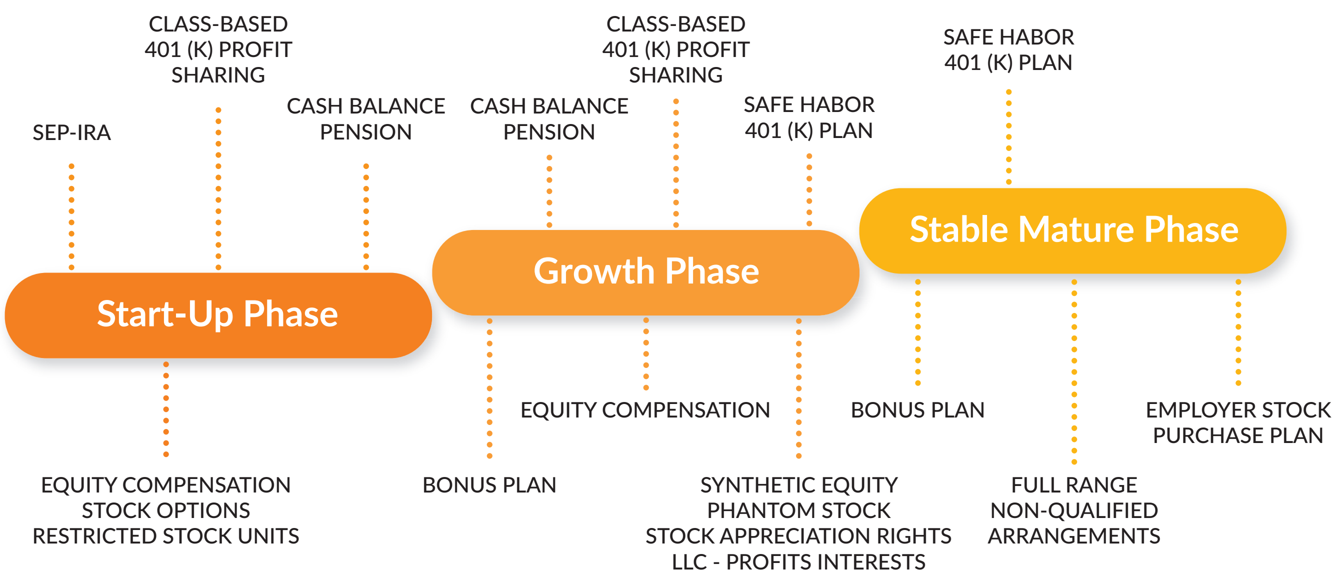
Compensation and Retirement Plans Evolve with You

The suitability of your business' compensation or retirement plan arrangement is ultimately dictated by goals of the company and cash flow, typically not the number of employees or revenue. It is important that companies balance rewards, retention, and retirement along with the associated tax benefits. The timeline below displays three key phases of an evolving business and the retirement and compensation structures that are most appropriate during each phase.

Broad Based Retirement Plans



Strategic Compensation Arrangements

Start-Up Phase

Broad Based

Businesses with a small number of employees, or even only shareholders, with good cash flow should try to get as much money into qualified plans as possible. This allows for tax deferred accumulation of retirement assets for key employees. These plans include:

- **SEP IRAs.** Can be very attractive given minimal plan maintenance.
- **401k/Profit sharing plans.** Increased plan maintenance cost but more flexibility than a SEP.
- **Cash balance pension plan.** Most complex of all the qualified plan arrangements but can generate deductible contributions in excess of $100k per person depending on employee's age and compensation level. Plans must be maintained for at least three years. Depending on how quickly the business adds employees, the arrangements can become too costly very quickly, but great while they last.

Strategic Compensation

Many new businesses have significant cash flow restrictions. This can severally restrict the ability to pay high salaries much less make contributions to a qualified plan.

- Stock compensation arrangements including nonqualified stock options are popular mechanisms at the early stages for businesses that have limited cash flow, especially for initial key hires. This can be particularly attractive when the anticipated goal is to be acquired.
- Extreme caution is advised when considering ownership interests, especially in S-corporation; not every executive is suitable to be a shareholder.

Growth Phase

Broad Based

As businesses increase the number of employees the ability to "target" reward specific employees can become more difficult in qualified plans. The discrimination requirements make it difficult to get the right contributions to the right employees without significant contributions to all other employees. The one possible exception is a class based 401k profit sharing plan that not only allows for employee contributions but provides the potential for different employer contribution rates across different employee groups.

At a minimum, employers will need to provide a 401k plan with a matching contribution, probably a safeharbor plan so that employees can contribute the maximum allowed without 401k discrimination testing restrictions. The most common safeharbor matching formula is 100% of the first 3% contributed plus 50% of the next 2% contribution for a total maximum exposure of 4% of an employee's pay. This is needed to stay competitive in the workplace.

Strategic Compensation

- This is the time when employers begin to want to structure different types of compensation arrangements for different employee groups.
- Bonus plans for the broad employee group are often structured at this time.
- Upper management bonus formula are tied to the increase in the value of company stock, such as phantom stock, stock appreciation rights and stock units. These arrangements can be settled in either cash or stock, most commonly cash.
- A few key employees may be considered for actual ownership.
- Synthetic equity often is considered during this time especially if ownership is driving toward a sale of the company.
- Profits interests in an LLC are also a consideration during this phase.

Stable Mature Phase

Broad Based

This phase generally highlights the limits associated with broad based retirement plans' ability to strategically compensate specific employees.

- A 401k plan with a matching contribution is standard, safeharbor contribution may be needed.
- Can be cost prohibitive to get key employees the level of benefit that is desired.
- Profitability and benefit culture will determine if additional employer contributions make sense.

Strategic Compensation

During this phase, employers have a tiered benefit structure, with additional tiers as you move up the management chain. Upper management and key employees will be compensated via multiple structures.

- In addition to the arrangements established during the Growth Phase, employers (especially large employers defined typically by employee size greater than 1,000) implement the most sophisticated arrangements. Arrangements such as employer stock purchase plans (ESPP) and qualified stock options are more common.

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To evaluate your retain, reward, and retire strategies today, contact:

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