How Much Is Enough?

◆ Issue #60 ◆ Douglas E. Reese

The 100% Solution
"What's your return on investment?"

By the time you read this article we will have celebrated Labor Day, a day when we take off work in recognition of…well, I'm not quite sure what. Maybe recognizing our nation's labor force and its value to society.

In our increasingly "labor-intensive" world, I wonder how many of us worked Labor Day. In a time of rapid productivity increase, we seem to require more time to do more things than ever before. I've touched on this subject before of finding "balance" amidst the hectic schedules, so I won't "be-labor" it, other than to lead into my thoughts with three specific questions.

First, let me present an idea for you to ponder. Most people are very familiar with the concept of "return on investment." For example, if you put money in a savings account, you expect to receive interest, and the same could be true with a bond. The interest you earn may be 2% on today's bank savings, or upwards of 8% on a lower quality bond. The basic rule is that as you are willing to take on more risk, you should expect to receive a higher return on investment. When you invest in even higher risk investments such as stocks, real estate, or a business venture you should expect an even higher rate of return on investment for your willingness to live with the increased chance that you might lose your investment.
Return on investment ("ROI") measures how well you are rewarded for your investment. We each make two very significant investments that last the greater part of our lifetime. How well are you rewarded for those investments during your lifetime? The two investments I am referring to are your investment in your work life, and your personal life. Other than the hours we are sleeping, all of our life's energies are directed towards these two vast investments. We divide our time, talents, energy and money to a vocation, and to our personal life (generically speaking, to include everything in our life other than work). For now, I'll focus simply on the money side of our work life, and our personal life.

Let's pretend I am your financial advisor, asking you to assess your return on investment in each area. Here are my questions to you:

1. You spend a lot of time at work…do you feel you're getting a good return on your investment there? (For time, energy and money put into the work, are you well rewarded with money and other benefits received from the work?)

2. You work, in part, to make money to support your personal needs. How's your return on investment here? (For the money you bring home and how it gets spent or saved, do you feel fairly rewarded and fulfilled?)

3. Are you getting a good return on your invested savings?

Here is "The 100% Solution." It's not a double your money scheme, but a real-life formula for financial success, which I've learned over nearly two decades of working closely with people, their money and investments.

The solution has three variables, with a formula of 25+25+50=100. The first 25% of financial success is having a plan that makes sense, meets your needs, is easy to understand and is realistic to act upon (this is much easier said than done). Another 25% of success is addressing appropriate issues with appropriate answers, which is a long way of saying, "keep good counsel." You will need a competent team of advisors for banking, insurance, estate, investments and tax planning, legal and accounting support. No one but you can achieve the final and most critical 50% of the solution for financial success. This 50% of the solution is dependent upon committing to a change in personal behavior, away from bad money habits, and towards good habits.

You've heard the term; "we're half way there." That is as far as any well-intentioned group of professionals can get you on the road to financial success. You can pay for a plan and counsel and you'll be "half way there." The other half, and the most critical half, depends on your personal interaction and accountability around your own money matters. How you handle the final 50% will determine your true return on investment in your journey of financial fulfillment.

Business ROI

If you own your own dental practice, this formula may help simplify your work. If you are an employee, it will give you a better understanding of how things work.

The book, "The Millionaire Next Door," rates dentistry very high on the list of top income earning groups. My experience in working with some of dentistry's finest is that "high income" does not equate to "financial success." My database of financial information on dental practices across the country, states that most dental offices run on little or no profitability (less than 5%). They have very thin cash reserves (less than ½ month's average collection), fairly high debt (3-5% of collection to service monthly payments) and marginal efficiency in maintaining healthy accounts receivable (usually more than 1½ month's collection in AR). This is not a flattering representation of a very decent profession, but one I've observed is more accurate than inaccurate across the U.S.

Dentistry does not operate towards financial success. The formula tends to be 50+40+5=5. Now, any mathematician will tell you this formula does not work. Some of you reading this have tried this formula and confirmed for yourself it does not work. So why do we continue to use formulas that do not work? Dentists spend 50% of their resources getting a plan prepared, another 40% seeking counsel to tell them what to do, and then they invest about 5% in the critical element—behavior change. The result…about a 5% positive impact in the situation from where it was in the beginning, and a lot of time and money spent in the hopes of achieving much greater results. In fact, in many instances the initial investment is never recuperated. The feeling…frustration in getting "less than I paid for." Considering the formula, who would be happy with so much investment, and so little return? Was it bad planning, bad counsel, or bad habits left unchanged?

The best-laid plans and counsel are only as strong as the weakest link in the behavior pattern of the one(s) implementing the plan. To the extent you are willing to give up freedom and control in the short-term, you can have financial freedom and security in the long-term. It requires creating a plan that you have the least likelihood of compromising. My history has taught me that the simpler the plan, the more likely the success.

Here's a simple formula to consider in looking at the dental practice. Begin with a very specific number, and the single most important number in the practice when it comes to financial health—your "Break-even" cost. If you don't know how much it takes to run the business, *all inclusively*, you can't begin to know if you're doing well, or doing poorly. In the "good old days," when dentistry had 50% profit margin, it wasn't such a big deal. News flash: those days are gone forever, and it is a big deal now!

Keep in mind, "all inclusively" means not only paying today's bills but also saving for tomorrow's possible equipment repairs and replacement needs, possibly funding year-end retirement plans, etc. Here is my basic formula for how money should be distributed throughout the practice budget. Obviously, your results may vary based on your circumstances, but these are good guidelines that work. Figures are given as a percentage of collection.

1-Doctor Compensation	33%
2-Team Compensation	27%
3-Debt Payments	0%
4-Equipping Costs	3%
5-Overhead Costs	30%
Administrative	6%
Building	6%
Clinical	16%
Marketing	1%
Total Costs	93%
Cash Surplus	7%

This formula shows 93% cost and 7% profit. Most practices I review use up much of this 7% profit in the form of higher debt and overhead cost. To the degree you do not have profit, you forego a "margin of safety" of which I am highly in favor.

Here's food for thought. What if your budget was set at such that each of the five groups of the budget got a fixed percentage of each month's collection. If you collect $45,000 and the doctor's compensation is 33%, then the doctor received $14,850 that month. And, if you collect $28,000, the doctor will receive $9,240 that month. The same goes for all areas of the budget. Caution: it is always a tough sell to the team, but it raises the question of return on investment.

Personal ROI

The personal plan is a little more difficult to simplify into a basic formula, because each person's situation may be vastly different depending on age, marital status, and number and age of children. But, we can still start with a basic formula that will give you something to use as a baseline. My frustration in working with clients on their personal financial picture, is getting them to live according to their desired outcomes, rather than living out their desires.

To live out one's desires, means to follow your heart, in the moment, spending at will and allowing emotion to take precedent over discretion. Most of America today has a spending problem. It is seen in the swelling consumer debt in this country. It is in the last 50% of the solution of financial success that this problem lies, in changing behavior patterns. And the older the person, the harder it is to change. And, the saddest reality for me, as a financial advisor who does not want to be in a position to be a judge and jury over my clients' ultimate spending patterns, is that their reality may be that they need to work an extra 3 to 5 years to build enough up in savings to support a lifestyle that always seems to grow beyond the paycheck.

The personal formula most people use is a little different than the business formula I mentioned earlier, it looks something like this…5+20+5=(10), where there is a 5% commitment of resources to planning, maybe another 20% committed to hiring professional help, and finally 5% committed to behavior change, ultimately resulting in a personal budget that ends up being 10% or so more than they can afford. This falls in line with the typical American who spends about 10% more than he or she brings home in pay.

Here's an interesting way to look at the home budget. This follows the concept of "get rid of as much as you can, as fast as you can, so you will compromise as little as you can." In other words, get money out of your hands and to its final resting place, as soon as you deposit your check, so there is less left in your checkbook balance that may be appealing to spend. These percentages are the percent of your gross income.

1-Have adequate taxes withheld	40%
2-Return "first of the fruits"	10%
3-"Pay yourself 1st"	10%
4-Pay debts, insurance, bills	20%
5-Manage your spending plan	20%

This assumes federal, state and FICA taxes at healthy withholding (your numbers may vary widely here). It assumes you give back 10% of your wages to some form of charity, and that you save 10% for the future (though not necessarily a figure you may need to meet long-term savings needs). And, it assumes that your total debts, insurance and bills come to about 20% of gross income. This leaves you with about 20% of your income to spend on lifestyle—such as clothes, vacation, medical needs, etc. Take a look at where your money goes and see how close you are to these figures. If you need to modify the percentages, do so, but consider this order of priority when you decide "who gets what."

Investment ROI

This is the most concrete of the three areas we've discussed in determining your total return on investment. You should have a good idea of what percentage you make on your money invested. A good rule of thumb is to set an annual rate of return goal that may range from 8% in a conservative portfolio, to 10% in a moderate portfolio, to 12% or more in an aggressive portfolio. To be sure you are positioned to meet your goal, you need to know the expected rate of return on each investment in the portfolio.

For example, if your annual rate of return goal is 10%, and you have ½ of your investments in growth stocks and ½ of your investments in municipal bonds, you might get 12% on the stocks and 5% on the bonds. This would be an average rate of return of 8.5% (before fees). If you are planning on 10% a year and getting 8.5%, it doesn't seem that far off. But consider if you have $500,000 over 10 years, this difference cuts $140,000 from your planned savings growth. If you plan to take out 7% a year this means your lifetime income will be reduced by $10,000 for maybe the next 30 years, not to mention the $140,000 you gave up in growth. Now that little 1.5% difference cost you $440,000. Do you know your return on investment, and are you meeting your goals to pay for your needs long after retirement?