

"For those facing the full gamut of personal finance decisions—educational, career, retirement, or investing—*Family Inc.* is a must read."

—**André Perold**, CIO of HighVista Strategies and George Gund Professor of Finance & Banking, Emeritus at Harvard Business School

Family Inc.



USING BUSINESS PRINCIPLES TO
MAXIMIZE YOUR FAMILY'S WEALTH

DOUGLAS P. McCORMICK

WILEY



FAMILY INC.

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Your Family's Wealth

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FOREWORD

I have watched Doug McCormick employ the lessons and teachings of *Family Inc.* for over 25 years. We became good friends as cadets at the United States Military Academy, where we endured the “Academy experience”—the rigors of school, military training, and the challenges of collegiate athletics; Doug as an accomplished wrestler and captain of the team and me battling on the gridiron for the football team. During that time, he established himself as a leader, an intense competitor, and a gifted, creative intellect, known for independent thinking. These attributes have propelled Doug to success through every stage of life: highest-ranking cadet and First Captain of the Corps, accomplished Army officer, distinguished student at Harvard Business School, and successful banker, investor, and entrepreneur as co-founder of HCI Equity Partners.

The breadth of his experience allows him to bring a unique perspective to the topic of personal finance. As an unemployed husband and father putting himself through Harvard Business School, Doug learned the challenges of acquiring wealth when you have none. Harvard exposed him to the best teachers and thinkers in finance. At Morgan Stanley, he developed an understanding of capital raising, mergers and acquisitions, and how Wall Street works and thinks. As a private equity investor and cofounder of his own firm, Doug understands business, entrepreneurship, and the tools corporate America uses to create enduring value. Few professionals have enjoyed such consistent success combined with such breadth of experience. His diverse life experience, educational accomplishments, and business experience make him uniquely qualified to advise us all on the pursuit of financial independence.

Family Inc. is a career road map and investment guide for everyone, regardless of life stage, education level, or profession. It offers valuable tools that would have helped me navigate my own career and financial progression as a student, Army officer, banker at Goldman Sachs, and CFO of the

NFL and Twitter. In many cases, I was following Doug's recommendations intuitively, but without understanding how they fit into the Family Inc. paradigm. My experiences are not unique. The book's teachings are relevant to the many people I have worked with throughout my career—for the soldier transitioning to civilian life, the banker with significant financial knowledge, the professional athlete who acquires wealth early in life, the millennials in Silicon Valley pursuing entrepreneurship, and my college-age daughter. Quite simply, *Family Inc.* is required reading for the Noto family. If you are going to read ONE personal finance book, this should be it.

In a field where so much has been studied, written, and restudied, it is hard to believe that it is possible to offer new, fresh, and compelling advice. However, this is exactly what Doug accomplishes. Most financial planning advice emanates from the Wall Street-centric perspective of professional investors and advisers, financial institutions, and organizations attempting to address your financial needs through products. Doug's approach is rooted in the insight that with the exception of the size of the numbers, corporate and family financial statements and the principles required to effectively manage them are essentially the same. He borrows best practices of corporate America and modifies them to fit your personal financial situation. This approach results in better decision making, which will lead to better outcomes and lower risk—and, I daresay, the purchase of fewer financial products.

Throughout the book, you will be exposed to numerous novel ways to think about the financial game of life Doug refers to as Family Inc. Examples of these conclusions include:

- For most of us, our labor represents our most significant asset. *Family Inc.* provides advice on how to most efficiently harvest this asset through investment and career choices. When is the last time you discussed your labor capital with your financial adviser?
- Any accurate measure of wealth or asset allocation must include your expected labor and Social Security values. This changes everything and is unheard of on Wall Street!
- Most investment programs are designed to minimize price volatility over relatively short planning horizons. *Family Inc.* recommends a portfolio that maximizes long-term, real, after-tax purchasing power in spite of shorter-term volatility. This results in significantly higher equity exposure than traditional advice has.
- Buy a home, enjoy it, and use it to create wonderful memories, but don't justify the purchase as a good investment.

- Labor and capital are commodities. Through entrepreneurship, you can help shelter these assets from competition.
- Mastering the lessons in the book can also help you maximize the impact of your charitable giving.
- Every family needs someone—the Family CFO—to ensure the members adequately manage their risks while effectively allocating both labor and financial capital to achieve financial independence.

Family Inc. was written as a user's guide for the individual. I am confident reading it will improve your financial wellbeing. But I would be remiss if I did not mention Doug's motive for writing the book and the public policy implications of this kind of fresh thinking in America today. Our economy and society are changing in ways that are making financial literacy more important than ever before, yet the disparities between those who have mastered these skills and those who have not continue to increase. While our political parties become more extreme in their approaches to address these symptoms, there is inadequate focus on educating Americans with the skills and tools to adapt to these changes and close this disparity. The kind of holistic, unbiased, actionable advice offered in this book must not only find its way into our formal education system but also into the family dialog. Regardless of your education, profession, wealth, or age, *Family Inc.* is meant for you.

Family Inc. is a great personal finance book. More important, it is a guide to personal empowerment.

ANTHONY NOTO
CFO, TWITTER INC.

ACKNOWLEDGMENTS

To my son, Mike, and my daughter, Kelly, this book is my gift to you as you embark on the management of our family businesses. You are both already on the path of financial independence. Because of the investments you have made in yourselves through your education, your journey is already well under way. It is my hope that these lessons serve you throughout your lives as you use these principles to make your own way in this world. Like a carpenter, mason, or metal craftsman sharing his trade with his children, I share these skills and lessons of my trade as an investor. Use these lessons in good health and ensure that your children someday inherit not only your assets, but also these lessons so that they may be good stewards of our family business as well.

Mom, thanks for your unwavering confidence and support. Dad, thanks for getting me started in this crazy business with my first stock purchase at the ripe old age of seven. And thanks to Dave, my brother, role model, and adviser with sound judgment and pure intent.

To the Crown Fellow Program and my classmates, thanks for demanding significance.

To my partners and colleagues at HCI Equity, past and present, thanks for teaching me the business and putting up with me.

To my editor, Bill Rukeyser, thanks for helping me find a voice for this important subject matter that is straightforward, accessible, and even occasionally entertaining, without compromising the intellectual integrity of the recommendations.

To my wife, Michele, thanks for being my partner in life and our Family Business!

Additional Praise for *Family Inc.*

“Stated succinctly, *Family Inc.* is one of the best books on family/personal finance I have read—and I have read many. McCormick’s unique approach to labor and asset accumulation sets the foundation for an enjoyable and relevant read from start to finish, and the personal examples keep it real and engaging.”

—James Schenck, CEO, Pentagon Federal Credit Union

“*Family Inc.* is not a ‘how to’ book—it is a ‘how to think’ book that empowers the reader to take control of their family’s finances. McCormick presents sophisticated financial principles and concepts in an accessible way, and teaches the reader how to tailor and apply them to their situation to achieve their financial and life goals. If you want one good book to read, reread, and keep as a long-term financial reference, *Family Inc.* is the book for you.”

—Brigadier General Mike Meese, USA retired and COO, American Armed Forces Mutual Aid Association

“Mission accomplished! This easy-to-read masterpiece provides a well-organized framework and process to review personal/family finances. Doug uses the disciplined approach of a successful business to explain key financial and life goal concepts, which will allow you and your family to confidently chart your own course to financial independence.”

—Herman Bulls, Vice Chairman, Americas JLL, Director, USAA, and former Assistant Professor of Economics at The United States Military Academy at West Point

“Financial planning in an uncertain world is hard; the unique sacrifices of our service members and veterans make this even harder. However, *Family Inc.* gives you tools to effectively evaluate and develop your financial ‘self-worth’ and, in turn, improve your financial security. It’s a must have for your life skills ‘tool kit.’”

—Cutler Dawson, President and CEO, Navy Federal Credit Union

WITH APPRECIATION
FOR AMERICA'S
ARMED FORCES
SERVICE MEMBERS

Most of us are aware of and can appreciate the sacrifices our country's service members have made to ensure our safety and freedom since 9/11/2001. They endure hardship and extended time away from loved ones, frequently putting themselves in harm's way for our collective benefit. However, there is much less appreciation of the financial sacrifices and hardships many service members endure long after their service. In many cases, they are required to move numerous times during their service, making it difficult for other family members to maximize their professional opportunities. Their active duty experiences are often underappreciated in other professional fields when service members attempt to transition from the military, and they experience higher rates of disability, divorce, and homelessness than the general population. All these factors threaten the financial security and welfare of our veterans.

Financial literacy can't eliminate these challenges, but it can mitigate their impact. I hope this book can serve as a valuable tool for veteran service organizations that are helping veterans while promoting awareness of the unique financial challenges our service members face. If you have suggestions or ideas about how this book can assist veterans in your community or organization, contact veteransupport@familyinc.com.

INTRODUCTION

A quick Internet stroll down the Amazon search aisle for Personal Finance and Investment yields a long list of popular book titles—*Rich Dad, Poor Dad: What the Rich Teach Their Kids About Money*; *Total Money Makeover*; and Jim Cramer’s *Getting Back to Even*, to name a few. While I have found some of these books enjoyable reading, most of the current universe of financial planning literature disappoints. Oversimplified “how-to” books of financial goal setting or technical works focused on a specific financial activity or asset class are not conducive to effective overall financial planning.

The principles upon which *Family Inc.* has been developed are based on proven corporate finance concepts modified to address personal financial planning and therefore are both timeless and time tested. This book is written, I hope, with the intellectual rigor of a corporate finance class but in the language of family discussion, with many examples from my own family.

Family Inc. is intended for people who have the potential to become high-income earners and want to develop a comprehensive, actionable, customized plan, one that acknowledges the relationships between job, net worth, age, consumption pattern, and long-term financial objectives. While it cannot guarantee financial security, it will give you the tools to develop a comprehensive financial plan and fully appreciate the implications of your decisions.

As a professional investor, I have spent substantial time analyzing various businesses and evaluating the financial profile of good companies. I have become involved in all financial aspects of the businesses my company invests in—strategic planning, financial analysis, budgeting, capital structure, capital raising, acquisitions, and restructurings. During the past 15 years, I have served all these businesses as an active board member or chairman of the board and in some cases as chief financial officer.

I realized along the way that many of the financial principles employed by successful companies are also relevant to personal financial planning and management. In these pages, I share those principles and recommendations for creating your own financial prosperity and security. The lessons are particularly timely in the current economic climate. While it may be comforting in these uncertain times to rely on a financial “expert” to manage your financial interests, only you can adequately prepare your family for the financial opportunities and challenges that lie ahead. Many people allow their financial adviser to manage them. This book will teach you how to manage your adviser—he or she does, after all, work for you.

One last point before we begin our journey. These principles and concepts of financial planning assume that you have the discipline and intellectual honesty to act rationally and stick to your financial plan. For example, many advisers suggest that you pay off the mortgage on your primary residence as quickly as possible. On the contrary, I recommend that you pay off real estate debt last (even after making other investments), given the relatively low after-tax cost of this debt. But this assumes that you actually save and reinvest this increased cash flow and don’t blow it on a new flat screen or vacation. For these principles to work for you, you need to know yourself and your family members and customize these lessons appropriately for your personal situation.

Now let’s begin the journey of developing your comprehensive road map to financial security and independence.

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SECTION I

EVERY FAMILY
NEEDS A CHIEF
FINANCIAL
OFFICER

Why Do I Need a CFO? I Don't Even Own a Business

Growing up, my brother, Dave, and I developed different attitudes and behavior about money. Dave's nickname was Spendsworth, given to him by our grandfather because, as Grandpa said, "He spends what he is worth." Dave supported his carefree spending because he always seemed to have some sort of job. Making money wasn't the hard part for him; holding on to it seemed to be. Like any good younger brother, I took the opposite tack. I, too, had many jobs—newspaper deliverer, farmhand, babysitter, Christmas tree trimmer, and stationery salesman, to name a few. But I saved almost everything I earned, made some investments with my father's help and even loaned some of it out to poor Spendsworth at usurious interest rates.

While most of these youthful habits have stood me in good stead, they haven't exempted me from the sometimes scary financial decisions and challenges that come with becoming an adult. In my twenties, I resigned an Army commission to go to Harvard Business School just as my wife, Michele,