Rich Dad's Cashflow Quadrant: Guide to Financial Freedom

Author: Robert T. Kiyosaki

The "rich" people have universally fascinated everyone. The fact that 5% of the world's population holds nearly 95% of the total wealth is really captivating. However, the topmost question on everybody's mind is, "Why only a certain group of people are able to become rich?" There are some people who achieve financial freedom in their 30s while there are others who can never be financially secure, no matter how hard they work. Robert Kiyosaki, in his book "Rich Dad's Cashflow Quadrant" succinctly breaks up the construct of the society into four main quadrants and elaborates on how people can become rich by stationing themselves in one or more of these quadrants.

Key Takeaways

- "How to become rich" is a question that everyone has grappled with at one point in time or another
- The people in society can be broken into four sections or quadrants: 1) employees, 2) self-employed, 3) business owners and 4) investors
- The "employees" and the "self-employed" make the left side of the quadrant. It is difficult for people in this quadrant to become rich. Additionally, a majority of the people lie in the "employee" quadrant
- The "business owners" and "investors" lie on the right side of the quadrant. People in these quadrants are usually very rich
- There are seven levels of investors, ranging from those who do not have any money to invest to capitalists
- In order to become rich, you have to become a capitalist. This would entail investing in yourself, building knowledge and then applying that knowledge in a judicious manner

How the Rich Make Their Money?

Our working society is broadly divided into 4 kinds of people depending upon the work they perform. They are:

Employee - They have a job i.e. they work for someone
Tagline: "I need a safe and secure job with benefits."
Core-value: Security

Most of the people lie in this quadrant. This is basically the default way of living and probably the most difficult quadrant to get rich. There are multiple reasons why this quadrant, despite not offering much in terms of getting rich, is so popular. Firstly, a large majority of people desire security and cash flow stability and seek out a lifestyle that will provide them with this. These people shy away from risk and subsequently, they see no need to become educated in the tools of finance. Instead, they seek out benefits with their jobs. Secondly, our entire system is generally geared towards "finding employment". Even as children, we were always advised to "study hard, find a high paying job and cinch a secured life for ourselves". There are very few children who are advised to consider starting their own business or create a living from investing. Additionally, our education system is designed to create employees, who need security, live from pay-check to pay-check and want allowances. For this group of people, job security is more important than financial freedom. While you can become rich working in the "employee" quadrant, chances are that it would be tougher compared to the other cashflow quadrants.

Self-Employed - They own the job
Tagline: "If you want to do it right, you've to do it by yourself."
Core-value: Perfectionism

The self-employed usually work in silos and are often referred to as "solo people". They own their job, are independent and often do all their work themselves as they believe in 'perfectionism' and do not trust anyone else with the job. Few examples of self-employed are doctors, lawyers, retail shop owners, small company owners etc. They trade their time for money. Since their income is directly tied to how much they are working, they effectively own a job. Their income is a direct function of how much work they do. So, if they want to earn more then, they need to devote more time to their work. Unlike employees, they do not enjoy the benefits of medical allowances and paid leaves. They do not even have the luxury of falling sick because their work will get impacted in their absence. This group often has a hard time finding good work because they have such high standards.

Business owners- They own a system/process
Tagline: “I'm looking for the smartest people in my company”.
Core-value: Make people work for them

If you want to get rich, then this is the quadrant for you. This group of people owns the system or process, where people work for them. According to Forbes, big companies are the ones with over 500 employees. However, with the proliferation of internet start-ups and digital technologies, this classification may not hold true anymore. There are a number of big companies now, which do not require 500 employees to work. Business owners recognise their own inability to perform all tasks well, so instead, they leverage their ability to find and cultivate talented people to work for them. They hire competent talent and then delegate as much as possible. When compared to self-employed people, who cannot stop working if they want a regular income, business owners have the option to “take a break” from their work. They own the system and have the confidence that their employees will work for them and that their business will be well taken care of, even in their absence. Being a successful business owner requires ownership or control of systems and the ability to lead people.

Investors- They make their money work for them
Tagline: “I'm looking for a good investment.”
Core-value: Makes their money work

Investors are the fourth and the highest level of the cashflow quadrant. Being a part of one of the three quadrants mentioned above is a prerequisite for jumping into this quadrant. Investors are considered to be one of the most financially free groups as they make their money work for them. Often, they not only make their own money work for them but also use other people's money. They invest in businesses, stocks, real estate etc. in an attempt to generate returns from their investments. More often than not, investors do not need to get directly involved in the working of the business or assets where they invest, and hence, they get plenty of time and freedom. The wealthy receive 70% of their income from investments and less than 30% from their wages.

The Seven Levels of Investors

Investors can be broadly classified into seven levels.

Level I: Those with nothing to invest

This is the zero-financial-intelligence level. The investors in this level have nothing to invest and usually live paycheck to paycheck. Even though they may understand the importance of investing money, they basically have no disposable income to invest. They end up accumulating debt, living above their means, and never getting ahead in life.

Level II: Borrowers

These are people who typically exhibit consumerist behaviour, readily spending their money.

Level III: Savers

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Savers tend to be methodical and litigious in tracking their finances, but are too risk-averse to achieve a high ROI. They understand and support the concept of saving money but do not necessarily believe that investing is the best way to do that. They often waste time holding on to the purse strings with a tight grip, while neglecting to brush up on financial intelligence. These investors believe in saving their money and investing it in a savings account. However, this is a fairly redundant exercise since all the money they save in a regular savings account is eaten away by inflation.

Level IV: The "I can't be bothered to invest" individual

This group of people has convinced themselves that they do not understand money and never will. They let their money sit and do a little in their retirement plan or turn it over to a financial planner who recommends safe diversification. They also often make the excuse that they are too busy to learn to invest.

Level V: Long-term investors

These people are aware that they need to invest and have a clearly laid out long-term investment strategy. They take advantage of intermittent investment opportunities and, whenever possible, invest in a tax-advantaged manner. They have control over their spending habits and minimize their debt and liabilities.

Level VI: Sophisticated investors

People belonging to this group of investors are mature, focused and diversified. They have learned from their experience and mistakes and choose to put this to good use. They usually buy investments at wholesale rates and put their own deals together. They risk less than 20% of all their capital in speculative ventures. They study on a regular basis and actively participate in the management of their assets. Their main focus is on increasing their asset base, minimizing tax burden and creating long-term wealth. However, they do spend a small fortune on professional advice.

Level VII: The Capitalists

These are the richest people in the world. They control major companies, banks, and other institutions that the majority of the population spend their money on. This group of people make money by leveraging other people's money, talent and time. They use other people's money to invest and grow their wealth. True capitalists create investments and sell them to the market. More importantly, they know how to manage risk and make money without money. These Capitalists make money in every market.

- When the market goes up, they make money.
- If the market goes sideways, they make money.
- When the market goes down, they make LOTS of money.

Anyone seeking to become a 6 or a 7 must become a 5 first.

How to Become a Capitalist?

A smart man learns from his mistakes. But a wise man learns from other people's mistakes. The person who wants to become wealthy must learn how to become a capitalist. The key to becoming a capitalist is to constantly glean knowledge, learn how others became wealthy, understand the reasons behind successes and failures, and then do the things that work. Capitalists don't just invest in things. They invest in themselves.

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Use Debt to Make Money

The money you make from your job can only go so far. If you are buying stocks, then you are constrained by the money which is in your account. Capitalists know the difference between good debt and bad debt.

- Good debt puts money into your pocket each month.
- Bad debt takes money from your pocket each month.

A capitalist investor does not waste his money on useless things. Capitalists buy items that make them more money. The more money the capitalist makes allows him to buy more things that make him even more money. A key thing to not miss is that the capitalist stays in the type of investment that he knows. There are many investments out there that will make money, but the Capitalist knows his type of investment very well. Capitalists do not believe in diversification. You invest in what you know and do what you are good at.

It's possible to become rich in all four quadrants or remain poor in any. However, it's comparatively easy and fast to become rich when you're working on the right-hand side of the quadrant i.e. the business owner and investor side. Nevertheless, you do not need to shift to another quadrant entirely at once. You can keep your feet in two or more quadrants. For example, if you are an employee, you can still jump to the right side by starting to invest. You can be:

- Employee + Investor
- Employee + Business owner
- Self-Employed + Investor

However, the best way to get rich is when you are entirely on the right side of the cashflow quadrant i.e. you are a **"BUSINESS OWNER + INVESTOR".**