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A corporate benefits parable

A look at people with the same career but dramatically different investment results

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Personal Finance

I have advised many corporate executives at various stages of their careers. Some make all the right decisions related to their personal financial planning, and consequently accumulate significant wealth. Some will avoid making important decisions or forgo available corporate benefits and miss out on some great opportunities to save and invest.

Imagine two investors, Jane and John. Jane goes to work out of college and takes the time to educate herself on personal financial planning and wants to maximize her financial position. At the same time, John goes to work but does not worry about his financial plan. They work in similar positions at the same publicly traded company, which offers all employees a 401(k) plan with a 4% company match. The plan allows for traditional pre-tax contributions or Roth contributions. It also allows for post-tax contributions beyond the annual limits of $19,500 for those under age 50 and $26,000 for those over age 50. This plan even allows for in-plan conversions from the pre-tax or post-tax account to the Roth account.

The company also offers a Health Savings Account and an Employee Stock Purchase Plan with a 15% discount on the price of the company shares.

Jane knows that if she doesn't contribute to the 401(k), she doesn't get the match. If the average college graduate earns $50,000 annually and the invested income grows 5% per year, the match in a 401(k) can add up to a significant sum over a 30-year career. (If the ongoing match in the retirement plan earns 7%, that account alone could compound to about $350,000 in 30 years.)

John heard about the match but isn't worrying about retirement at his young age. If he waits five years and then starts contributing to get the match, the compounded value of his account would be about $60,000 less than Jane's.

Participating in an Employee Stock Purchase Plan is similar to the 401(k) decision. If you participate, you get the additional savings. If you don't, you lose that opportunity.

I've advised numerous people with access to ESPP plans, and fewer take advantage of this benefit than do the 401(k). The benefit amount is generally less than a 401(k) match at lower income levels, but an investment in an ESPP does not need to be deferred for 30 or more years until retirement.

If Jane and John's employer offers a 15% discount on their shares and allows employees to invest up to 10% of their pay into the plan, it would provide an initial $750 bonus, assuming the share price does not change during the year. Jane gladly participates to get this bonus, but John won't bother for that small amount. What John doesn't realize is this $750 discount bonus earning 7% and increasing with pay raises could grow to well over $132,000 if compounded during a 30-year career.

Some savings plans depend on the benefits offered by an employer while many others are unrelated. For employees, it's not enough just to participate in their company 401(k). Employers' savings plans often have dozens of investment choices within the plan that should be strategically chosen.

Someone investing in stock funds will likely accumulate more than someone investing in stable value funds over a 30-year career. Then, there are tax strategies that need careful consideration. Sometimes paying taxes on money contributed to a plan now rather than paying them later can allow for tax-free compounding that can have a highly positive impact in retirement. Just as eating right should be a healthy lifestyle decision, participating in available savings plans and investment opportunities is essential to long-term financial health.

The ideal financial plan starts as early as possible. Some young people even start saving money in tax-advantaged accounts from summer job earnings and allow those contributions to compound over many decades. Courses on financial planning can be greatly beneficial to young investors, and seeking the advice of a certified financial planner is highly recommended. NHBR

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