

THE PHYSICIAN'S BALANCE SHEET

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“What are you really worth?”
That’s a loaded question!

As a member of a local hospital’s Quality Council, I’m used to looking at metrics. Lots of numbers. Lots of spreadsheets. As a wealth advisor to physicians, I’m used to looking at financial statements. Lots of numbers. Lots of statements. In both roles, we measure, we report, and we recommend actions based on those reports. It’s interesting that in both of these worlds – that of the healthcare industry and of personal wealth management – the world is changing quickly around us. Things we didn’t use to measure – now matter a great deal. The stakes are high. It’s important that our reports help us see the big picture.

One of the more important reports in my “day” job is the Net Worth Statement -- or the Balance Sheet. Most of us only think of the financial balance sheet -- the one with financial assets on one side and liabilities on the other. It’s an important and helpful tool, to be sure. But I propose a different lens through which to view wealth. I call it The Holistic Balance Sheet.

If I asked you to create your own balance sheet, you’d likely start by thinking of the things you own. Most likely, you would rattle off the same things that appear on a mortgage loan application. Almost everyone names their home first. Never mind that many homes are "under water" and do nothing but suck money. It’s still what most of us think of first. And what’s next? ... usually a retirement account (IRA, 401K, 403B, 457, etc.). For many physicians, these two items represent 85%-95% of financial assets.

Hopefully, there are some other investments such as cash, stocks, bonds or mutual funds as well, though. And for a few, there may be some form of business ownership. It could be ownership in the practice itself or in a surgical center or the real estate in which the practice is located. Often these have less value or more debt than was originally

envisioned. Put them together and you have the financial assets.

There’s more to the story, of course. On the right side of the statement, we note the mortgages, the student loans, and may even consider the income tax liability embedded in those pre-tax retirement plans. The result is our net worth. And the picture isn’t always pretty.

The average doctor has no idea how much of their financial capital is necessary to maintain lifestyle throughout a lifetime. And study after study shows that very few are on track to accomplish their retirement goals. Much of the problem has to do with limitations on qualified retirement contributions. In a large healthcare organization, a radiologist may be subject to the same IRS limits on contributions as the newly-hired tech. But the problem is likely more due to a lack of urgency in planning for the future and the busy lives we all lead which is part and parcel to human nature.

While Financial Capital is relatively understood (even if not acted upon), there are other important parts of the Holistic Balance Sheet that are usually not considered. The first of these is “Human Capital”. Human Capital often takes two forms. The first is the defined-benefit pension -- the type of retirement plan that guarantees a specified payment for either a number of years or for life. While these are less prevalent than they used to be, they still exist for most of us if only in the form of Social Security. Now we can certainly debate the likelihood of changes in a system like Social Security, but for those retiring today, such an arrangement certainly has value.

However, it doesn’t have a place on a traditional "financial-only" balance sheet. Why is that? When I’ve challenged my banking and accounting friends, they usually scratch their heads and say, "Huh, I never thought of it that way, but it makes sense." They know that it in the financial world we have a nifty way of converting a stream of future payments into a present value equivalent (the Net Present Value calculation). There are times when this calculation may be required by

law. Three examples include divorce, death, and in determining the loss in a wrongful death suit. But outside of these situations, the value of such cash flows is ignored in the professional's balance sheet.

The most important form of Human Capital, though, is the future value of earnings. What is the future stream of your earnings worth? It depends on a number of factors: the current and future levels of compensation; how many years one is expected to work; the dependability of the income stream. Imagine two physicians. Dr. Jane is fresh out of her residency and planning to work in Family Practice. She'll start at about \$150,000 and average \$250,000 over her career in today's dollars. And she may be able to practice into her late sixties or even longer. Her future stream of income may total eight or nine million dollars. After adjusting for the costs of basic self-maintenance and the time value of money (which would reduce the value) and for future cost-of-living increases (which would increase the value), experts might tell us that her Net Present Value of earnings is around \$5,000,000. Wow! That's a very different view than looking only at Dr. Jane's anemic, debt-ridden financial balance sheet.

For a fifty-year-old orthopedic surgeon, the variables are different. Dr. Joe is earning considerably more. Perhaps \$600,000 annually. But with the physical demands of the job, he may only have another 5 - 7 years to earn that. So his Human Capital may only be 3 or 4 million dollars. Human Capital is a depleting asset and the retirement horizon is squarely in view.

Though the details and issues vary, there are some important lessons for both Dr. Joe and Dr. Jane.

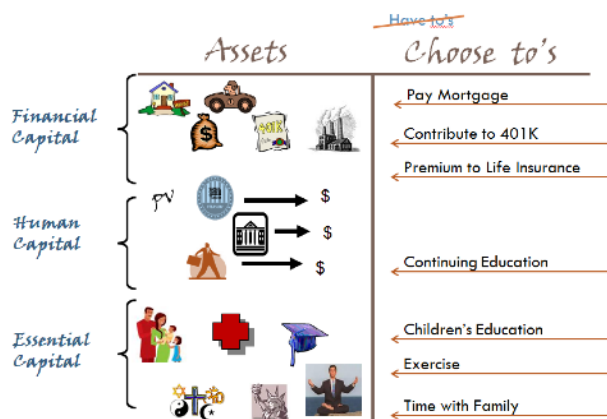
- Each has a lot riding on their continued ability to work, of course. The importance of protecting their Human Capital cannot be overemphasized. That's where traditional disability and life insurance products come in. They "hedge" the risk of having that reserve of human capital evaporate in an instant.
- Another important issue is the urgent need to be systematically converting their Human Capital into Financial Capital. Saving and investing is not something to be put off. The time value of money dictates that doing so sooner is always worth more than waiting until

later. And precious few can get where they need to be by simply maximizing the 401k contributions.

- Also in developing their investment strategies, Jane and Joe may want to have their financial advisors or brokers take their Human Capital into consideration when developing their allocation strategy. Those with a more "bond-like" career path (say an MD who is also a tenured professor at a university-based hospital) could reasonably be more aggressive in her portfolio. On the other hand, the entrepreneurial managing physician of a smaller doc-owned practice clinging to independence probably shouldn't be taking on as much risk in his portfolio.

You're getting the picture that there is more to the Holistic Balance Sheet than what shows up on the quarterly account statement. But there's another vital question to be asked and answered: "Is there anything more valuable than your Financial and Human Capital?" The answer is usually a resounding "Yes!" Asked another way, "Is there anything you wouldn't trade for a few more shekels?"

The answers I hear to that question vary. But several themes emerge including: family and other important relationships (#1 response); health (a close second); education and life experience; quality of life; reputation and integrity; faith; values; the ability to make a difference; peace of mind that we'll enjoy a successful retirement, etc. When busy physicians get to (or are forced to) take the time to consider this question, they come up with a number of things that they value more than their money or their careers. We refer to this as Essential Capital. These things are the things that really matter most.



As busy professionals, we are not always in tune with this, though. On the busy treadmills of life, working 70 hours a week or more, influenced by a materialistic society, our actions often belie our values. We sacrifice our own health or our most important relationships -- sometimes beyond repair. There are, of course, financial implications as well. Stress and burnout and sometimes disability can impede our ability to maximize our human capital. A divorce can remove half of our financial capital from our balance sheet. Failure to live and practice in accordance with our ethical values can lead to lawsuits.

Holistic Wealth takes into account Financial, Human, and Essential Capital. Which is most important? That's probably a trick question. Because they actually are all important. It's tough to enjoy certain aspects of quality of life without financial resources -- now and in retirement. The private school education for the kids, the second home at the beach, the sabbatical in the south of Spain require dollars (or, at least, Euros). Investing (more money or more time) in Human Capital by sub-specializing pays off for many practitioners. The point is -- they are all important. They are all related. The key is for them to be in alignment. Often, they are not.

Everything noted here is true for everyone -- not just for doctors. It is probably more pressing for the medical professional than for most, though. There are several reasons. Despite rumors to the contrary, physicians still enjoy higher than average compensation, prestige, and lifestyle. But historically, the price for that has been to put the needs of others (your patients) ahead of family and your own. This is especially true for the

boomers. To their credit, younger doctors aren't so willing to make that trade-off.

Regardless of your age, if you're reading this, you're probably inclined to that same realization -- "Money is not the most important thing." That's not to say that money or other forms of Financial Capital aren't important, though. They are! But only to the extent that they are in alignment with what's most important.

Whether you are in the final years of your career, just beginning it or somewhere in between; take the time to review your wealth from a broader, more holistic perspective. You may find that you're wealthier than you think. And, perhaps, you can create a more meaningful life for yourself, your family and for society at large.

Bill Lyon is the creator of The Holistic Balance Sheet™ and The Financial Navigation SystemSM, a unique process that helps successful people find greater success in all aspects of life. He lives in Greater Cincinnati with his wife Barbara and two sons.

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