock-picking systems, and scrutinize earnings reports and market trends. Finally, the investor narrows his or her choice down to one special "gem." But if you let this stock become your pride and joy – your child, as it were – you may suffer grave losses for it. The fact is, emotional attachment to stocks is nothing more than human nature – and wanting to be right. But do you want to be right and also broke?

Another problem is, the market doesn't send out an email when conditions change. You have to pay attention on a day-to-day basis. But **in order to follow your investments closely, be prepared to put in the time that's required. If you're not so inclined, stick to mutual funds**, where you'll only have to review things on a quarterly basis. If you're using the services of a brokerage house, you can also program your stocks to sell automatically if certain high or low prices are reached. But be aware that there is a fee for every transaction, whether it's automatic or not. And those fees can add up.

Generally speaking, the economy moves in cycles. So does the stock market. Upward trends are followed by downward trends. Of course, everybody wants to buy stocks during boom years, but finding investors in a bear market can be like pulling teeth. Yet there are more bargain investments in leaner times. Staying out of the market in those years can be a big mistake.

Guidelines for Selling Stocks

For the most part, we've devoted this session to buying decisions. But the only thing harder than buying a stock is deciding when to sell. To conclude this session, we'll focus on some simple guidelines for helping you decide whether to sell a stock.

Many investors find it hard to sell a stock – especially if it's a strong company providing some good passive income. But very few stocks exist outside the influence of the market as a whole, or even of a segment of the market. More often than not, a good stock that's performing badly is in a sector that's performing badly.

History is a great teacher of this principle: when a down market occurred following the dot-com boom, the technology sector as a whole was hit hard. It wasn't just stocks with massive debt and no income. Profitable companies with solid business structures were devalued as well. But here's the really hard lesson of those to me. In many cases, people who held on to tech companies are still waiting for those stocks to return their losses. And it's been more than 10 years.

If you own a stock in a sector that is being battered – even a good stock – you should almost definitely sell, because even good companies aren't safe from the power of a strong downward pull. Never forget Warren Buffett's number one principle of successful stock market investing: Don't lose money!

And if one of your stocks is going up, remember that **a profit doesn't exist until you've taken your money off the table.** Despite this obvious fact, many investors like to inflate their egos by viewing their stocks online and relishing how much money they've made. In reality, you haven't made a penny until you press the "sell" button. So don't be afraid to push it.

When a stock is suddenly spiking upward, you may sense it's out of control. The price-to-earnings ratio becomes very inflated, media attention may start up, and you begin to wonder just how much higher it can possibly go. **Stop wondering and sell at least part of your investment – perhaps one-third or a half of what you own.** That way you can take some profit off the table and still keep yourself in the game. If your stock does hit the moon, you won't be left kicking yourself for selling completely out of your position.

The real secret to knowing when to sell is to keep yourself as well informed as you possibly can. Nothing influences the stock market more than the news. Read *The Wall Street Journal*, read the business section of *The New York Times,* read articles on the Internet, and then read some more. Keeping informed is like buying insurance: the more information you have, the more you're protected.

Summing up, no aspect of stock market investing is an exact science. When it comes to knowing when to sell, there are only indicators that can give us clues. Learning from the mistakes of others is a great strategy for avoiding making those same mistakes yourself. If a solid company has a downward-spiraling stock price, look for clues as to why and find out what is happening within that sector. Remember to keep a clear head when evaluating stocks and don't become emotionally attached to them. Finally, never forget that knowledge is powerful. Read the books of those who have been successful trading and investing because they offer a wealth of knowledge and experience. There are many factors – perhaps too many factors – that affect the financial markets. But if you're willing to put in the time and effort to read and research your investments, you will be well prepared to take profits and avoid losses.

This concludes our discussion of stock market investing, to which we've devoted two full sessions. In session six we'll explore a new route to financial freedom. But first, let's take a look at Your Travel Planner.

Your Travel Planner

What are your goals for your stocks (other than just making money)? What is your time frame for accomplishing these goals?

Are you ready to completely turn your money over to a mutual fund manager? If you want to retain more control, how much risk are you willing to take on?

How patient are you? If you're naturally impatient, how will you stay focused on your long-term goals? Describe some specific strategies for staying patient.

What is your risk tolerance? What balance do you want your portfolio to have?

Who are some of your investor role models? How are their goals similar to yours? How are they different? What elements of their investing strategy would you like to emulate?

What are your primary motivations for buying and selling stocks? Fear that it will drop? Excitement that it might go higher?

What are some information sources you can use to stay abreast of the stock market?

The Map

If stock investing appeals to you, and if you haven't already done so, include investing on your routes to financial freedom.

Session 6: Creating Passive Income Through Real Estate Investment, Part One

Need to Know Before You Go

Long-term real estate investment has always been an outstanding business opportunity – and the basic reason is very simple. As someone once said, “They aren’t making any more land.” For that reason, real estate is a great investment to hold. As in any market, there can be fluctuations, but in the long run, land retains its value and usually increases as well.

For building passive income, our approach to real estate investment is very simple. It can be summed up in just a couple of points. Each of these points, of course, could be the subject of a whole session in itself, but for now we’ll give just a very brief explanation of each one. Once you get a sense of how passive investment from real estate actually works, much of what you’re about to hear will be self-explanatory.

A Singular Opportunity

First, your immediate goal is to gain control of one single-family home. We’re not going to be dealing with commercial properties. We’re not going to look at any duplexes or apartment buildings. Just a single family home in a solid neighborhood – not an affluent neighborhood and not a struggling neighborhood. So to begin, you’re going to use some of your leisure time to scout out various areas that you might be interested in. If you see a house with a for-sale sign and it looks interesting, write down the address but don’t even think about making an offer until you’ve looked at least a half-dozen different neighborhoods.

A Critical Point

When you’ve found a solid neighborhood and a single-family dwelling that looks good, be aware that **this property – or some property like it – will be your only purchase for at least one year.** This is an extremely critical point. You are going to acquire only one property, and you are going to make the smallest possible down payment you possibly can. Ideally, you will make no down payment at all. Then you will rent out the property at a rate that will cover your mortgage payments and your other expenses.

Once these costs are covered, you can devote whatever is left over to passive income. The amount of this passive income will increase over time – but if you really want to get ahead as a real estate investor, you will spend little if any of this income at least for the first few years. Instead, you will save it in order to make a down payment on another property. And when you have that second property, the cycle can begin all over again. In this way, you can leverage control of the maximum number of properties with the smallest amount of cash outlay. In a moment we’ll discuss how to make yourself attractive to lending institutions – but for now the most important thing is to identify the immediate goal. That goal is to find a solid neighborhood – find a good single-family home in that neighborhood – and use the rent to maintain the property and to generate some income. Then, when the time is right, you can use that income to get control of another house.

Staying Ahead of Inflation

But that's not all. You can also make money simply by the power of real estate to stay ahead of inflation. To see how this works, here's an example. Let's say you buy a property today for $100,000 cash. It may appreciate in value 5% a year for 10 years, during a time when inflation averages only 3%. If this happens, the property will be worth more than $163,000, while another investment that matched the inflation rate would be worth only about $135,000. Your real estate investment would have beaten inflation by $28,000. And if you had put the $100,000 under your mattress, your cash would buy only about 65% of what it will buy today.

But here's what makes leveraging so powerful. What if instead of paying cash, you paid only 10% down and financed the balance? You would start with $10,000 in equity. If you rented the property so that your tenants covered all of your expenses, in 10 years your $10,000 equity would have grown to $73,000 – and that's before you add the thousands of dollars by which the mortgage was paid down. If it only paid down $27,000, your equity would be $100,000, or 1,000% of your initial $10,000 investment.

At first the mortgage reduction will be small, maybe only a few dollars per month per property. This doesn't seem like much, but considering that it's every month, on every property you own, it starts to add up quickly. In addition, with each payment you make, the amount that goes toward reducing the mortgage goes up and the interest goes down. Every month you own the property, more of the payment goes to reduce the mortgage until the mortgage is fully paid.

The beauty of it is that the higher the inflation rate, the greater your growth in value. But there's still more. While the value of the property is going up, so is the monthly rent. As the rent increases and the mortgage pays down, you start enjoying the passive income flow this produces.

As we learn how to make all this happen, let's remember that we're talking about investment, not speculation. **Our focus will be on finding good properties that will pay for themselves and generate income.** There are a lot of get-rich-quick schemes in real estate, but this isn't one of them. Remember: first and foremost, our goal in this program is to create freedom. We want to get you out of the money-for-time trap that forces you to play financial defense year after year. When you are the owner of six or eight self-sustaining rental properties, that goal will be achieved.

This is not just possible, but actually inevitable if you stick to the principles you'll learn in this session and the one that follows. It takes patience, but it doesn't take a lot of money. It doesn't even take a lot of hard work. Discipline and commitment are much more important. That's why real estate is such a great investment opportunity, and that's also why more people don't take advantage of it. They're in too big a hurry. They give up too quickly. They're still trying to trade their time and their labor in order to become wealthy, and that trade just doesn't work anymore. So they become discouraged and quit.

When you follow a passive income real estate strategy, you're not leveraging your own money and labor – you're leveraging the assets of the people who rent your properties. Those people are actually helping you become wealthy. When you own rental properties, you create a down-line of tenants who go to work for someone else and earn money to pay off your mortgages. It may sound insensitive, but that's the way the system works – and anyone who doesn't take advantage of it is missing a great opportunity.

Real estate investing isn't limited
to wealthy tycoons.

The truth is, more often than not, real estate is how those tycoons became wealthy in the first place. A hundred years ago Andrew Carnegie, one of the richest men in the world, made exactly this point when he said, "Ninety percent of all millionaires became so through owning real estate. More money has been made in real estate than in all industrial investments. A smart wage earner today invests his paycheck in real estate."

When you make that investment, instead of being a slave to a weekly paycheck, you provide a way for other people to help you get rich. Even if you buy only one rental house a year, each purchase allows you to benefit from the labor of another person, and this will eventually make you rich. It won't happen overnight, but slowly but surely it will happen. It always has and it always will.

It's just a matter of remembering that **buying right is far more important that buying often.** It's seeing why the income your properties generate is far more important than the number of properties you own. And to ensure that your income keeps coming, you need to be aware that the price you pay for a property is not nearly as important as the cost of owning it. By keeping that cost low, you can turn a trickle of income into a flood by raising rents only a small amount each year.

Right now, let's hear from a real estate investor who has successfully made that journey, including some unexpected turns in the road.

> *When I began to think about real estate investing, there was one thing that really attracted me. It was the fact that, at least in theory, a person could start controlling property with little or no money at the outset. I had heard the stories of people getting rich with no down payment on their purchases, and that really appealed to me – because I couldn't have made a down payment even if I'd wanted to.*
>
> *Here's what I very quickly learned. There is actually more than one kind of down payment. Or to put it another way, there are two kinds of equity that you can invest in a piece of property. One is plain old hard currency. You go to the bank for a loan, and they ask you how much cash you can put up. The more you have, the better you look to a banker. But I was surprised to learn that making a substantial down payment is not the only thing lenders look for. It's not even the most important thing. There's another kind of equity investment that's even more attractive than cash. It's not cash equity, it's* <u>*sweat equity*</u>*. Sweat equity is a term I had never heard before I started trying to buy property, but having it is the reason that many people succeed in real estate – and not having it is the reason many people fail.*
>
> *In the fewest possible words, sweat equity is the amount of work you put into developing your property. You may not have money, but if you can convince a lender that you're going to knock yourself out improving the fixer-upper you want, the lender may very well give you*

> *what you want. That's because your hard work is not only going to raise the value of your individual property, but it will raise the value of the entire community. And after all, it's the community that the lender really cares about. If there are enough people like you putting sweat equity into their buildings, the outcome is bound to be good. That's why your sweat equity will almost always be more attractive than someone else's cash.*

Don't Sweat It!

In terms of passive income, what we've just heard is something of a mixed message. On the one hand, it's good news that you can become a real estate investor with little or no money. The "no money down" route to success has been much talked about, and it really does exist. For the purposes of this program, however, sweat equity as an alternative to financial capital is not really workable. That's because our goal here is not working harder and longer – even if it eventually brings increased income. Our definition of wealth is financial freedom based on passive income. Toward that end, you're going to learn to buy property so that it shows a cash flow right from the start. The flow will be only a few drops at the very start, but it will grow into a rising tide – and there's even a real chance that it may turn into a genuine flood of wealth

Of course, once you have financial freedom
you can choose to do whatever you want with it.

You can even work harder than ever. However, that should be a choice rather than a necessity. Because the truth is, you don't have to work yourself to the bone in order to generate passive income through real estate investment. But remember: we're making a sharp distinction here between investment and speculation.

But what are the real differences? Well, one difference is the role of time. For a speculator, a quick payoff is an important goal. A good example of real estate speculation is known as "house flipping." The speculator buys a property, renovates it, and then sells it as quickly as possible. Depending on the kind of renovation, the whole process can take 90 days or less. That's the goal, anyway. If there's a downturn in the market, however, speculators can get stuck with renovated properties that no one is prepared to buy. And since they're speculators rather than investors, they're not prepared to rent out the property to create income. They wanted a quick payoff, and they were willing to work very hard for a concentrated period of time. If the payoff comes, the speculation was successful. If the payoff doesn't come, or doesn't come quickly, the speculation failed.

To build passive income through real estate, you're going to be an investor rather than a speculator. That means you're going to take your time. You're not going to be in a hurry. When the market is hot and prices are going up, you're not going to get caught up in the euphoria and pay too much. When the market cools off and prices fall, you're not going to sell in a panic because you're afraid prices will go down even more.

Plenty of real estate gurus will urge you to buy all the property you can. The idea is that it will go up in value and you'll get rich when you sell. But what if it doesn't go up in value? What if you can't sell your property because there's nobody who wants to buy it? A real estate investor, as opposed to a speculator, never has to face those problems. Real estate investors never <u>have</u> to sell their properties. They may choose to sell, but they're never forced to, because they never depend on the value rising.

So far in this session we've made three very important points. **First, we're going to measure your success as a real estate investor in terms of passive income.** We're not going to focus on how many properties you own, or how quickly you can turn them around.

Secondly, we're not going to buy properties in the hope that they'll go up in value. The truth is, they almost certainly will over the long-term, but that doesn't need to happen in order to generate income. Regardless of what the market is like at a given moment, you can always invest your income in upgrading your properties. New carpet, new windows, new siding and air conditioning are all wise improvements that will enable you to raise your rents, increase your cash flow, and consistently improve your property. And even when the value of a property does increase, you may choose not to sell it because of the passive income you're receiving.

Finally, we've made the point that this isn't about generating sweat equity. You've not going to be working harder and harder in order to make up for a lack of capital. In fact, the most work you're going to do will be scouting around for properties and negotiating the right terms. Once you've taken control of a property, you'll be hiring a professional property manager. That will be paid for by a percentage of the income from your property. If something in your property needs attention – whether it's a plumbing problem or electrical repair or anything else – your manager will be responsible for hiring someone to fix it. Passive income is more than just making money. It's more than just working hard. Lots of people are doing that. The problem is, they're not building real wealth. On the other hand, passive income from real estate is a great way to do just that. More in a moment.

Key Questions in Real Estate

When you first start thinking seriously about investing in real estate, two thoughts are certain to enter your mind: How can you find good properties to invest in, and how can you make the best possible deal for those properties?

For some insight on those questions, let's listen to a real estate investor who solved them for herself – and who created major passive income in the process:

> *I got interested in real estate because it seemed like a solid investment in the literal sense. I wanted something I could see and put my hands on, not just a symbol like a stock certificate or a bond. Since I was a complete novice, I started out by reading books and attending a few seminars. And I quickly noticed one thing. Almost all the experts stressed the importance of finding properties that were not only well-built structures, but that could be acquired under the most favorable terms possible.*
>
> *In the years since then I've bought a number of properties and I've come close to buying many more. In terms of finding good properties, I've found that certain strategies work much better than others. I think if you listen carefully to what I've learned, you can save yourself a lot of work – and possibly make yourself some very good money.*

I wish I could tell you that there's some secret source of great properties that you can tap into right away. Actually, if I knew a secret like that I would probably keep it to myself – but there's no point in wondering about that, because there are no secrets in finding good properties. And in a way, that's a secret in itself – because some of the best properties are right out there in the open, hiding in plain sight.

The Multiple Listing Service is a good example of this. The MLS is a catalog of all the properties listed for sale by brokers in your area. There are hundreds and hundreds of properties. Some of them are good deals for investors, and some aren't. The trick is to ferret out which properties have motivated sellers without making offers on all of them. With a lot of practice, I've learned to see through agent jargon like, "Handyman's special" and "Fixer-upper." That means the property looks bad, smells bad, and has at least one major system that doesn't function. And for me, that almost always means it deserves a closer look. I don't want to buy a house if it's in total disrepair, but I also don't want to limit myself to properties that can only get worse. So those kinds of properties are often a good starting point. In other words, the MLS has worked so well for me that I am generally in the market for really ugly properties. Coincidentally, these are the same properties that most agents prefer not to spend a lot of time with. In many cases, they're very cooperative – particularly if you're in a position to offer cash and a quick closing.

One really good thing about properties in the MLS is that you know they're actually for sale. This may seem like an obvious statement, but compare it with some of the other methods touted as great ways to find deals. They involve locating owners, then finding out if they want to sell, and sometimes convincing them to sell even if they don't immediately want to. Properties in the MLS also have the advantage that all the information is pretty much laid out for you. That's a major time saver. And with the computerized access that's now available, it's only a matter of a few keystrokes to view all of the properties that a broker has to offer – everything from handyman's specials to fine homes that are in move-in condition.

Compared with the MLS, I discovered that some other strategies were much less effective. When I first got into real estate, for instance, I was very aggressive. I decided to initiate a direct-mail campaign to real estate agents. I was hoping that I might be able to find MLS-listed properties even before the listings became public. All I had to do was let agents know what I was looking for. So I bought a thousand agent names from the Board of Realtors and created a three-part mailing to send to every one of them.

The theme of my mailing was this: if you, my dear broker, have a property listed that fits my criteria, I'll make an offer and you get to keep the entire commission. I sent out my first thousand letters, all mailed first-class, and the phone calls came rolling in. All seven of them – and that was all. The week after the letters went out, I got seven calls, of which four *were good properties but out of my price range, and three were overpriced listings about to expire.*

My second mailing generated more results – about 15 calls – but all were basically in the same categories. The final mailing, a postcard, received no response at all. Basically, I wasted about $1,400 on a campaign that generated absolutely nothing..

I still think the idea of mailing to brokers has some merit, but if I do it again, I would make some major changes. First, I'll target only the 200 or so agents who list the types of properties I buy. Second, I'll do a better job of writing the letters, emphasizing how the agent and his seller would benefit from working with me. Third, I'll make my campaign a continuous one throughout the year, testing different letters for response and mailing the best to the same agents over and over. And lastly, I'll personalize the campaign by following up with a phone call to the 50 best prospects.

Here's another investor with more ideas for finding properties – and once again, some of the ideas worked better than others:

I've had an ad in the "real estate" section of the Yellow Pages for almost 10 years. I change the wording a bit each year, but the message is always the same: "I buy houses." This ad generates only three or four calls a month, but for some reason the quality of the calls is better than those that are generated by any other method I've ever used. The sellers are motivated and cooperative, and they have unlisted properties.

I love the Yellow Pages ad because I have to deal with it only once a year. I pay for it and forget it. Depending on the size of the ad, they're not cheap, but you can also get billed monthly if you prefer. Also, since mine is one of the very few ads in the book that promise to buy houses, I haven't got much competition.

I've also had success with putting up flyers in targeted neighborhoods. Last year, I had 10,000 double-sided "I buy houses" flyers printed. I hired someone to put this flyer in the door of every single-family property they saw in my target area. Every three weeks, 3,000 of these flyers were delivered, and the response from qualified sellers was excellent. For a cost of less than $500, I made two deals that have repaid me many times over.

For purposes of comparison, I want to mention something that happened when the market got really hot. An acquaintance of mine – more of a speculator than an investor – decided to rent two large billboards in the same area of town. He got absolutely zero response. For some reason, the billboards made people suspicious. In contrast, my flyers seemed handmade and accessible. Or at least that's the only way I can explain it. The lesson is, stick with what works for you, even if you don't know exactly why it's working.

That's good advice, but the "whys" of successful real estate investment aren't really the only keys to getting where we want to go. We've looked at a number of the "whys" in this session – and in our next session we'll move from the "whys" to the "hows." But first, let's look at Your Travel Planner.

Your Travel Planner

What are your real estate investing goals? (Hint, it has to do with passive income rather than owning lots of properties.)

What is your motivation when buying a property? (Hint, your answer shouldn't be "hoping that it increases in value.")

Take a look at the MLS online in your area. Identify several properties that look interesting, and write them down here:

What are some other creative ways you can find properties? Flyers? Yellow page ads?

The Map

If real estate investing appeals to you, jot down some of the tools you will use to get you to your real estate goals and some of roadblocks you might encounter. See the sample map for ideas.

Session 7: Creating Passive Income Through Real Estate Investment, Part Two

Need to Know Before You Go

Welcome to session seven. Here we'll turn our attention to what it's actually like to own and invest in real estate – and there are some interesting twists and turns on this path. We'll see how the challenges, opportunities, and tricks of the trade play out in the real world. Most importantly, we'll learn why real estate is one of the most reliable routes you can follow – not just to passive income, but to long-term wealth and security also.

In the previous session we looked at the process of getting into real estate investment and acquiring your first property. We talked about patiently scouting out neighborhoods and finding a single-family home for your first investment. Hundreds of thousands of people have gone through this process – and within six months of buying their first rental property, almost all of those investors have the same reaction. It sounds something like this:

> *What's going on here? When does the money start rolling in? It seems as if all I'm doing is paying bills, dealing with my tenants' complaints, and worrying about how I'm going to pay my property taxes. There are a million little things I never expected, and it seems like all of them cost money. At this point I'm barely breaking even.*

Time Is on Your Side

When new real estate investors have feelings like these, patience is the main thing that's needed. Remember: even if you're only breaking even after paying your bills, you're still paying down the mortgage every month – which is virtually the same thing as making a monthly deposit to a savings account. Moreover, time is on your side. As your rents rise with inflation, your passive income flow will start increasing each month – $25 more, then $50 more, and so on, and it will all begin to add up. Over the long term, as the mortgages are paid down on your property, more and more of the income will be yours. For you, that will mean **prosperity, security, and overall financial freedom – which are what passive income is really all about.**

All of that is true even if you own only one property. But why stop there? Not buying at all is just as bad as buying too quickly – and it's not hard at all to buy one rental house a year. In fact, it gets much easier as you become a more experienced real estate investor. Just keep a few key principles in mind. Learn all you can about your local real estate market. Develop the ability to recognize solid properties and potentially good deals. And have the confidence to present and negotiate your offer to a seller. Those are the basics. But let's go beyond the basics. Here are four hands-on ideas that should always be in your mind as a real estate investor.

The Essence of Real Estate Is People

First, never forget that houses, or deals, and financing are only the tip of the iceberg. The essence of real estate, like any other business, is people. Here's a real-life example of what that means:

About six months into my real estate career I made my first deal. The seller was an elderly lady named Dorothy, and she was very forceful in letting me know her feelings. She was convinced that she had been cheated in the past when she'd sold a house, and she was not going to let that happen again. Of course, I made it clear to her that I had no intention of trying to cheat her – and I was sure she knew that anyway. I suspected that her war stories were just a way of setting me up for some hard negotiating. So I was surprised when Dorothy told me right up front that all she wanted for her home was the loan balance plus $1,000 to move. There was no doubt that her property was worth much more than that, but Dorothy had a perfectly reasonable explanation. It seems that her husband had recently died, and she was going to live with her daughter and grandchildren. The bottom line was, she wanted to be gone by the end of the month. For her, that was the most important consideration.

Although this was my first actual deal, it wasn't my first attempt at a deal. Up to that point I had made at least a hundred offers that had gotten nowhere. Like many new investors, I hadn't fully grasped the fact that real estate was about people, not properties; as a result, I had never really considered why an owner wanted to sell – and whether the price would be low or high. I just assumed their motives as sellers were the mirror image of mine as a buyer.

Dorothy taught me the all-important lesson that people don't necessarily want what you think they should want – and they don't necessarily act for the same reasons you do. Her house was in pretty good shape; she could have sold it for full value in 60 days or so. But what she wanted wasn't the top price. What she wanted was speed. She wasn't motivated by money but by a desire to start a new phase of her life. She wanted to put her old life behind her, and her house was a symbol of her old life. With this in mind, Dorothy was perfectly content to accept about a third less than the actual value of her property, provided the transaction could take place as soon as possible. That turned out to be exactly one week later.

Up to that point, I had assumed that anyone who owned a rundown house in a questionable neighborhood would be willing to sell cheap. I had also assumed that anyone with a nice house in a good neighborhood would be looking for top dollar. If I had known what I finally learned from Dorothy, I could have saved the time and energy I put into all those fruitless offers. People are unique individuals, and sometimes the only way to really know what they want out of a deal is to ask them. So if you're making offer after offer and getting rejection after rejection, you should think about talking to sellers about what they want, instead of assuming that you already know.

Never Rent to Anyone You Know

Second, once you've purchased a rental property, the next all-important step is finding a reliable tenant. To make this easier, here's a principle that will rule out a substantial number of applicants: Never rent to anyone you know.

> *I still have a lot to learn about real estate, but there's one thing I can tell you for sure: sooner or later your friend, or your cousin, or the person you once talked to at a dinner party is going to be looking for a place to live – and they'll be looking at exactly the same time that you have a vacancy. It's going to seem as if this is a perfect solution for both of you. After all, your cousin Joe's a nice guy, and he even has some carpentry skills. He eagerly offers to do some work on your property and fix it up real nice. So, in a gesture that you will never cease to regret, you offer your vacant property to Joe. He gets a discounted rent because of the work he's going to do for you, and you get a tenant you can trust. Everybody wins, right?*
>
> *Well, everybody wins except anyone who's even remotely involved in a situation like this. Here's the thing to keep in mind about renting to people you know: you and your friend or family member are entering the agreement with opposing views of the possible benefits. You as the property owner are happy because you know your buddy will treat you fairly – meaning that the rent will be on time, the repairs you agreed on will be made in a timely fashion, and he won't let your bathtub overflow. He goes in happy because he knows you'll treat him fairly too – except to him that means you'll let him slide on the rent at Christmas, take his time on the repairs, and let him raise pit bulls in the basement. You think he'll be the perfect tenant; he thinks you'll be the perfect landlord. It's a conflict of viewpoints that isn't easily resolved, at least not without a lawyer.*
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> *When you become a real estate investor, your outlook on life undergoes a major change. Unless your friends are also property owners, they haven't experienced this kind of entrepreneurship. The chances are they have no idea what it's like to invest huge chunks of time and money in a property. I know someone who once lost not one but an entire group of college friends when he evicted one of them for nonpayment of rent. Suddenly he became "the landlord," and he was no longer welcome at the softball games. In my own experience, my brother-in-law can't see me at family gatherings without mentioning how shabbily I treated his best friend by forcing him to pay late fees every month.*
>
> *The fact is, I have never once seen a friend-to-tenant transformation work out to the satisfaction of both parties. On the bright side, since no one ever tells people that renting to friends and relatives is a very bad thing, there are an awful lot of buying opportunities out there. They come into being when owners realize they're never going to see a dime out of Cousin Joe.*

There Is No Single Best Way to Develop Passive Income Through Property Ownership.

Many new real estate investors have a mentor, or even a "guru." This is someone who provides not advice, but a comprehensive world view that helps to direct and focus the newcomer on a particular strategy. This guru can take the form of a real estate professional, an academic instructor, or a family member who has experience in the business. One of the major attractions of these experts is their certainty that their particular strategy is the last word in real estate investing. But really, there is no last word. Our third concept is that there is no single best way to develop passive income through property ownership. Instead, there are many ways, each of which can work well for a particular person in a specific situation.

> *My father had success in real estate, and he was convinced it was because he never varied in his approach. He always bought houses for cash, and then refinanced several of them as a package. Then he had more cash to buy more houses. No property – regardless of the type, condition, or location – ever got any other treatment. And like most gurus, he was willing to defend his method to the death. He was certain that all other strategies were less profitable, more difficult to execute, and basically inferior to his special favorite.*
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> *Real estate gurus are compelling figures to new investors precisely because they are so focused and certain of themselves. Following a particular guru can be extremely valuable for overwhelmed novices, because it allows them to learn a particular technique in great depth. The downside is that guru-worship limits the new investor's experience. As a result, their followers tend to have a narrow viewpoint in terms of what a "good" deal is. This causes them to pass up some profitable opportunities.*
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> *When I stopped working for my father, I lost access to his banking relationships. The "pay cash for house" option dried up, and I was forced to learn some new strategies. It was tough at first, but it was also necessary – and ultimately it brought me a lot steadier income. When I look back now at my files from previous years, I see all the opportunities I missed. Properties that didn't fit my dad's "cookie cutter" would have been great buys, but I just couldn't see them.*

People Don't Always Tell the Truth, Especially Where Money Is Concerned.

Our last concept is absolutely essential to understand, but maybe not easy to accept. The fact is, people don't always tell the truth, especially where money is concerned.

> *I grew up with the idea that lying was a bad thing to do. Furthermore, getting caught lying was embarrassing and could get you into a lot of trouble. But somehow people who apply to rent houses missed this lesson as kids – or maybe they unlearned it as adults. Because no one ever told me this, I spent the first four years of my real estate career checking*

applications only very casually. As a result, I ended up renting my houses to some really disappointing tenants. It seemed as if my properties must have some sort of curse on them. Otherwise, how could perfectly good applicants somehow self-destruct just weeks after moving in?

I first began to wise up about this when I got not one but three separate calls from collection agencies about a tenant I'd just rented to. I kept telling the callers that they had the wrong party, since my tenant's record was clean when I checked it. Finally, one of the creditors gave me a description of the tenant and her car, and I realized that I'd somehow missed something. What I'd missed was the fact that I was being deliberately misled with wrong information.

Since learning this lesson, I've become an application-checking fiend. I look at driver's licenses, credit cards, and even passports. I cross-check current addresses with those on the credit report, and then cross-check owners' names with those of landlords on the application. I verify phone numbers. And I have a firm policy that nobody gets to live in one of my houses if I find any sort of falsity on their application. After I discovered that something like 60 percent of my applicants were giving wrong information, I developed a full-page instruction form explaining to all potential tenants that lying about their rental, credit, criminal, or work history would result in automatic rejection and loss of their application fee – so guess what happened. Not a thing. Nothing changed. I've rejected 8 out of the last 10 applicants I've had due to falsification of the application. There's an old saying, "Let the buyer beware." I say, "Let the property owner beware, or the property owner will be sorry."

In this session our intent is providing practical information for getting started in real estate investment. Of all the ideas we've looked at so far, the one that causes property owners the most trouble is the last topic we just discussed – the process of finding good tenants for your rental property. So for the balance of this session we'll focus our attention on that topic. After all, if you're going to create passive income through rental properties, you're going to need people to live in those properties and pay the rent. And it can't be just anybody, either.

How to Find Good Tenants

The process of finding tenants virtually always starts with the placing of an ad in the newspaper, or more recently on the Internet. Usually ads for house rentals generate quite a few calls, especially when interest rates are high and people are thinking of renting rather than buying. If your property is one that appeals to tenants beyond college age – and especially to people with children – you may find that some want to rent with an option to buy. This can be a very desirable situation, because once a family is established in a property, it may suit them to pay close to your asking price rather than dealing with the cost of another move.

But in any case, your first move should be a suggestion that the caller drive past the property to see if it's appealing. You should do this before making an appointment to actually show them the house. This policy will hugely cut down on the time you spend standing on the porch, waiting for a prospective tenant who does not show up.

Step One: Tell Them to Drive Past the Property

A big part of any "no show" problem is the pre-screening process. Most prospective tenants will try to tell you what they think you want to hear, especially over the telephone. They'll almost never say they can't afford the rent, or that they don't understand leasing with an option to buy. Often they'll go ahead and make an appointment that they have no intention of keeping. So you should definitely invite them to drive past the house and then call you back if they're interested. Tell them what the rent is going to be and how much you expect up front as a deposit, and then invite them to make the drive past it. More often than not that's the last you'll hear from them, but at least you won't be waiting out in front of your rental house.

Step Two: Ask Good Questions

If and when you do meet with a prospective tenant, be prepared to ask some well-focused questions: "What is your total household income before taxes?" "Where are you living now and what are you paying?" "How long have you been there and why are you moving?"

Any applicant who seems unqualified should just be told that's the case. Do this frankly but in a friendly way. Make it clear that this is strictly a business decision and nothing more. If you want to soften the blow a bit, you can use some very detached phrasing. For example, "As an owner I need to have a very clear cutoff point regarding income. I wouldn't want to waste your time or your deposit on this rental, but can I keep your name and call you if I hear about anything else?" If prospects insist on seeing the house anyway, it's a good idea to show it to them. Just make it clear that the bulk of your time has to be given to qualified renters**. If you're concerned about asking questions about people's income and motives, you'll need to get over it.** The ones who get offended are the last people you want to make an appointment with anyway.

As you ask your questions, always be aware of fair housing laws and stay within the rules. Fair housing laws state that your willingness to rent or sell housing to a particular person cannot be based in any part on that person's race, religion, color, sex, handicap, nationality, or familial status. Unfortunately, there are applicants who threaten to file discrimination suits even against owners who choose not to rent to them for very legitimate reasons. But the fact that someone threatens you with a complaint should not intimidate you, provided you have followed the letter of the law.

The key to staying safe is to have clear guidelines for renting to an applicant.

These guidelines should be objective, easy to quantify, and unrelated to the applicant's membership or non-membership in a protected class. They should be nothing more and nothing less than predictors of the tenant's ability to fulfill the lease – that is, to pay the rent on time every month and keep the property in good condition.

Examples of these guidelines include the prospective tenant's earning history, whether the prospect has ever been evicted, and how many places of residence the applicant has had in the last several years. Be sure to verify all this information.

It's a good idea to print these questions out as a form and actually fill out the form for each prospect. This avoids the appearance that you are trying to dissuade some tenants and not others. All rejected applications should be kept on file for at least three years, with a note on your reasons for rejecting the applicant. Before you begin showing your first property, call your local fair housing agency for additional advice.

If prospects mention leasing with an option to buy, ask whether they've ever entered into this kind of agreement before. If the answer is no, you can explain how a lease/option works, then end with "Well, I'm not sure I explained that very well – I can give you some printed information about this after we look at the house." Then you can give them downloaded printouts at the end of the appointment. In this way you're taking the blame if they didn't understand – and they almost certainly won't understand. You're also saving time by giving them something to read rather than going through it all again during the meeting. The printouts can be accompanied by a rental application form that they can return at the next meeting.

Sometimes prospects take an application and never return it. They seem excited about the property when they leave and promise to get the completed application back in a day or two, but then you never hear from them. If the applicant seemed really attractive to you, you may be thinking about making a follow-up call – but you may also think that if applicants are really worthwhile, they would keep in touch with you.

Step Three: Make Follow-Up Calls

There's actually a very simple answer to this problem. Yes, you should indeed be doing follow-up calls – not only to the people who took applications, but even to the people who didn't. This is the best way to get feedback as to what prospects like and dislike about your property. You can speculate all day as to why people aren't returning the applications, but the only ones who can really tell you why are the people themselves. By the way, there's an obvious means of avoiding this problem in the first place. Ask people to fill out the application onsite rather than return it to you. In your initial phone call, you can ask applicants to bring a driver's license or photo ID and a $20 application fee in the form of a certified check, money order, or cash. This way, they can actually apply before they have second thoughts or find another property.

Instead of winging it with each prospect to schedule an appointment, set aside a period of time each week that seems convenient for most people – Saturday from 11 a.m. to 1 p.m. usually works well. You should also be flexible, however, and if they really can't make the scheduled time, you can offer alternatives. Just remember that being customer friendly is always a good idea, but building your personal schedule around potential tenants is always a bad one. You can appear to be accommodating them without inconveniencing yourself, by offering several appointment times. The truth is, tenants won't appreciate you any more because you jump when they say to jump. In fact, it sets a tone for the rest of your relationship that you probably don't want to encourage.

Some owners ask prospects to call an hour before the appointment in order to confirm. Use your own judgment about whether to do this. You don't want to be treating potential tenants like children, but you also want to maximize the chances that they'll actually show up. A good trick is to say that you always forget appointments, so the call is really for your benefit.

The practices we've discussed in our two sessions on real estate investment are followed by virtually all successful property owners. There's also one other quality that's shared by all high-performing real estate investors – and that's a personal code of ethics. Although the real estate business seems to be about roofing and siding and money, it's actually about human beings finding places to live. Your decisions will affect many people in very basic ways. As a result, it's important to decide how you'll act with tenants, applicants, service providers, and everyone else you'll meet in the course of your work. Meeting the highest ethical standards is not really difficult. Just ask yourself, "Am I behaving fairly?" and "Is this the way I would like to be treated if I were a renter instead of an owner?" When you are able to answer both these questions in the affirmative, your real estate business will soon be almost running itself. Your reputation as a fair-minded owner will grow, and so will your passive income revenues.

We've now reached the end of session seven and our discussion of rental property. In our next session, we'll look in detail at some other kinds of property that can be just as rewarding, but first, fill out Your Travel Planner.

Your Travel Planner

What are some screening questions you will ask prospective tenants? ("What is your total household income before taxes?" "Where are you living now and what are you paying?" "How long have you been there and why are you moving?" are a few examples.)

What are your renter guidelines? (Prospective tenant's earning history, whether the prospect has ever been evicted, and how many places of residence the applicant has had in the last several years are some examples.)

Describe your Personal Code of Ethics.

The Map

If developing successful real estate investing appeals to you, and if you haven't already done so, include real estate on your routes to financial freedom.

Session 8: Building Passive Income from Intellectual Property

Need to Know Before You Go

Welcome to session eight! If you read the biographies of people who have been very successful in business over the past hundred years, you'll find that none of them got there by being overly cautious – or even by being cautious at all. They saw a clear connection between big risks and big rewards, and they were eager to take the big risks. But here's the problem. There are lots of biographies of successful people, but there aren't nearly as many of people who were unsuccessful. And you know what? Unsuccessful people are also drawn to big risks. It's just that they're going to stay unsuccessful until the risks pay off – and for many people, that day never comes.

For the purposes of this program, the ultimate success story is the power to support yourself entirely by passive income. That's the final destination our map is leading to – complete financial freedom. When you arrive there, you will have a sufficient number of income sources – or one big one – so that you don't need money from anywhere else. In this session we're going to see how you can move toward that goal. We're also going to see that it really is a process of moving toward the goal over a period of time, and not just arriving there all of a sudden tomorrow morning. But it can be done. In fact, more and more people are finding that it has to be done, because the alternatives are rapidly fading away.

Entrepreneurs Are Everywhere!

Starting in the middle of the 20th century, America was built on the concept of long-term employment with one company. It began during the 1940s, when workers were desperately needed for the war effort. The whole idea of firing people began to evaporate. Losing one's job had been such a potent threat during the early part of the century, when men like Andrew Carnegie and Henry Ford tried to break strikes by closing plants and firing workers. But when every pair of hands was desperately needed, companies began to provide cradle-to-grave security, including health benefits, vacations, and elaborate grievance procedures.

Well, that was then, and this is now. Today almost nobody stays with one company for a whole career, and increasing numbers of people are never with a company at all. Being an entrepreneur is becoming the norm, not the exception. Lots of positives have come with this profound change – but I don't think anyone would say that it happens by itself. It takes lots of planning, and it also takes lots of guts.

> *I graduated from college four years ago with a degree in graphic design. Lots of my friends who had the same degree were talking about starting their own businesses. It seemed very simple: work at home, build up a network of referrals, and then create intellectual property that I could license out. Pretty soon all I'd need to do would be to cash the checks. But except for me, not one of my friends has made it work – and for a long time I had to do a lot more than just cash checks. That's why most people work for someone else, even if they know that trading time for money is a losing game. And to be honest, I couldn't have been*

a freelancer and developed passive income revenues if I hadn't had a financial cushion in place first.

When I decided to stop trading my time for money, I saw that my goal in life was to do the exact opposite. I wanted to have enough money in exchange for the smallest possible amount of time. As I thought it over, it seemed like there were three practical ways of reaching that goal.

First, I could become a full-time independent contractor – a classic freelancer. At first this seemed like the easiest route. I would have flexible hours, the ability to pursue any job or assignment that appealed to me, and the flexibility to change my tactics and strategies at a moment's notice. The downside was having to charge low fees at the start, because I didn't have experience. And, at least at the outset, I would still be trading money for time until I had the capital to build passive income.

It also occurred to me that I could actually start an organization – a company with an office and some employees and, of course, me as the head. That would mean getting investors or a bank loan – but I also felt it would give me more credibility than if I was just sitting at home with my computer and my telephone. This route began to seem more attractive when a major client at my current job took me aside for a confidential chat. I was flattered when he told me that he was happy working with my employer, but he was especially impressed with my work individually. He even suggested that if I were to start my own operation, he would probably follow me with his account.

That was very exciting, but I could also see a potential complication. What if this client turned out to be less pleased with my work once I no longer had the support and infrastructure of my current employer? I had better be prepared for a lot of hard work – and in a sense, my client would actually be my new boss. Officially, I would be self-employed, but the reality would be something very different.

Finally I decided that a third route might be best. I would put off leaving my job for a while, but I would also start pursuing passive income ideas in the meantime. With this route, I would have enough money to pay my bills and still enter the arena of entrepreneurship. The only trouble was, I could be wasting valuable time. As long as I was still working nine to five, I couldn't develop my ideas to the maximum. Also, as long as I was still getting a paycheck, I was going to need a lot of discipline. I would be tempted to just pay my bills and goof off the rest of the time.

In the end I did go with the third option – but about three months ago I found myself gravitating toward the life of a full-time entrepreneur. I've found that it really is very difficult to be a successful risk taker when you're also working all day to keep a safety net in place. Also, I did have some money saved so that I wouldn't have to worry about paying bills for at least six months, provided I didn't go on any shopping sprees. So I took the plunge.

> *And here's the main thing I've learned. There are lots of opportunities when you're working for yourself, and there are many ways to reach the goal of passive income. There may even be too many ways – because what really makes the difference is being able to turn down good opportunities so you can pursue better ones. You need to think long and hard about your core plan, and don't let a little cash change your mind.*

If you're looking for financial independence and creative ways to bring that about, here are some key ideas to keep in mind:

Save Some Money Before You Quit

First, start saving some money before you stop being a salaried worker. In other words, don't quit your day job – at least not right away. Today there is no such thing as job security, but when you're an entrepreneur, the risk is all on you. So you'd better have some savings. It's a good idea to have about six months' worth of living expenses on hand. You should be especially careful about health insurance. This is a big expense – often it's equal to what people pay in rent. But you really need to get it when you can. If you have a health problem without having insurance, not only will you have trouble funding treatment, but getting insurance later will be even more difficult.

Freelance on The Side

Next, have some clients already on board when you go out on your own. You should be doing freelance work on the side long before you switch to it full-time. If you don't, it can take months or even years to establish accounts that will pay you at a decent rate. So in the time leading up to the switch, make sure you have clients lined up well before you quit. Then crunch some numbers. It will be exciting to be out on your own supporting yourself with multiple income sources – but if you happen to be married with a family, you had better know exactly what your expenses are and whether you'll be able to meet them every month. When you consider those expenses, be sure to add in the cost of health insurance and any retirement plan you're funding. Working on your own takes planning and financial discipline, so make sure you're ready for it.

The Customer Is The Boss

The truth is, even if you're no longer on salary, you still have "employers," except now they're called clients or customers. You have deadlines and commitments, and unlike many people in the corporate world, if you don't meet your deadlines, you don't get paid. So you no longer have a boss looking over your shoulder and you're no longer just trading time for money, but the trade-off is you have to manage yourself very carefully. You have to "be your own boss" in a very literal sense.

Effective time management must become a major priority.

One system that works well involves dividing the day into three parts**. Start the morning by catching up on any projects on which you may have fallen behind during the previous day.** Sometimes, no matter how well you've planned, things will come up that prevent you from getting work done as you'd intended. So don't do anything the following day until you've caught up. Sometimes you may not have to do this at all, and other times it may take most of the morning.

In any case, **use the middle of the day for staying on track with your various responsibilities.** If you have a website business, make sure you update it. If you have stock market or real estate investments, stay on top of them.

Finally, **use the afternoon to look for new opportunities and to stay in touch with people who can help you find them.** When you're first setting up your passive income sources, there will be days when you're working harder than ever before. But if you do it right, those will only be days – not years. Keep your eye on the prize, and the prize will come.

> *Working for myself, I'm always aware of the need to maintain a consistent cash flow. First, I need to obtain clients – preferably those ready to fund quality work. And if you're in a service business, as I am, the next concern is about getting paid. Even companies and individuals that have good payment practices can have their own cash flow issues from time to time. There is also the need to always market myself – and to manage the work flow so that I can always be available when a good client calls.*
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> *Even if I meet all these demands, there will still be dry spells. There will be times when new work isn't coming in, or when I'm having trouble collecting what I'm owed. Those are the times when I need to have an alternative to my primary business. In other words, I need passive income. It's not just a luxury. It's a necessity. I need a way out of the business model in which I work once and get paid once. Making that happen is what passive income is all about.*
>
> *It's really important to be organized, to feel that there's a schedule and that you have to meet it. You'll drive yourself crazy if you just flit back and forth from one project to another – and it's very easy for that to happen. The only way to be sure you've got the right focus is by prioritizing your time in advance. And when you want to prioritize, you have to give yourself time just for that – free from all distractions. Then get your time frames lined up. If you don't, things that seem really urgent but not important will keep you from doing the things that are really important but not urgent.*

When You Work for Yourself, You'll Like the Boss

One of the best things about having a schedule is that you can break it if you need to – but at least you'll be aware of what you're doing. When circumstances change, priorities have to change too, at least in the short term. Agility and flexibility are a couple of big advantages that entrepreneurs have over larger organizations. Many opportunities come up that are time-sensitive, and if you're locked into an artificially rigid schedule, you'll miss them. The trick is to know the difference between maintenance work and a chance for real growth work. You need both, and you've got to make time for both.

"Passive income" is a very imperfect term. There's actually no such thing as purely passive income. At the very least, you have to collect your checks and deposit them, right? And there's usually a lot more than that. Rental property has to be managed. Websites have to be kept up-to-date. Maintenance work has to be done on a regular basis – daily, weekly, or monthly – and there are consequences if you don't get it done. Growth work, on the other hand, doesn't have a consequence attached to it unless you give it one. So make sure you know how much maintenance work your income sources require. That way you'll know how much time you really have for growth projects.

You'll find it best to work on only one growth project at a time. Keep working on it until it starts working for you. When a project is first starting out, do whatever it takes to get it to the point that it has a life of its own. That may mean getting it to the point where you can share it with potential collaborators or customers, or it may mean getting it to the point that it can start to generate income. Once a project has started earning passive revenue, let it work for you while you work on something else.

Sometimes people assume that leaving the salaried world means starting a whole new life. In a way that's true, but it shouldn't mean abandoning everything you've learned and gotten good at. If you're working in the marketing department of a large corporation, for instance, you don't have to go into an entirely new field just because you want to become self-supporting. Instead, ask yourself how you can create passive income by using the skills you've already developed.

Get Intellectual

When you do this, you'll find that very often it takes you into the area of intellectual property – that is, work you've generated in the form of words, sounds, or images. All of these can be copyrighted, and you can gain income by allowing access to them.

Here's an example. A freelance translator noticed a discussion on the Internet about copyright issues. She wondered, "Do I have any rights to the translations I produce?" The answer turned out to be yes, especially if there was no contract stating otherwise. This led to some very productive ideas for creating passive income.

> *When a piece of writing has been out of print for many years, the copyright ownership of that book may lapse. Or, in the case of a foreign language document, it may be the copyright of the translation that loses force. As a translator, the difference between these two issues is very important to me. For example, no one owns the copyright to Shakespeare's plays. I can print an edition of the plays on my computer and try to sell it, and neither Shakespeare's heirs nor his many publishers can object. But if I translate* Hamlet *into Finnish, and someone in Finland wants to publish my translation and I've copyrighted it, that person or company has to get my permission – even though the play itself is in public domain.*
>
> *This has opened a huge resource for me in producing passive income. In the past, I had taken it for granted that any translation work I did became the property of the client who paid me, as part of a work-for-hire deal. But that's true only if I agree to it, so retaining rights to my translations can become a negotiating point for me. And if I translate some-*

> *thing on my own rather than as part of a work-for-hire deal, I own the rights to the finished work even if the original was in the public domain. That means I'm entitled to a royalty check whenever anyone wants to use my translation. Once I understood this, I immediately started translating some well-known public domain stories, especially stories that were often anthologized. This has been an excellent source of passive income for me – and the more stories I translate, the bigger it gets.*

As technology continues to advance, you may be surprised by what intellectual property has come to include. For example, English may be your only language, but you can still own the rights to a translation. Even if you used a computer-aided translation program to complete the work, the rights to the translated text still belong to you. So be aware of the many areas of your life in which you may be producing something that qualifies as intellectual property. If you're in service industries such as consulting, photography, or even manufacturing, there's a good chance this is the case – and if it is, here are some steps you should take right away.

Protect Your Intellectual Property!

Assert your rights by inserting a copyright notice, getting trade or service marks, or obtaining patents to protect the product of your work. You must protect the fruit of your labors by making it difficult for others to sell it or use it for their own profit. It's actually much easier than you might think to copyright something. Usually just stating that material is copyrighted – at the bottom of a website, for example – is legally all that it takes. With printed texts, just draw the letter "c" with a circle around it and then write your name. Copywriting designs or software innovations can be a bit more complicated, so it's a good idea to consult an attorney. But don't neglect taking this step. You can't draw passive income on intellectual property unless you can prove that the property is yours.

Charge a separate fee for your protected materials whenever they are used. This can provide a major passive income source. And if you can't be sure that you'll be able to control the use of your creations, you can deal with that problem in your original contract.

Here's a case in point. You're a landscape architect and you create a beautiful design for the parklike area around a new office complex. You invested talent and imagination in the creation of this design. You also needed a lot of time to produce it – not just the hours you spent making the design itself, but also the years of experience that you needed beforehand. Even more importantly, the design you've produced will now be available to anyone who visits the office park. If another real estate developer wants to develop a similar office park, it's very possible that the developer will copy your design without any compensation for you. To deal with that possibility, you can negotiate a licensing fee from your original client in addition to whatever your one-time payment might be. This will insure you against the probability that your efforts will be reused for profit by others.

If your client won't agree to the licensing fee, then you have a strong argument for drastically increasing your basic fee. If you're creating intellectual property, you're an artist in your own right – and in the art world there's a good reason why prices can be sky-high. Let's say that an artist creates a painting of a landscape and it sells for ten thousand dollars. As the painter continues her career and builds a reputation, the value of the landscape begins to increase – so that when the original owner puts it on the market, it sells for a hundred thousand dollars. That's a profit of ninety thousand dollars for the owner, of which the artist gets not one cent.

Therefore the artist is fully justified in building a fee for the owner's future profit into the artist's original price. Although it's possible in the world of fine art, you can offer your clients the option of a continuing licensing fee and the passive income it will bring. Or you can up your original price. Since licensing is the best option for both parties, the chances are they'll go for it – and you'll be getting checks for years to come.

You can also **negotiate a royalty** if a client uses your copyrighted material to generate sales. This is a legitimate fee for the continuing use of your intellectual property by a profit-making enterprise. What's more, when this royalty or licensing fee is taxed as passive income, it can be offset by passive losses generated by other sideline activities – such as real estate investing, for example. Unless you are a "real estate professional" – that is, you spend at least 50 percent of your time in the real estate business – your passive losses in real estate can be deducted from other passive income up to a legal limit. You'll want to check with a tax accountant for the details.

As you become more successful and better known, you can **create passive income by subcontracting work to other professionals**. This can vastly increase the total volume of work you can handle, and the income you make will be compensation for your administration and quality-control efforts. I hope you're beginning to see that there are plenty of passive income opportunities out there once you start thinking creatively. In fact, after you take advantage of all the possibilities in your primary expertise, you can begin looking in other areas for passive income. And as you might expect, the Internet is an excellent place to look. True, there are plenty of scams in cyberspace, so beware – but there are also very real opportunities.

An excellent way to start is by **joining an affiliate program** related to your main area of expertise: this means posting links on your website and collecting a commission for any sales that come through those links. As you become more confident on the Internet, there literally is no limit to what you can do, and the costs can be kept very low.

Claim Your Place in Cyberspace

Cyberspace is a perfect environment to give your ideas a life of their own. Whenever you have an idea that you think is really good, buy a domain name on www.godaddy.com for $10. Then put together a simple web page, or even a free blog space. Now for less than $20 you have a place for your idea to start taking life and for you to communicate that idea to prospective clients. If you're not especially Web-proficient, just jot down your thoughts and find someone to help you. For a minimal fee, almost any high school student will be Web-savvy enough to handle these tasks. If you forget your own ideas and don't act on them, one thing is certain: nothing else is going to happen. But once your thoughts and concepts are out in the world, you never know where they might take you. But you definitely ought to find out.

In this session we've seen how the workplace is becoming a much more improvisational, entrepreneurial setting. We've seen also how you can profit from that. The first step is making a commitment to stop trading money for time – but you also need sufficient funds to act on that commitment until some money starts coming in. We've also seen how the concept of intellectual property can open income trails that you may never have imagined. To follow those trails, you just need a certain amount of creativity – plus the assertiveness to get paid for what you've created. It can definitely be done. Just remember, as we said at the start of this session, it won't happen by itself.

In Session Nine, we'll explore some other trails to passive income that may surprise you. But first, let's fill out Your Travel Planner.

Your Travel Planner

How much money do you have in savings? How much money do you need to cover six months' worth of expenses?

Do you currently freelance on the side? What clients would go with you if you went on your own?

How can you create passive income from the job you're already doing?

What intellectual property could you create for licensing and royalty fees?

What protections do you have in place for your intellectual property?

Do you have a website? If not, take 15 minutes and research domain names and hosting. What are some available domain names for your business?

The Map

If you're interested in developing intellectual property, jot down some of the tools you will use to reach your intellectual property goals and some roadblocks you might encounter. See the sample map for ideas.

Session 9: The Pros and Cons of Direct Selling

Need to Know Before You Go

Hello and welcome to session nine! The path we'll explore in this session is multilevel marketing – and the opportunities for passive income that it may present. I say "may" because this particular business model has long been surrounded by a certain amount of controversy. As we proceed along this path, you'll see why this has been the case. You'll also be able to form your own conclusions. But as a prelude to this discussion, let's step back and take a fresh look at the concept of passive income itself.

Whether we admit it or not, Americans have always had mixed feelings about the benefits of hard work. On the one hand, we admire people who live by the sweat of their brow – and we really admire people who get ahead that way. At the same time, we don't really hold a grudge against those who inherit wealth, especially if they share some of it through philanthropic or charitable causes. In other parts of the world there's a deep resentment against the rich, but that anger has never really taken hold in this country – probably because so many of us want to be rich ourselves. And given a choice, most of us would like to get rich the easy way rather than the hard way. We'd prefer winning the lottery tomorrow to spending 20 or 30 years building up a business. And along the lines of our program here, we'd rather just get a check in the mail or a wire deposit to our bank account than work nine to five all week for a payment on Friday. In short, we admire people who work really hard, but in our own lives we'd like to replace that hard work with passive income to the greatest possible extent.

These dual feelings about work and wealth and what it all means come into sharp focus around our topic in this session.

In a sense, multilevel marketing is the ultimate in passive income.

In multilevel marketing, if things go according to plan, you very quickly develop an ever-expanding group of subordinates whose work benefits you as well as them. To see how that happens – or how it's supposed to happen – let's start with the basics.

MLM 101

Multilevel marketing – also called MLM, or network marketing – is a way of selling products and services through a chain of semi-independent distributors rather than through traditional retail outlets such as stores or mail order. Each MLM distributor has two basic jobs. The first job is to sell the company's products or services, and the second job is to recruit more distributors for the same purpose.

In turn, each new recruit that a distributor brings into the organization is encouraged to bring in his or her own recruits. Eventually an active distributor develops a substructure known as a downline. Once that's happened, the distributor not only gets commissions on his or her own direct sales, but also gets a commission on the sales of the distributors in the downline. There are also usually performance bonuses for reaching certain sales levels. Since each distributor profits from sales of the downline, it is to the advantage of the distributor to help those below to succeed.

The basic concept of MLM has existed for at least a century, but in post-war America its first big success was the company then known as Amway – a contraction of "American Way" – which was founded in 1959. Since then, Amway has conducted business in the United States and Canada, as well as through a number of affiliated companies in more than 90 countries and territories around the world. In 2005, this family of companies reported sales of $6.4 billion. Its product lines include personal care products, jewelry, dietary supplements, water purifiers, air purifiers, insurance, and cosmetics. As the Amway website puts it, "For more than 45 years, Amway Corporation has enabled people to have a business of their own."

If you've followed our description of MLM so far, one key question may have already occurred to you: Is there a limit to how big a downline can get? The short answer is, "Yes, there certainly is a limit, if only because there's a limit to the number of people in the world." This may sound facetious, but one of the objections to MLM is that it's simply a pyramid scheme, like a chain letter.

At one time or another, almost everyone has been asked to participate in a chain-letter scheme, with the promise of hundreds of personal checks soon appearing in your mailbox – all made out to you. Chain letters promise a phenomenal return on a small effort. They're also illegal, for the simple reason that the payoff is impossible. But to see what this implies for multilevel marketing, we need to look a bit closer at the mechanics of how chain letters work.

Chain Letters Can't Work

The simplest form of a chain letter contains a list of people's names, usually between five and 10 of them. You're supposed to send a check to the top person on the list. Then you erase that top person, sliding the second person into the top position. You add yourself in the bottom position, make copies of the letter, and mail them to your friends. The promise is that you will receive huge amounts of money when your name reaches the top of the list.

Except you won't. Chain letters can't work, and here's why. Let's assume that there are 10 names on the list and that everyone on the list is honest and keeps perpetuating the chain. Within just a few generations of the letter – and long before your name has reached the top – thousands of people would have to have received copies. In order for you to get any money, the letter would have to go through 10 generations, which requires the involvement of millions of people. If even a few chain letters actually continued through several cycles, the entire country would grind to a halt under the weight of billions of letters. Fortunately, that has never happened, and it never will.

So why do people think chain letters could work? And is there a connection between this belief and the appeal of multilevel marketing? Regarding the first question, people are tempted by these schemes because the human mind does not have an intuitive grasp of the mathematical progression. There's also the fact that not much effort is required, and not much expense: you send out a couple five-dollar checks with the possibility of getting hundreds of such checks yourself. Along the same lines, there was a fad in 1980s for so-called pyramid clubs, some of which cost $1,000 to join. There are also pyramid phone-calling schemes, and the Internet has been a very fertile field for similar scams. But again, nobody makes any money – except possibly one person. That's the person who initiates the letter and whose name is at the top of the list.

How Are MLMs Different?

Now – how is this the same, and how is it different, from a multilevel marketing operation? More specifically, do MLM companies set any limits on how extensive the downlines can become – because if they don't, there's going to be the same problem we saw with chain letters. We're gong to be talking about a downline that includes everybody in the world.

Actually, different MLM companies set different rules about how the number of levels through which distributors will be paid will work. Some link the number of levels to the total sales volume, or they simply impose an arbitrary cutoff point. In addition, once they've reached a certain sales volume, downline distributors are often allowed to split off from the parent distributor and operate as the head of their own chain. In any case, you can see the benefits to being one of the first people in the mix. You will be getting payments from everybody below you, at least until your most successful recruits have split off. Meanwhile, if you've continued your own recruiting efforts, you'll be bringing more people in all the time. Every time they make a sale, you get a commission – and you also get a commission every time one of <u>their</u> recruits makes a sale. **Once this gets rolling, you don't even need to make any sales of your own. It's pure passive income.**

Is this too good to be true? Well, sometimes it is. For one thing, top-level distributors in MLM companies are supposed to provide training and support services for the downline. But in reality that doesn't always happen. Sometimes new recruits are talked into joining with promises of gaining financial independence and great wealth – and that's pretty much all they're told. Out of their own pockets they have to buy samples of whatever the product might be, but there really isn't much incentive to do much selling. The real key to reaching the pot of gold is to recruit new people, so that's where the effort goes.

As with a chain letter, the cost to get started in MLM is often relatively low – generally less than 100 dollars for sample products. And as with chain letters, the payoff is described as virtually unlimited – so many recruits figure, "What have I got to lose?" Yet some people are soon investing thousands of dollars in their MLM business – on more sample products, meeting fees, transportation costs, promotional literature, tapes, books, and an extensive list of other materials made available – at a profit – by the parent company.

It has sometimes been asserted that MLM is not a pyramid scheme because actual physical products are sold and change hands. But the sale of products by itself is not a defense against unfair trade practices set forth in federal and state law. MLM is a legal form of business only if it conforms to rigid conditions set forth by the Federal Trade Commission and by state regulations. Many MLMs ignore these guidelines and operate only because they have not been prosecuted. Moreover, recent court rulings are using a 70 percent rule to determine an MLM's legality. That means that at least 70 percent of all goods sold by an MLM company must be purchased by retail customers, not by distributors or aspiring distributors. At the present time, this standard would place most MLM companies outside the law. At least one MLM acknowledges that less than 20 percent of its sales are made to non-distributors.

Does Anyone Ever Make Money in an MLM?

So far, it sounds like multilevel marketing is nothing but bad news. So let's ask another very pertinent question: Does anyone ever make money in MLM? And here's some good news. The answer is yes. But as in any other for-profit enterprise, the amount of money that can be made is proportional to the effort, time, commitment, and planning that goes into building the business. It generally takes distributors about a year of working 10 to 15 hours a week to have an income of about $1,000 a month – which isn't at all a bad return on investment. But the real money is in residual passive income, which can take three to five years of concentrated effort to build.

Each MLM will have its own compensation plan, which is simply the mechanism by which you get paid. The plan makes clear what volume of sales you need in order to get any money, as well as how many levels of downline will pay you and under what circumstances you will qualify for bonuses. There are also "hybrid" plans that combine one or more elements of the basic structures. Most people are inclined to believe in whatever plan their company has in place. If they didn't believe in it, after all, they wouldn't have signed on in the first place. Some plans are designed to pay a higher percentage of the available bonus money up front. These will be payments for personal sales and on commissions for group sales in the first three levels. Others are constructed to pay more in the deeper levels, and some spread the bonus payout across all levels of the compensation plan.

Regardless of the type of plan, the key to remember is that you can make money with any of them as long as the company itself is legitimate. The product and the effort you make are what will make the difference.

While most multilevel marketing plans are legitimate, others are illegal pyramid schemes like a chain letter. Needless to say, it's very important to know the difference. In pyramids, commissions are based on the number of distributors recruited. Most of the product sales are made to these distributors for their personal use in the form of samples. They never actually reach the public at large. The various goods and services – which can be anything from vitamins to car leases – are only props to make the enterprise look legitimate.

Joining a pyramid is risky because the vast majority of participants lose money. They pay the rewards of the lucky few at the top of the chain. **Most people end up with nothing to show for their money except the expensive products or marketing materials they were urged to buy.**

If you're thinking about joining a multilevel marketing plan, take time to learn about exactly what's involved. What kind of track record does the company have? What products does it sell? What volume of products is sold to the public-at-large? Does it have the evidence to back up any claims made about the product? Is the product competitively priced? Is it likely to appeal to a large customer base? How much is the investment to join the plan? Is there a minimum monthly sales commitment to earn a commission? Will you be required to recruit new distributors to earn your commission? These are just a few of the things you'll need to know. As you look more closely at the deal, more questions will occur to you – and you should not hesitate to ask them.

Important Things to Note

Be skeptical if a distributor tells you that for the price of a "start-up kit" you'll be on the road to riches. The start-up kit usually includes some inventory and sales literature – and sometimes a commitment to sell a specific amount of the product or service each month. You may also be asked to pay for participation in training programs, or for buying sales leads. You may also have to give out of pocket for the products themselves.

If you do choose to become a distributor, be aware that you are legally responsible for claims you make about the company, its products, and the business opportunities it offers. Your responsibility applies even if you're repeating claims you read in a company brochure or advertising flyer. Based on these facts, **be sure to verify the research behind any claims about a product's performance before repeating those claims to a potential customer**.

In addition, if you solicit new distributors, **you are responsible for any claims you make about the earnings potential.** Be sure to describe the opportunity honestly and avoid making unrealistic promises. If those promises fall through, you could be held liable.

Use common sense when evaluating any multilevel marketing opportunity. The MLM field is growing, and solicitations to join seem to be everywhere. Its promoters would like you to believe that this is the wave of the future – a business model that's gaining momentum and growing in legitimacy, and that will eventually replace most other forms of marketing. Many people are led to believe that success will come to anyone who believes in the system and adheres to its methods.

Unfortunately, just calling something a great business model makes no more sense than calling a lottery ticket a great business venture opportunity. It's certainly true that somebody has to win the lottery, and it's also true that some investors – perhaps even thousands of them – have profited from multilevel marketing. But let's be very frank. MLM's structure of an ever-growing sales chain is mathematically unsustainable – and its system of allowing unlimited numbers of distributors in any market area is inherently unstable. In addition, MLM's core business – personal, face-to-face retailing – is contrary to trends in communication technology, cost-effective distribution, and consumer buying preferences. But the retailing activity is in fact only a pretext for the actual core business, which is enrolling investors in an ever-expanding organization that promises exponential income growth.

In any multilevel or network marketing business, the incomes of the distributors at the top and the profits to the sponsoring corporations come from a continuous supply of new investors at the bottom. It could be argued that MLM's true constituency is not the consuming public, but the hopeful investors. The pool of these investors grows significantly in times of economic transition, globalization, and employee displacement.

Promises of quick and easy passive income and the linking of wealth to ultimate happiness also play well in this setting. More specifically, here are seven promises often made by the MLM industry – and some information you should definitely have before you buy into them.

Seven Promises of MLM

Promise number one: MLM offers better opportunities than all other conventional business and professional models for generating large amounts of passive income.

The reality is, for almost everyone who invests, MLM turns out to be a losing financial proposition. Statistically, fewer than 1 percent of all MLM distributors ever earn a profit, and those earning significant passive income are an even smaller percentage. Sales and marketing obstacles account for much of this problem – but even if the business model were more feasible, sheer mathematics would limit the opportunity. The MLM business structure can support only a small number of financial winners. If a 1,000-person downline is needed to earn a substantial income, those 1,000 will need 1 million more to duplicate the success. How many people can realistically be enrolled? Much of what appears as growth is really only the continuous churning of new enrollees. The money for the rare winners comes from the constant enrollment of nonwinners. Unless there are severe limits on numbers of distributors in an area and careful evaluation of market potential, the system is also inherently unstable.

Promise number two: Network marketing is the most popular and effective new way to bring products to market. This is because consumers like to buy products on a one-to-one basis, as the MLM model allows.

However, there is much evidence that personal retailing – including nearly all forms of face-to-face selling – is a thing of the past, not the wave of the future. Retailing directly to friends on a one-to-one basis requires people to drastically change their buying habits. They must restrict their choices, often pay more for goods, and engage in potentially awkward business relationships with close friends and relatives. Once again, MLM depends on selling the opportunity to sign up more distributors much more than on selling any product or service.

Promise number three: In the future, all products will be sold by MLM. Retail stores, shopping malls, catalogs, and most forms of advertising will soon be rendered obsolete by network marketing.

Actually, fewer than 1 percent of all retail sales are made through MLM – and much of this consists of purchases by hopeful new distributors who are actually paying the price of admission to a business they will soon abandon. MLM is not replacing existing forms of marketing. In fact, it does not really compete with other marketing approaches at all. Rather, MLM represents a new investment proposition couched in the language of marketing. Its real products are distributorships that are sold through misrepresentation and exaggerated promises of income. People are buying products in order to secure positions on the sales pyramid and the passive income that promises. The possibility is also floated that you may become rich – if not from your own efforts then from some unknown people who might join your downline.

Promise number four: MLM is a new way of life that offers not only income, but happiness and fulfillment. It provides a way to attain all the good things that the world has to offer. Joining a company is not just a moneymaking venture, but a genuinely spiritual experience. It's like becoming part of a family. MLM is a positive, supportive new business that affirms the human spirit and personal freedom.

Yet the most prominent motivational theme at MLM recruitment meetings is material success, plain and simple. Fortune 100 companies might blush at the excess of promises of wealth and luxury put forth by MLM solicitors. These appeals are often in conflict with people's true desire for meaningful and fulfilling work in which they have special talent or interest. Spiritual concepts like prosperity consciousness and creative visualization to promote MLM enrollment – the use of words like "communion" to describe a sales organization, and claims that MLM fulfills spiritual doctrines – are very deceptive. When a product is wrapped in the flag or in religion, buyer beware! The “community” and “family” offered by MLM organizations to new recruits is based entirely upon their purchases. If the purchases and enrollment decline, so does the “family.”

Promise number five: Success in MLM will be easy because your friends and relatives are natural prospects for sales. Those who love and support you will become your lifetime customers.

But the commercialization of family and friendship advocated in MLM marketing programs is a highly suspect and potentially destructive element for the individuals involved. Friends and family do not always appreciate being approached to buy products, especially if it happens more than once. It’s one thing to buy Girl Scout cookies from your grandchild. It’s another thing to buy a diet program from your sister-in-law.

Promise number six: You can do MLM in your spare time. As a business, it offers the greatest possible flexibility and personal freedom. A few hours a week can earn a significant passive income – which may eventually make any other work unnecessary.

But for most people, making money in MLM requires a serious time commitment as well as considerable skill and persistence. Beyond the work and talent that’s needed, the business model inherently infringes on areas of life that are not affected by most occupations. In MLM, everyone is a prospect. Every waking moment is a potential for marketing. There are no off-limit places, people, or times for selling. Consequently, there is no free space or free time once a person really buys into an MLM system. While claiming to offer independence, the system comes to dominate people’s entire life and requires diligent adherence to the program.

Observers of the MLM phenomenon have noted the degree to which it seems to be fear-driven. Solicitations often include dire predictions about the impending collapse of other forms of distribution and the lack of opportunity in other occupations. Jobs outside MLM are demeaned for not offering unlimited income potential. In contrast to the disintegration or insensitivity of corporate America, MLM **is presented as the last best hope for the American economy.**

Last, promise number seven: MLM is the best option for owning your own business and attaining real economic independence.

But does MLM constitute true self-employment? There’s a strong argument that owning an MLM distributorship is an illusion. Many MLM companies forbid distributors to carry other companies’ products. Most MLM contracts make termination of the distributorship easy and immediate for the company. Even short of termination, downlines can be taken away arbitrarily. Participation requires rigid adherence to a “duplication” model, not independence and individuality. It’s possible to see MLM distributors not as entrepreneurs, but as joiners in a complex organization over which they have little control.

With all those promises and all those refutations in mind, let’s conclude this session with three very specific pieces of advice for getting involved with multilevel marketing. Remember: there are indeed people who have gained excellent passive income through network marketing. In addition, there are people who have become fabulously wealthy. You might be one of them. You might also be someone who can play tennis like Roger Federer or sing like Pavarotti. Or – you might not be. Either way, please keep the following advice in mind.

MLM Advice

First, **avoid any compensation plan that includes commissions for recruiting more distributors.** This is a red flag that could indicate an illegal pyramid. The company's emphasis should be on the income you can gain from selling the product, not the number of new people you can bring in. Be cautious of plans that claim you will make money through continued growth of your downline – that is, the number of distributors you recruit.

Second, **beware of companies that ask new distributors to purchase expensive products and marketing materials.** If the company claims to sell miracle products or promises enormous earnings, ask the promoter to substantiate those claims. Don't pay or sign any contracts in an "opportunity meeting" or any other pressure-filled situation. Insist on taking your time to think about your decision. Talk it over with a family member, friend, accountant, or lawyer.

Third and most important, **do your homework!** Check with your state attorney general about any plan you're considering – especially when the claims about the product or your potential earnings seem too good to be true. Remember that no matter how good a product and how solid a multilevel marketing plan may be, you'll need to invest sweat equity as well as dollars for your investment to pay off. The fact is, it may indeed pay off, and it may pay off very handsomely. But be aware that multilevel marketing is a high-risk means of building passive income.

This has been a largely cautionary session about a controversial route to passive income. In our next session we'll look at the possibilities presented by licensing and franchising. These too have sometimes brought controversy – but they've also brought very significant income to many people. So decide for yourself when you join me for session ten, but first let's fill in Your Travel Planner.

Your Travel Planner

Have you ever been part of an MLM business? What was that experience like?

Do you enjoy selling? Are you good at selling face-to-face? Are you willing to sell to friends and family? Be honest about your potential for success in a MLM business.

What are some MLM opportunities you've explored?

What are the key questions you'll ask when identifying a MLM opportunity.

The Map

If you're planning on investing in an MLM business, jot down some of the tools you will use to reach your MLM business goals and some roadblocks you might encounter. See the sample map for ideas.

Session 10: Creating Passive Income Through Franchising

Need to Know Before You Go

Earlier we spoke a bit about creating passive income through the licensing of intellectual property, especially in the form of Internet content. In this session we'll be looking at a special category of licensing called franchising.

Supersize Your Income!

Chances are you have some knowledge of franchising already – but if you don't, you've missed one of the major transformations in the U.S. economy over the last 50 years. The history of McDonald's, for example, has become more than just a story – it's a full-fledged legend. How in the 1950s Ray Kroc – a milk shake machine salesman – traveled to Riverside, California, to learn why a certain restaurant was selling so many milk shakes. What he found was a drive-in hamburger stand owned by the McDonald brothers. The brothers had perfected an assembly-line method of serving hamburgers that gave Ray Kroc an idea – an idea, it turned out, that would have a huge effect on the American way of life. Kroc made a deal with the McDonald brothers that allowed him to open independently owned versions of the restaurant in other parts of the country. Plain and simple, it was a franchising deal – and the rest, as they say, is history.

Although the real history of McDonald's is a bit more complicated than the legend, the importance of franchising is certainly correct. Ray Kroc went on to become one of the wealthiest people in America, and the concept of franchising became one of the foundations of American business. That story has been told many times, and it's almost always told from Ray Kroc's point of view – that is, from the viewpoint of the franchisee. But what about the McDonald brothers? They were franchisors. For purposes of passive income, their role is the one we really need to look at.

What happened to the McDonald brothers can be described very simply. For a while they received payments for the use of the McDonalds' name and the McDonalds' methods in drive-ins across the country. Ultimately, they were bought out by the company that Ray Kroc founded. Needless to say, they did very well in this transaction. They might have done vastly better if they had not been bought out, but that's a separate discussion. The point is, this was a successful example of franchising all around, and one that people have tried to duplicate ever since. Sometimes it's worked, and sometimes it hasn't. By the end of this session you will have a good idea of what franchising is and how it can be used to generate passive income. Based on what you'll learn, you'll also have a lot better chance of success with franchising than most people who get involved with it. So please pay attention, because franchising has real potential for those who know how to use it.

What Is Franchising?

First, a definition: Franchising is a contract in which a franchisor licenses a name, a trademark, or a way of doing business to a franchisee. In exchange, the franchisor collects recurring payments – that is, passive income. The payments can be in the form of a flat annual fee, or a percentage of profits, or both. Sometimes, especially in large franchising operations, the franchisor provides advertising, training, and other support services. In turn, the franchisee must provide accurate financial records and must maintain certain standards of doing business.

Franchising has existed in America for more than a hundred years. Singer sewing machines, Coca-Cola distributorships, and Western Union telegraph offices were early examples of franchise businesses. Automobile dealerships were also franchise agreements between the manufacturers and local salespeople. But the food service industry is where franchising has really made its reputation. One of the first examples was A&W Root Beer, which has existed as a franchise since 1919. In 1935, Howard Deering Johnson and Reginald Sprague established Howard Johnson's as the first full-service restaurant franchise. Independent operators used the Howard Johnson name, food, supplies, logo, and even building design – all in exchange for a fee.

And of course McDonald's is arguably the most successful franchise of any kind in the world.

The Challenges of Franchising

The growth of franchises in the United States has not occurred without problems. As in multilevel marketing, some franchisors have focused more on the sale of franchises than on selling goods and services to the public. In some cases, franchisors made misrepresentations to franchisees, or failed to provide important information, or did not follow up with training and innovations. Because of this, and because of the large number of franchisee business failures that were taking place, legal remedies were put in place. Today franchisors are required to furnish pre-sale information to prospective buyers. At present, the problems once associated with franchising are definitely less prevalent and franchising is recognized as an extremely powerful business model, both in America and around the world.

But before we go any further, one basic point needs to be made.

*If you sell a license or franchise your business,
the arrangement that results will not
necessarily involve passive income.*

If, for example, you license computer software with the obligation to provide regular upgrades, you will have to keep working – unlike a stock market investment, in which all you have to do is track the ups and downs of your stocks. In this sense, franchising is more like real estate. You probably will not be able to completely disengage from the day-to-day operations of your franchisees. But to the extent that you are able to do that, franchising your business will come under the definition of creating passive income.

Having said this, there is no doubt that franchising your business can have tremendous advantages. But before you begin the process of franchising, you must first determine if your concept and operating system are actually franchisable. Specifically, your business should meet the following criteria:

Four Criteria of a Franchise

First, your business should have credibility. You must be seen as both responsible and successful by prospective franchisees. They will have to earn enough profit after paying fees and royalties to gain an adequate return on investment – and if there isn't evidence that they can do that, they're not going to buy into your franchise.

Second, your business needs to be unique in some very attractive way. It must have sufficient differentiation from other franchises either in terms of products and services, marketing, lower investment cost, or target market. But this doesn't mean your business has to be unique in every way – because Pepsi is not totally different from Coke, nor is Burger King completely different from McDonald's. There's just enough difference so that customers are in a position to make a choice, and for the franchisee to influence them to make the right one.

Third, your system and your business model should be relatively easy for a new franchisee to learn in a short time frame. Some businesses have been passed from parents to their children over many generations. They have an almost organic quality about them that is very difficult to transfer to an outsider. This is not the kind of business that lends itself to franchising. Even if you are the founder of a business that has existed for only a few years, don't even think about franchising if you think of the company as "your baby." Because nobody else will feed and bathe your baby just the way you do – and that can only lead to trouble. In short, the basics of your business need to be transferable, and you have to be ready, willing, and able to pass them along.

Fourth, just as the structure of your business must be transferable, the physical realities of it should also not depend on a specific setting. **Your concept should adapt well to many locations, and there should be widespread demand for your products or services.** No aspect of lobster fishing is suited for franchising, because there just aren't that many places that have lobsters. Conversely, some of the best-known franchises have been successful precisely because their environment is transferable.

This was one of the truly inspired elements in McDonalds' success. During the late 1950s, air travel and the interstate highway system were just becoming staples of American life. People were traveling more than ever before, often with their families. When they were on the road and needed something to eat, it was reassuring to find a restaurant that was exactly like the one back home, down to the smallest detail. More recently Starbucks has created a variation on the same theme. A customer who orders a drink with an elaborate Italian name at the Starbucks on the corner can get the exact same drink across the country. In this sense, both Starbucks and McDonald's were perfectly suited for franchising. Their sameness and uniformity may be the butt of jokes, but it's also made them a huge amount of money.

Without a doubt, the idea of franchising your business can be very exciting. Franchising multiplies and maximizes the profit-making potential of a proven business. If done effectively, it can provide a passive income that far surpasses the returns from a single-location enterprise. If all goes well, you will create a network of allied but semi-independent businesses – and they'll be bringing you passive income with every sale they make. Unlike multilevel marketing, this network will not depend on the downline recruiting of more and more distributors. Instead, the business model will be very simple and traditional. When products or services are sold to the customers, everybody makes money – including you.

Before You Think of Franchising ...

But certain things need to be in place before you can even begin to think about franchising. First and foremost, **your own business has to be well-established and successful**. The bottom line has to be very solid, not just this year but over the course of a substantial history. Also, for franchising to be worthwhile, expanding your business should be inherently exciting to you. It should not be just about more money or increased profitability. If that's all you're interested in, you can probably become more profitable by laying off employees than by taking on new partners.

Think hard about these issues, and see what issues come up in your mind. It may be that your business is a good candidate for franchising right now. But even if your business is not quite ready to take the leap into franchising right now, there are things you can do now to prepare for franchising down the road.

For example, we've already mentioned the need to demonstrate consistent returns on investment.

Profitability is always a determining factor in the success or failure of franchising.

Franchise investors want to put their money in a venture that offers a guaranteed return – or as close to a guarantee as possible. That's why they are willing to pay franchise fees of $100,000 or more. In exchange, it is not unusual for franchise investors to expect a 20 percent annual return. And they expect to see solid reasons to support that expectation.

You also need to have proven and well-documented operating systems in place. Efficiency is the key to running an effective franchise. Successfully franchised businesses have fine-tuned their operational procedures, which are supported by practical and comprehensive operations manuals. Franchise investors don't want to reinvent the wheel in order to find out what works.

Also, **before you decide to venture into the world of franchising, you should probably have opened more than one location for your business already.** The lessons you learn are a preview of what you'll encounter in full-scale franchising. You'll also begin to understand which geographic locations hold the best potential for future franchises. More importantly, multiple locations will demonstrate to potential investors that your business concept is transportable and capable of prospering in more than one market.

Grooming key employees is another basic need**. Long before you make the decision to franchise your business, you should have a team of people in place who can make it all work.** These employees should have a deep understanding of your business' operating systems as well as the ability to communicate their knowledge to others. You might want to identify a few outstanding employees and involve them in preparing an operations manual for future franchisees. This can be an extremely useful and informative project, even if you don't actually get into franchising until far in the future.

With all this in mind, let's meet three business owners who are considering franchising. As you listen, ask yourself whether or not their companies seem like good franchise prospects. More specifically, ask whether you yourself would like to own one of the franchises. And if the answer is no, what would have to change in order for your no to become a yes?

> *Since I was a teenager, I've always worked in restaurants. First I was a waitress, and then I started spending more time in the kitchen. Eventually I became a chef and had jobs in a*

few very high-end establishments. But I was always fascinated by food preparation at all different levels. Once I even thought of opening a place that served nothing but variations on peanut butter sandwiches, which I still think is a good idea. If you disagree, try researching the amount of peanut butter Americans eat every year. You may want to steal my idea.

But instead of peanut butter sandwiches, I wound up with a concept that may seem even more mundane. One day at home, just for fun, I started experimenting with ways of making prepackaged toasted sandwiches in a regular toaster. In other words, if you want to make a grilled cheese and tomato sandwich, you can just put the packet into the toaster and heat it up. You don't have to actually put the sandwich together every time you want to eat one. This can save a lot of time, because you can't really make a grilled cheese sandwich or a tuna melt or a BLT in a microwave. Anyway, this was something I learned how to do, and then I decided to test it. I set up a booth at a big art fair near my house, and in one day I sold more than a hundred packets. I knew my instinct had been right.

Based on my experience, I knew how to talk to owners of small shops and restaurants – and I knew which ones could move this product. So I started selling into a number of places in my home town, especially places that did a big lunch business for people in a hurry. I also knew the importance of displaying the items well, so I provided the shops with ways of displaying the product attractively. Finally – and again because of my background in restaurants – I knew that some of the smaller places would be slow to pay. So I targeted the ones that I knew would pay on time, which was crucial to survival in the early days.

After a year, I had more than 100 accounts for my packaged meals. But the ones that did best weren't actually full-fledged restaurants. They were stalls or pushcarts in malls and other public spaces. In fact, some of these accounts wanted to go over to selling nothing but my products. At lunchtime there would be lines of people, and the toasted sandwiches were all they wanted to buy.

That's when the possibility of franchising first came into my mind – and I thought more seriously about it when I had my second baby. My products had been selling for about two years, and the demand was still strong. In fact, my biggest priority became coming up with a broader range of products. But I also want to spend more time with my family, so franchising is starting to look like a really solid possibility.

This business would seem to be an ideal candidate for franchising. The concept has already proven itself over a substantial period of time, and in multiple locations. The costs involved are relatively small, so if a particular location doesn't work out, the exit strategy will be simple. One problem might be gaining proprietary rights to the process of creating the packaged meals. If the business is as successful as it has been so far, it won't be long before competitors start appearing – especially since, once it's understood, the process seems to be quite simple. This question is one the business owner should take up with an attorney, because it's a question potential partners are sure to ask.

When I was a growing up, I always loved horses. I was never able to have my own horse, but my parents enrolled me in a riding academy and I spent a lot of time there. I got to know the horses so well that it was almost as if they belonged to me. I also loved to draw horses, or read about them, or watch movies about them. And I made friends with a lot of other kids who felt the same way.

After college I became a teacher in a middle school, and I noticed that there were a certain number of girls who were just the way I had been. I'd be talking to the class, and they'd be sitting there drawing horses. The surprising thing was, these girls were always very good students, just as I had been. It was really a very distinct personality type.

Meanwhile, my own interest in horses had by no means gone away. I got a weekend job with a top trainer who owned a riding academy like the one I had attended as a girl. From her I learned all aspects of running a really outstanding yard.

After working with this trainer for several years, I decided to set up my own business. I would specialize in training preteens and teenagers to ride horses up to competition standard. This involved a very big financial investment. Training horses and training kids to ride them isn't something you can do in your back yard unless you've got a very big back yard. To help get a grip on this, I enrolled in business school part time. My instructor in a business startup course helped me draw up an initial business plan. Based on the plan and my solid background, I was able to purchase an existing facility. It needed an upgrade, but it also had a lot of potential.

Very quickly this business literally took over my life. I had no problem at all building up a clientele, but there were times when I felt overwhelmed. I had to deal with administration, finance, and marketing as well as the core business. I wasn't prepared for the amount of paperwork involved, particularly in relation to employees. Still, the one thing I never had to worry about was getting customers. There's just a lot of interest in this on the part of many kids, and there are very few outlets for that interest.

Recently I had the idea of trying to brand or franchise my riding academy in the way that others have done with health clubs and fitness centers. Obviously in a given city there are only so many riding academies you can have. But I think you could have a number of them across the country, and this would become <u>the</u> place to go for kids who are interested in horses. I haven't looked into it in any detail, but the concept of expanding in that way definitely seems interesting.

Unfortunately, this business seems to be the mirror image of the prepackaged meals we discussed a moment ago. It's hard to think of a more labor-intensive, high-investment, high-maintenance enterprise than a riding academy. As the owner says, there is a large customer base waiting to be served – but the expenses of serving it are huge. There are also other issues to consider here that don't exist in the average retail business. Insurance will be a significant cost for franchisees – and in light of this, it will be very important to find highly trained and competent employees. That might not be easy, and it might not be cheap. All in all, this business sounds like a labor of love for the owner, and labors of love are not easily transferable to multiple locations. Neither are horses, for that matter.

> *Most people who start their own businesses are creative individuals and they have a fairly high tolerance for risk. They're not exactly dreamers, but they do have imagination. They're not comfortable with the idea of just doing one thing for the rest of their lives, even though that one thing might bring them financial security. They're more interested in freedom than security.*
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> *For those kinds of people, accounting is not exactly a turn-on. They know that a new business needs to affiliate with an accountant, but that's about all they know. It's not really something they want to think about. They like to focus on marketing or developing their product, and they just want somebody else to look after the numbers.*
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> *As a CPA with my own small firm, I did some research and saw that most accountants offer the same basic package, such as tax planning and payroll services. Although I was confident that our services were some of the best around, I wanted to get a competitive edge in an increasingly tough market. So two years ago I launched a specialist small-business development service aimed at entrepreneurs. This new service has really increased our profitability per customer and boosted our business volumes.*
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> *From talking to prospective clients, I realized that many new business owners need specialized help, but they don't know who to go to and who to trust. They tend to be wary of anyone who describes himself or herself as a general business consultant. They think that they'll get lost among the accountant's larger clients and not get any personalized attention. By listening to feedback, we identified a market for a trusted business development. We also researched our competitors and found that there were no other practices in our area offering a similar service.*
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> *In launching our business-development branch, the fact that we already had five offices was an advantage. We were big enough to be credible, but not too big. It's true that all diversification strategies carry some risk, but we wanted to minimize that risk by limiting the resources we committed to the project. We got the job done, it's been successful, and we also learned a lot. If I did it again, I'd take a bolder approach. For example, a launch event of some kind would have been a good start to an initial marketing push.*
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> *Fortunately, or unfortunately, I don't have to do it over again. But we have been thinking of creating a franchise for accounting services along the lines of the H&R Block tax preparation. The target audience would be freelancers, startups, and small business owners. I think this is an idea that has a lot of potential.*

This seems like an excellent possibility for franchising. The target clientele has been identified, and the owner has a clear understanding of exactly what customers are going to want.

Moreover, the business has already proven itself in multiple locations. Startup costs can be very low, depending on the location of the offices, and the H&R Block comparison is an excellent one. In fact, the possibility of a buyout by a major corporation could be a huge upside. H&R Block was long ago bought by Sears, and that fact could create a very exciting scenario for possible franchisees.

If you do get started in franchising, you'll quickly learn that you've entered a new enterprise – with all the possibilities and challenges that doing that includes. Regardless of the exact nature of your business, you'll have at least two roles: selling the franchises and then servicing the franchises. Of the two, ensuring the success of your franchisees is the more important. So make sure you're prepared for this. Be aware that franchise holders are much more like partners or shareholders than like employees. They can provide you with a great source of passive income, but it will never be completely passive on your end. As we've said, franchising is more like real estate investing than like putting your money in the stock market. It's also a bit like gardening. You'll want to grow your franchises the way other people grow roses. One you're sure that your business is ready to franchise, the key to success is successful franchisees. Without them, no franchise system can last. With them, you might become the next McDonald's – or would you prefer a Burger King?

Now please join me for session eleven. There we'll explore a very different area of our map to financial freedom. We'll see how you can create passive income not only for yourself in the present, but also for those who come after you far into the future. But first, let's take a look at Your Travel Planner.

Your Travel Planner

Do you have a business that might be franchisable?

What makes your business credible?

How is your business unique?

Is your business easy to learn and duplicate?

Can your business adapt to many locations?

Do you have a solid team of people?

The Map

If you're considering franchising your business, jot down some of the tools you will use and some roadblocks you might encounter. See the sample map for ideas.

Session 11: Creating a Passive Income Legacy

Need to Know Before You Go

Hello again, and welcome to session eleven! Here we're going to be looking at how you can create a legacy of passive income. By legacy, I mean income that will persist far into the future. This is a path that extends beyond the edges of our map into the realm of the future. When you follow this path, the income contribution you're making now will go on – even after you're no longer contributing.

Consider Your Legacy

If this doesn't exactly sound like a barrel of laughs, please bear with me. The material we're going to cover in this session is extremely important. Most people who have achieved financial success devote serious attention to how that success can be perpetuated – and in this session we'll look at some of the best ways for bringing that about. It's interesting also that at least a few very successful investors have renounced the whole idea of leaving a legacy – or at least one that can be put in a bank account. For these individuals, the best gift to their heirs is the chance for them to start over all by themselves – if not quite from scratch, then from pretty close to it.

The best-known proponent of this belief is Warren Buffett, the icon of stock market investing and one of the world's wealthiest people. Buffett has long been an advocate of low taxation, with one important exception. He would support an inheritance tax of 100 percent. That way everyone starts life on a level playing field, no matter what the person's parents and grandparents might have done. In theory at least, this would ensure that everyone tries harder and the entire society benefits.

Actually, there have been varying reports of how far Warren Buffett wants to go with this. He may not advocate the complete elimination of inheritance, but he definitely wants to limit it. He has often said that wealthy parents should leave their children with enough money to have what they want, but not enough so they do nothing at all. He has also pledged a $31 billion legacy to the Bill and Melinda Gates Foundation – a tidy sum that will be going outside his family forever. As a result, Warren Buffett has opened a fundamental debate about the concept of financial legacy. Is it better to limit what you pass on and not spoil your heirs or to let them inherit the wealth and build on it?

Do You Want to Leave Your Money to the IRS?

While the majority of affluent Americans age 45 and older intend to leave an inheritance to their families, one in four has not yet made any plans to do so. Much has been written about the eventual transfer of $41 trillion in wealth from the baby boom generation. This transfer will definitely take place, but it may not go where the boomers intend. Instead, it may go to the Internal Revenue Service. This is what's going to happen unless more attention is given to planning alternatives. Ironically, 70 percent of individuals planning to leave a financial legacy cite the impact of estate taxes as their biggest concern.

Is $2 Million Too Small?

Two-thirds of those who do not have any plan say, "I intend to. I just haven't gotten around to it yet." The main reason given for not having a legacy plan – or even a will – is a very simple one: procrastination. Laziness might be another word. Or denial. Surprisingly, the number two reason given for not having a plan was "My estate is too small" – even in a study where the average net worth of subjects was almost $2 million.

Yet most people definitely need estate planning, especially if there's a desire to provide passive income. Typically, the older you get, the more assets you acquire and the more complicated your affairs become. Without a legacy plan, your most personal decisions about where your assets go could be determined by others. Your heirs could also face legal obstacles and tax burdens derived from this confusion – not to mention some intense family strife.

That Giving Feeling

Studies have also uncovered some surprising findings related to charitable giving. When asked if they would leave all or part of their estate to charities, universities, or nonprofit organizations, only 10 percent of affluent Americans over the age of 45 said that they are likely to do so. Of the 56 percent who are not at all likely to leave anything to charity, many say they don't trust that their money would be well spent. Others simply can't think of any organizations to which they want to leave money – and the vast majority intend to leave an estate to their children instead.

From the perspective of a legacy, it's important to look at charitable giving for several reasons. First, it can of course make a positive difference in the general quality of life – but giving to charity can also reduce the amount of estate tax that must be paid. The size of this tax will naturally affect the size of whatever else is in an estate. Yet estate taxes on a legacy are a given in almost three-quarters of people age 45 or older. In fact, 80 percent of affluent Americans in this age group believe that estate taxes should be eliminated completely.

The Gift Tax Provision

Besides charitable giving, another underutilized element in legacy planning is the gift tax provision. While most people are vaguely aware that something of this nature exists, less than a third of them have actually taken advantage of it. Of those who either aren't aware or who haven't gifted yet, 59 percent say that they are likely to in the future. But that's what they say about all aspects of legacy planning. They intend to do it, but they just haven't gotten around to it – which may be another way of saying they intend to live forever.

In a strange and almost childlike way, legacy issues can become vehicles for magical thinking among a substantial number of people. The focus is no longer just dollars and cents, but power, influence, and the continuation of life itself.

> *As I've gotten older, money has meant more to me than ever before – but in a totally new way. It really isn't connected with buying anything. It's just something I think about in a lot of symbolic ways. It's almost as if money is the power to stay connected to my family, and to the world in general. When I call my broker or my banker, they have to listen to me – and I know it's not because they think I'm such a fascinating person. It's also a way that*

I stay connected with my kids, who of course are grown now with families of their own. Having money lets me give them gifts from time to time, or help with their expenses. But the truth is, I'm not in a hurry to give them any really substantial sums because I sense that that would detract from my power. I feel as if it would literally reduce my net worth, not just financially but somehow as a person. I know it's selfish, but right now, the first thing I think about when I wake up in the morning is the amount of money I have. It's also the last thing I think about at night. I'm aware that I've gotten off track with this, but I'm not sure what to do about it. The truth is, besides my money there's not a lot going on in my life right now.

What do people think their heirs will do with the money? Most of those who expect to leave a legacy think it will be a cushion for their children's futures – something basically unnecessary but nice to have. In contrast, most of the potential recipients believe they could definitely use help with their day-to-day expenses, or help to fund their own eventual retirements.

Contrary to what many potential givers may suspect, receiving a legacy rarely leads to a splurge behavior or laziness.

Only 5 percent of those who anticipate receiving a legacy say they plan to make a once-in-a-lifetime splurge or work less. Of those who have already received money, the majority have not treated it frivolously. **The most frequent uses of the legacy include paying for children's education, maintaining a lifestyle in the face of rising costs, or creating a new legacy that can be passed along in turn**.

It's interesting that more than 50 percent of affluent Americans age 45 and older received a legacy themselves at some point in their lives. About half who have lost one or both of their parents have received an inheritance from them. One in three has received an inheritance from relatives other than parents – and some are still waiting to do so. Of those with one or both parents still living, seven out of 10 anticipate receiving a legacy.

I joined the army when I was 16 years old. I said I was 17 and that's how I got in. It was the start of World War Two, and they weren't asking too many questions. When the war ended, I found that the country had changed a great deal from when I was growing up in the Depression. And I must say, it was a lot better. Based on my service in the military, I was able to go to college for nothing. Later I was able to get a loan on my first house on very favorable terms. It's true that I didn't inherit anything from my parents at all, but I did get a different kind of inheritance from my Uncle Sam. I try to remember that when I start to think that everybody has it easier today. In a lot of ways they do have it easier. They're not standing in lines to get a cup of soup like in the 1930s. But they're also not getting a free ride from the government with things like education for their children.

Subjects such as leaving and/or receiving a legacy can be very emotional for family members – but most people do agree that it can be very beneficial. Research shows that almost everyone who has indeed talked with his or her parents about legacy plans feels it was a positive experience: all were happy to know their parents' intentions, even if they didn't agree with them. On the other hand, a high proportion of older people were uncomfortable with discussing this. Some of their reasons were: "I don't want anybody to count on the money" or "I want my heirs to be pleasantly surprised" or "I intend to talk about it when I'm older."

But as we said earlier, reasons like this are just different versions of procrastination or denial. To move beyond this, let's look at some of the very practical issues of creating a passive income legacy. It's a complex subject but a very important one – and fortunately, there are also some surprisingly simple solutions.

You Need to Have Some Plans

Regardless of where you stand on this issue, there's a lot to consider. As your income grows, you should think very seriously about how – or whether – you want to perpetuate it. One thing is certain: you need to have a plan for your money. Or rather, you need to have several plans covering the present, the near-term future, and the very long term.

This may seem like a daunting task when you first start to think about it, but financial planning doesn't have to be difficult. It begins with four questions to ask yourself – and you should ask them not just once but at least twice a year, because you may find that your answers change.

Four Questions

Let's look at the four questions one by one:

First, where do you want to be in financial terms? Setting a financial goal is no different than choosing a travel destination. You're trying to get somewhere with your money. You're trying to reach a certain goal – and knowing your goal means everything in money management. If you don't know where you want to be, you won't know how to get there. And you won't know how to avoid or minimize the risks along the way. You may not even recognize the risks at all.

Second, how much time do you have to get where you want to be? The time you have to reach your financial destination will determine the level of urgency you feel. Again, it's like planning a trip. Once you see how far you have to go, you may be comfortable with the time you have to get there – or you may need to give yourself more time – or you may need to adjust your goal in order to meet your deadline.

Time is a huge factor in investing. The relationship between your time and your objective will always play a role in your planning. If you have five hours to travel 500 miles, you're going to think about planning your trip differently than if you have five hours to travel only a tenth of that distance. It's the same with money. You have to know how far you need to go and in what time frame. That's the only way to create an intelligent plan for getting there.

Question number three: Where are you now in your financial life? How much money can you put toward your goal at this moment? What's your starting point? The answer to this comes in two parts: your net worth, which is the total value of everything you own, minus the debts you have to repay; and your monthly cash flow, which shows your monthly income and spending patterns. It's a snapshot of how money flows into and out of your life. When this information is clear in your mind, you can start making informed decisions. If you want to create a passive income legacy of $200,000, for example, you'll be able to see how much money you can designate toward this goal right now. You might have $25,000 in a retirement plan and $15,000 in savings account. You don't want to touch your retirement savings – but perhaps you can move some money from your savings into a vehicle that will benefit your heirs.

Fourth and last: What financial vehicles will let you meet your goals in the time available? When you plan a trip, you need to know how far you have to travel and how long you have to get there. Once you have that information, choosing the vehicle and the route should be obvious. Investment and estate planning decisions can be very clear too. You just have to know your legacy goals and be familiar with the vehicles that can get you there.

Life Insurance

One of the most important of these vehicles is life insurance. This may not sound very creative or exciting, but life insurance really is an extremely effective way to provide a legacy for your heirs. Since there are several different kinds of insurance and the benefits come in different forms, please pay close attention to the following. It can save you money, and also increase the money that your heirs will eventually receive.

Life insurance provides funds for your family – or actually for anyone you designate – after you're gone. The person you designate is called the beneficiary. There are no restrictions on how the beneficiary can use the money – whether it's to pay debt, the cost of the funeral, estate taxes, college tuition, or any anticipated expense.

Basically, there are two categories of life insurance coverage. Individual coverage pertains to you alone and is bought by you either through a broker or directly from an insurance company. You may also be able to buy group coverage if it's offered by your employer or another organization. Generally, group coverage is cheaper because of the group rates.

Within the two categories of group or individual coverage, there are also two basic kinds of policies: **term insurance and permanent insurance**. The first of these pays off if you die within a specific period of time – which is the term of the policy. Like auto and homeowner's insurance, term insurance covers you only during the time you're making payments. For this reason, it's less expensive than permanent life insurance. There are three different varieties of term insurance:

Three Kinds of Term Insurance

Convertible term insurance lets you convert the policy into a permanent one at any time. There's no medical exam, but premiums may go up as you age

Level term insurance lets you pay the same premium every year for the length of the term. Your beneficiaries are entitled to the same payoff if you die at any time during the term. If you want to renew your policy at the end of the term, your premium may rise significantly because you'll be considerably older.

Last, **decreasing term insurance** pays a death benefit that gradually goes down in value over time. Premiums usually remain the same throughout the term.

Permanent insurance is generally more expensive than term. Unlike term insurance, the permanent variety continues in force until you die, as long as you make timely payments. It may also include a savings feature that builds up a cash reserve you can use while you're alive. In fact, if there's enough in the reserve, you can use the cash to pay the premiums. There are also three varieties of permanent insurance:

Three Kinds of Permanent Insurance

First, **whole life** lets you pay a fixed premium for a fixed death benefit. There is a cash savings feature that, over time, provides you with a cash reserve.

The second variety, **universal life**, is a little more flexible. You may be able to change the amount of insurance as your needs change. Some changes may require a medical exam.

Third, **variable life** invests some of your premiums in stocks, bonds, and money market funds. The upside is that your investments may perform well and provide a larger cash reserve. The downside is the risk that the investments will lose money. Sometimes a minimum cash value for the policy is guaranteed, but this is unusual. Most insurers guarantee a minimum death benefit, although it may not be what you had hoped to receive.

Variable-universal life combines the premium and death benefit flexibility of universal life with the investment flexibility and risk of variable life insurance.

What Kind of Insurance Is Best?

So what kind of insurance is best? Fortunately, for most people there's a very simple one-word answer to that question. **Term is best.**

But before we explain why, it's important to look in a bit closer at the differences between term and whole life, which is the most popular kind of permanent insurance.

The basic difference is this: a term policy is life coverage only. On the death of the insured, it pays the face amount of the policy to the named beneficiary. You can buy term for periods of one year up to 30 years. Whole life insurance, on the other hand, combines a term policy with an investment component. The investment could be in bonds and money-market instruments or stocks. The policy builds cash value that you can borrow against.

Whole life insurance is expensive partly because you're also paying for the investment portion. That extra cost might almost be worth it if these policies were a good investment vehicle. But usually they aren't. Insurance agents like to call these policies retirement plans – but leaving aside the fact that there are many better ways to save for retirement, these policies come with high fees and commissions – and these costs are deducted from the annual return. On top of that, there are up-front commissions that are typically 100 percent of your first year's premium. Even worse, it's often impossible to tell what the return on the investment will be – or how much of what you pay in goes toward the insurance and how much toward the investment. Another problem with whole life is only an expert can tell if a policy you own or are considering will ever become a decent investment. Whole life policies hardly ever yield a reasonable return unless held for 20 years or more. So if you buy one, be prepared to pay into it for the very long haul.

Premiums for term insurance are downright cheap for people in good health up to about age 50. After that age, premiums start to get progressively more expensive. The same holds true for whole life policies, although people who need coverage in their 60s and beyond may have no alternative but to buy whole life. Most companies won't sell term policies to people over age 65.

This has been some complex information, but let me repeat: it's also very valuable. If you're not sure you've understood it all, here's an easy way to get the gist of it. The secret is in the phrase "whole life." Never buy it in your whole life! That's really all you need to know.

Life Insurance as Passive Income

Life insurance can definitely be a passive income resource – but who will benefit from that resource is not always clear. For example, if you are the insured and you are the owner of the policy, the proceeds of the policy will be subject to estate tax when you die. But if you transfer ownership to a life insurance trust, the proceeds will be completely free of estate tax.

At the time of this publishing, the estate tax rate is 46 percent, so a life insurance trust can save hundreds of thousands of dollars for a substantial estate. However, there are several drawbacks to such an arrangement:

Should You Trust?

For example, you can't change the beneficiary of the policy. In fact, **the trust itself is legally the beneficiary**. The trustee alone has that right, and you cannot serve as trustee of your own life insurance trust. Of course, you will designate the beneficiaries of the trust. But because this designation cannot be changed after the life insurance trust has been set up, you will lack the flexibility to deal with changed family circumstances with this particular policy.

Second, the life insurance trust must be irrevocable. Once you have set up and funded the trust, you cannot get the policy back. If you become uninsurable owing to a health issue, you will be committed to this trust as your only life insurance.

Third, you must find or hire a trustee. Again, you yourself can't serve as trustee of your life insurance trust. That means that you will have to find or hire a third-party trustee – which is often the bank where the trust is located. Fortunately, many banks and trust companies offer reduced fees for life insurance trusts because they involve essentially no investing decisions.

Despite these drawbacks, many people find that the tax-saving potential of a life insurance trust is worth the extra effort. It allows you to remove from your estate a significant asset that you are unlikely to want access to during your life. And it ensures that the life insurance proceeds go 100 percent to your beneficiaries, not to the federal government. Consult a banker or an attorney for more information on legacy planning in general and insurance trusts in particular.

We've now seen some of the obstacles that people put on the path toward creating a legacy. Hopefully, we've also seen how important it is to get past those obstacles. The problems start when we bring psychological or emotional issues into what ought to be purely logical decisions. So this has been a largely left-brain session. Session twelve, the final session on our program, will be quite different. There we'll look at wealth, income, and financial freedom from a much different perspective. Let's take a look at Your Travel Planner.

Your Travel Planner

Do you have a will? Why or why not?

If you do have a will, what is your intent for the legacy that you'll leave your heirs? To act as a cushion, or to provide for necessities?

Where do you want to be financially?

How much time do you have to get there?

Where are you now in your financial life?

What vehicles give you a chance to get there on time?

Do you have life insurance? What kind?

The Map

If you're planning on using insurance to pass on your legacy, add this to your map, showing tools and roadblocks on the way. See the sample map for ideas.

Session 12: Wealth and Your Future

Need to Know Before You Go

Welcome to session twelve. This is the final session in our journey. In session one, we spent some time discussing the definition of passive income, and also its primary purpose. We determined that the destination of passive income is not really financial riches, but financial freedom. The destination is not having the power to do everything; rather, it's freedom from having to do anything. Although we may think of wealth as driving expensive cars and vacationing in exotic locations, a great many wealthy individuals would agree with the more modest goals we've set in these sessions.

The Characteristics of a Millionaire

Not long ago a book called *The Millionaire Next Door* reached the bestseller list. The authors – Thomas Stanley and William Danko – discovered that most millionaires really could be just like your neighbors. They don't jet around the world or eat caviar for breakfast. Most of them live in average neighborhoods in average houses. **In other words, they live below their means.** Their lifestyles are not frugal, but not extravagant either – and they think saving money is as much fun as getting it. But they do take their investments very seriously through study on their own as well as advice from financial advisers. Yet the typical millionaire is not a person with a stellar academic record. The majority don't have MBAs or other advanced degrees. Some didn't go to college, and a few didn't even finish high school.

As the book further points out, most wealthy people are self-employed or own a business. They don't like to work for other people. Most are self-made success stories. The majority of millionaires received no family money and do not plan to give their own children a lot of money. They want their children to succeed the same way they did, on their own.

But here's the most striking fact about these wealthy people: they're happy about their lives. They feel good about where they are and where they're going. Now, looking at that from the outside, that might not seem very noteworthy. After all, if people are rich, why shouldn't they be happy? But the deeper question is: are they happy because they're rich, or are they rich because they're happy?

The answer to that is very important for gaining a perspective on passive income – both in your own life and for those who come after you. So in this final session we'll be looking at the connection between happiness and passive income, and we'll see what you can do to optimize that connection.

Happiness and Passive Income

In our society, the link between being rich and being happy is mostly taken for granted. Relatively little research has been devoted to it. But a major study by the University of California at Berkeley showed that the financial component of money and happiness is a very individual matter. As the researchers put it, "We did find that income had a positive relationship with a sense of well-being and satisfaction among individuals high in extrinsic orientation." In plain English, that means if you value the things money can buy, then money will make you happy. But what about people with a less materialist outlook? If the most important things in your life are personal fulfillment, or creativity, or spiritual seeking, will money fail to make you happy?

Will Money Make You Unhappy?

Well, not only will it fail to make you happy, but it might actually make you unhappy. For example, if people chose a career solely because they thought it would make them rich, they'd probably feel good if they did get rich. But if they chose a career because they wanted to make the world better for humanity, and then they got rich anyway, they could feel quite confused. In fact, they could feel downright depressed. Among those with a strong tendency to value work because they enjoyed it or it fulfilled them, those making more money were less happy than those making relatively little money.

Even in areas of life outside their primary career, receiving monetary rewards for doing an enjoyable task can make the task less enjoyable. Our sense of fulfillment and personal reward in life is actually very fragile, and money can easily destabilize it. People have a fundamental need to feel as though their actions are freely chosen. We all need to feel that we're not doing things just for the money – unless we actually are. Very simply put, if we make the choice to sell out, that's one thing. But if we feel as if we've sold out without ever having made that choice, the feeling can be very different, and considerably worse.

As you might expect, the negative side effects of wealth become more pronounced as you move up the financial ladder. A person who needs money to buy food will not feel the same about a financial windfall as a person who already has a million dollars in the bank. At higher income levels, psychological and emotional needs start to displace physical necessities. So the more successful you become financially, the more careful you need to be in other areas.

Again, this precept has implications not only for our own lives, but for those who we hope will benefit from our legacy. Inheriting a substantial amount of money from a rich uncle is usually a good thing in someone's life, but it's not always a good thing. As Woody Allen said: "Money is almost always better than poverty, if only for financial reasons." But the fact is, there are other values in our lives besides the financial ones. We need to be aware of how organizing our lives around making money can affect those values – and in a moment, we'll see how a number of different people can attest to that.

> *I always tried to have two different sets of goals – one set for my work and another for my life outside work. I had seen lots entrepreneurs get confused around this. When people go into business for themselves, they mix their financial objectives with personal ones. So I always felt that my business had only one goal, which was to make money. And the way to do that was by developing and retaining customers. After all, if you don't make money, you go out of business. You can't grow. You can't do anything. It's over.*
>
> *My personal goals were a lot more diverse. I wanted early retirement, job satisfaction, career security and financial independence, and to be my own boss. But now I see that what I thought were personal goals were actually all about my work. It's strange how that happened, because I had always been very concerned about dividing things into categories and keeping one category separate from another. That's why I always tried to work on my*

business but not in my business. My business was custom-made signs, but I did not make the signs. I hired people to make signs. I worked on my business by being on the outside, spending time with customers and potential customers. I was always aware of being with people who might have a reason to buy, if not immediately, then sometime in the future.

Because of the difference I saw between working on my business and in my business, I knew that my employees were an absolutely critical element of success. In a way, I saw them as if they were my customers – because if you treat employees as your best customers, then they will treat your customers extremely well. If you treat your employees poorly, then they will treat your customers the same way. When my company exceeded $200,000 in monthly sales for the first time, the payoff was an all-expense-paid trip to Las Vegas for everyone in the firm.

As an entrepreneur, I always felt it was extremely important to be a leader. Your employees have to be able to depend on you just as you have to depend on them to run your business. A lot of company owners know something about their product or service, but they lack other business skills. Some are not good leaders or managers, and others won't pay to get the right people.

When it came to investing, I can see now that my tendency to compartmentalize things got in the way. I wanted to develop some passive income for myself through stocks, and I wanted to invest in mutual funds for my family. I ran into problems in two different ways. First, I thought that I could turn this all over to an investment manager, just as I had turned the operational side of my business over to my employees. I thought that if I found someone who had a good reputation and I paid him top dollar, I could be hands-off about this and go on like before. But as it turned out, when I looked at the results, I was very disappointed. The investments had in no way outperformed the market as a whole. If I was just going to be on the Dow Jones average, I could have done that myself and saved the big fees I paid my adviser.

If you have investments aimed toward passive income, you really have to see them as a third category between business and personal life. You can't see this as just another aspect of one thing or the other. It's something all its own. So you have to learn to spend time on it without spending too much time on it, especially at the beginning. That's what I'm learning to do now. So far, I haven't had any money come in, but at least I'm confident that I'm on the right track. And I'm also glad that I didn't lose any more money than I did.

One of the problems with being smart and successful in one area is believing you can do the same in all areas. We just heard form someone who obviously had evolved a system that worked well in his business, but it was not transferable to his investments. He is clearly a very hard worker and a dynamic thinker, but he misunderstood the meaning of passive investment. You are only passive in the sense that you passively accept the money. You're not passive in turning your investments over to somebody at the outset, and then more or less forgetting about them. Remember: the "Millionaires Next Door" enjoyed studying and stayed on top of their investments. The trick is learning to do this without turning it into another full-time job. It can be done – but as this investor discovered, sometimes it costs a little money to learn the business.

> *They say that necessity is the mother of invention, and it really is. From the moment I learned that I was pregnant, I knew that I wanted to stay at home and take care of my baby. I did not want to return to work full-time. I absolutely wanted to stay home, but I also wanted to provide a supplemental income to our household. Actually, I had to provide some income. That's just the reality of the area we live in.*
>
> *So every day I was online looking for stay-at-home jobs. However, I discovered that there are not a great number of legitimate work-at-home opportunities. There are a lot of phony ones, but not many real ones. I even responded to work-at-home ads at the back of a baby magazine, but they also were scams. So finally I came up with an idea of my own.*
>
> *From the very first, I was sure my idea would work – and also from the very first, my goal was to turn this into a passive income source. That way I would be able to contribute to the family budget without having to spend most of my time working. I knew it wouldn't happen all at once, but I also knew it would not take very long. That's how confident I was in my idea.*
>
> *When I was expecting my first child, I was very interested in prenatal and infant stimulation – especially classical music effects in baby development. I was spending a lot of time on the Internet researching pregnancy, prenatal care, and development. Once I was on an expecting moms' board, and they were talking about playing classical music for their babies. I had an idea that could combine two interests: the desire to stay home with my baby, and my focus on infant development and stimulation.*
>
> *Around that time there was a lot of buzz about the first 12 months to three years of a baby's development. I began looking at different infant stimulation and prenatal products. I also was aware of those junky baby gift baskets that people buy when they can't think of anything else. There's nothing worthwhile in them – just little tubes of lotion and powder. But it costs about $60 to send one to family and friends. All the members in my family got one when they had a baby. People spent good money to send them, and they were things that nobody could use.*
>
> *So I thought I could put together some things that actually benefit an infant, preferably with long-term benefits. My idea was to put together a classical music CD and some development toys. I made them affordable, starting at 20 dollars. A really good business started with those gift packages. There were five for babies and five for birthday gifts. The products increased as the business grew – and in much less time than I expected, I was able to license my brand to virtually every hospital gift shop in my state. And I'm sure it won't stop at the state border either. Meanwhile, my family has a really substantial source of passive income, and we're able to save a good part of it too.*

Unlike many entrepreneurs, this young woman succeeded despite very limited experience in business – or maybe because her experience was limited. She is also unusual in that her commitment to her business was very contained. She didn't want to devote her life to this. She just wanted to generate some income so she could use her time the way she really wanted. She was also extremely confident from the very start that she would be able to meet her goals. This is an almost ideal mindset for creating a passive income. Not everyone can have this combination of certainty and serenity, but in this case it paid off well. As someone once said, "Success is not always overcoming difficulties. Sometimes it's finding easiness." It doesn't have to be hard, and it can even be fun.

> *For 30 years I worked in mechanical engineering for a Fortune 100 company. When I retired, I had no intention of sitting around the house, and I don't fish or play golf either. So I got a job teaching math at a local community college. Every day I did my best to generate understanding of mathematics in my students. But at the end of every class, I was overwhelmed by all the students who asked for extra help. Their goal was to transfer to the state university, and they were extremely focused on getting the best grades they possibly could.*
>
> *I spent a lot of spare time working with my students one-on-one. There was such a strong demand that I would have to tutor full-time in order to reach them all. Then I had the idea of creating a business to meet student demand for extra assistance. But I was an engineer and a teacher, not a business entrepreneur. I knew my field, but I had always been an employee of a large organization. I didn't know the first thing about starting and managing a business.*
>
> *I spent a year checking out the competition. I had always been interested in the way one company could succeed just by copying another company, with maybe just a single area of difference. How different is one cell phone from another? Does anybody choose an airline because they really prefer it to a different airline? The main buying decisions are based on price and convenience – so I decided to emphasize that. I was going to promote my tutoring service as a kind of neighborhood business. And since many of my clients would come from the community college, my first employees were also graduates of that system. They were people who had successfully transferred to the state university, just as my students wanted to do.*
>
> *I rented a small storefront near the college, and opened the doors with four students already signed up. Soon I was offering math, English, special education, and economics. I opened other learning centers, always within a few blocks of a community college. It was just like Wendy's opening across the street from McDonald's. After four years, I now employ 30 tutors, and more around exam times. And I have never advertised. All my clients come from referrals.*
>
> *At this point in my career, my goals are different from what they would have been earlier. In as few words as possible, I want to sell this business. I want to open a few more satellite*

> *branches and then get bought out by one of the national tutoring organizations. I have such a strong following that whoever buys me will pretty much own the market in this area. So I'm confident I'll be able to meet that goal.*
>
> *With whatever I make from that sale, I want to create investments that will bring passive income to my kids, who are in the middle of raising their families. I hope that they will save some of that income, or invest it, but that's really up to them. I know they're concerned about college costs down the road, so I hope some of the money will go to that. I also hope they look into the benefits of the community college system, which has certainly been of great benefit to me.*

This is a person who is very different from most entrepreneurs. Instead of trying to find a business opportunity, the opportunity seemed to find him. With no need of income for himself, passive or otherwise, he will be able to help his family far into the future. This is a legacy in the true sense. It's about money, but it's also about happiness.

According to Charlie Brown, happiness is a warm puppy. According to half the self-help books in America, happiness is a net worth like Donald Trump's. And according to the other half of the self-help books, happiness is inner peace and a weekly yoga class. So what is happiness? What is fulfillment? And what, if anything, do they have to do with money in general, and with passive income in particular?

What Is Happiness?

There's no doubt that in the United States and in other industrialized countries, happiness is often equated with wealth. Economists measure consumer confidence on the assumption that the resulting figure says something about progress and public welfare. The gross domestic product, or GDP, is routinely used as shorthand for the well-being of a nation.

But some places take a very different approach. In the small Himalayan kingdom of Bhutan, for example, the national priority is not the GDP but the GNH, or gross national happiness. The king of Bhutan has been instituting policies aimed at raising this measurement as high as possible. This means spreading the benefits that would normally go to the wealthy across the entire society. **It also means questioning the meaning of wealth itself.**

Around the world, economists, social scientists, corporate leaders, and bureaucrats are developing new ways to measure quality of life. These will take into account not just the flow of money, but also access to health care, free time with family, conservation of natural resources, and other noneconomic factors. **The goal is to return to a richer definition of the word *happiness*.** After all, that's the word that the signers of the Declaration of Independence had in mind when they included "the pursuit of happiness" as an inalienable right. They said it was equal to liberty and life itself. And it's worth noting that the inclusion of the word *happiness* in the Declaration did not occur without argument. An earlier draft referred to, "Life, liberty, and property" – as in an SUV and a second home in Colorado. But happiness eventually won out. As one commentator has noted, "The Founding Fathers' theory of happiness was an expression of public good and of the contentment of the people. The 20th-century idea was that you should smile because you're at Disneyland. As for the 21st-century concept, that remains to be seen."

The prime minister of Bhutan believes he's already seen it. "We have to think of human well-being in broader terms," he says. "Material well-being is only one component. It doesn't ensure that people are at peace with their environment and in harmony with each other."

America had a brief flirtation with a similar concept in the early 1970s, when a book called *Small Is Beautiful: Economics as if People Mattered* became a huge bestseller. That ended abruptly with a gas crisis, followed by a burst of consumer-driven economic growth. That growth has continued to this day, often propped up by deficit spending by both private individuals and the federal government.

Yet many experts say this explosion of materialism will eventually lead us in another direction. In the early stages of a climb out of poverty, for a household or a country, incomes and contentment grow at the same pace. But beyond a certain point, about when annual income passes the equivalent of $30,000, happiness does not keep up. Even more striking, beyond a certain level of wealth, people appear to redefine happiness – which also means redefining wealth.

The purpose of this program has been to introduce you to the concept of passive income, and to present some of the most reliable means for creating and sustaining it. But there seems to be an evolutionary mechanism that drives people to ever-higher goals. In the United States, and certainly for the majority of people listening to this program, we've passed the point in which our survival depends on aggressive and acquisitive behavior. This is a relatively new situation for human beings to be in – and the question becomes, How can we raise our quality of life, when increasing our income is no longer the most important factor in that?

To raise your income, to create new forms and resources of income, here are some things to remember. Invest in yourself through intellectual property. Take advantage of the moneymaking opportunities in Internet technology. Buy income-producing real estate. Invest wisely in the stock market. Take out some life insurance policies. But don't stop at any single point on the map. The ultimate destination – true financial freedom – is still under construction. You yourself are building it with every forward step you take. Only you can say what it will finally look like or where it will be – because the destination is different in every person's heart.

Just don't miss out on the next Microsoft, which is our final thought for this session. Thank you for being with us – and may the future bring you great wealth, however you choose to define it.

Let's check in with Your Travel Planner.

Your Travel Planner

What does wealth mean to you?

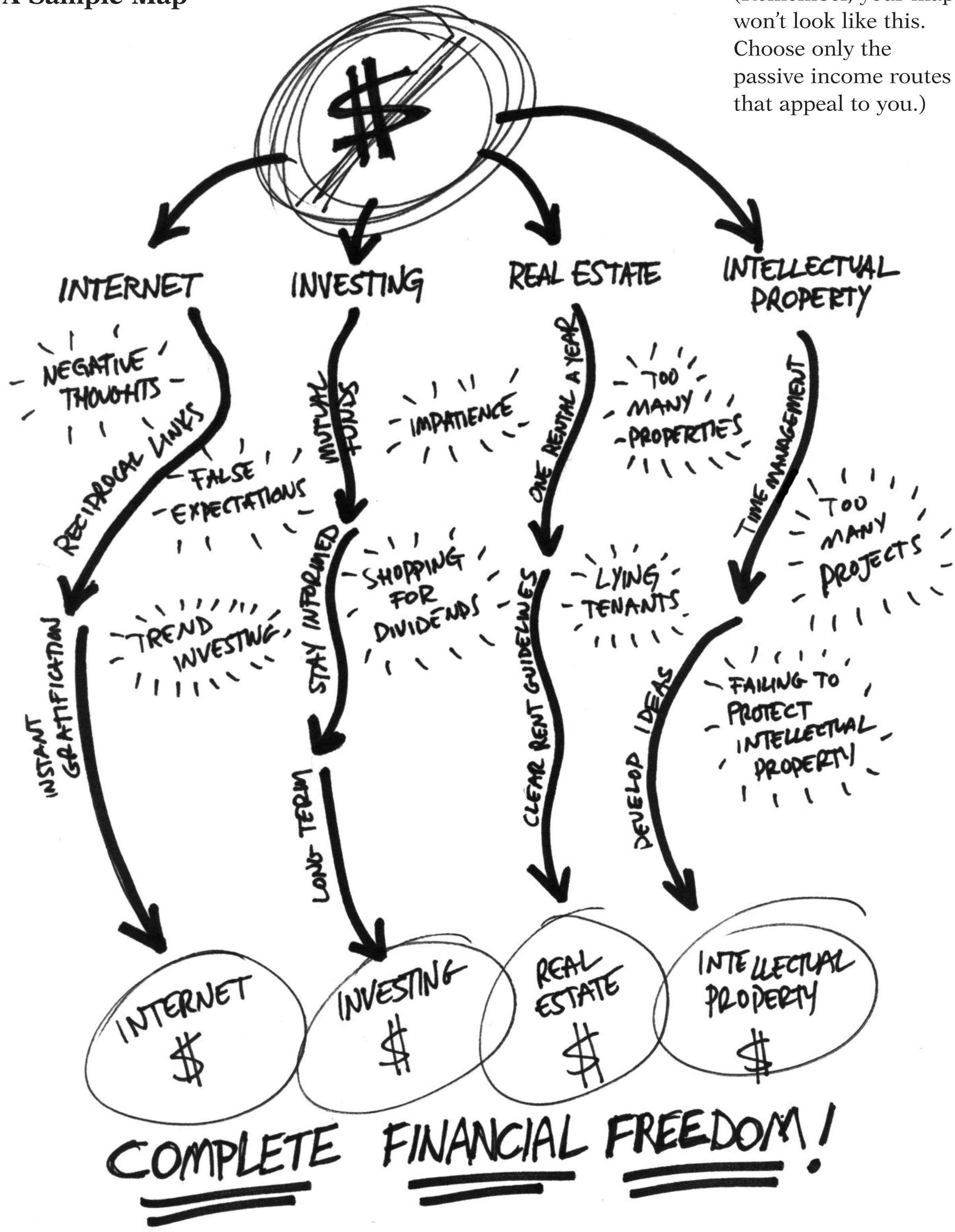
What is the relationship between material wealth and happiness, according to you?

The Map

You should now have a pretty complete map of the routes toward passive income that interest you. Your routes should show the tools for getting to your goals and the roadblocks you might encounter. Feel free to go back and revise your map as often as you'd like. And, keep your mind open to new, uncharted routes …

A Sample Map

(Remember, your map won't look like this. Choose only the passive income routes that appeal to you.)



My iJournal

My iJournal

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Business That Fits Your Life
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Wealth Magnet:
Principles of Wealth Attraction
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Lessons from the Richest Man Who Ever Lived:
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