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Protect your business: think human capital

If stars leave, your company will suffer

By Bob Rhyme

Think risk management and you probably envision financial and legal issues. These are important, but one of the greatest risks your business faces lies in the loss of human capital. If key employees depart, either for perceived "greener pastures" or due to unforeseen circumstances, your business can, and will, suffer.

Without its best talent, a company can see its value drop as sales decline and other key relationships deteriorate. A business owner may even confront delaying retirement. This explains the critical nature of protecting against the loss of important staff members.

CONTINGENCY PLANNING

You should plan to protect your business against an unexpected loss of an employee due to death or disability. Life and disability insurance covering key employees that is payable to the business can provide capital that will allow the business time to strengthen cash flow, hire and train replacements, and assure creditors of business continuity. Life and disability insurance covering a business owner also can prove important.

Should something happen to a business owner, the payout from life insurance policies can allow the business to continue operations while searching for new ownership. Or, the policies can be valuable to help fund buy-sell agreements with other owners; the death benefit would allow the surviving co-owner(s) or business to purchase the business.

Good people are the foundation of any business. To ensure that foundation stays firm, you need to protect your company from their loss. This can prove one of the most important risk-management initiatives you undertake as a business owner.

GOLDEN HANDCUFFS

A company's star talent will naturally be thinking about their future, asking, "Where will I be in 10 years?" Without a prosperous future ahead, these peoples are more likely to leave. Instead, provide them with "glue on the seats" by offering incentives for them to stay.

Economic incentives are usually the best. While an ownership stake is certainly one option, this can open a business up to many complex responsibilities and obligations. And for smaller, privately held companies, ownership doesn't always prove the best option.

One alternative is known as a "Supplemental Executive Retirement Plan" or SERP for short. A SERP is a form of non-qualified retirement plan that allows an employer to provide a retirement benefit specific to the needs of its key employees. The SERP can be based on the deemed benefit that will be provided or the SERP can be based on a deemed contribution amount. The company's ability, within certain limits, to design each SERP to match the needs of key employees while maximizing incentives to promote the growth of the business is paramount. For example, the right to receive a benefit could be subject to a vesting schedule. If employees leave before the designated vesting date, they forfeit any unvested portion. So, if an employer has placed $100,000 in the plan but only $30,000 is vested, $70,000 is forfeited to the employer upon leaving.

Through their vesting options, these plans encourage key employees to stick around. As an added plus, the benefits are not taxed until received by the key employee. Of course, any amount that the employer may put aside to informally finance the benefits also is not deductible until the benefit is taxed. Finally, the plans can encourage a company's growth by tying benefits formulas to performance goals that increase the company's value, enhancing the incentive for the company's success.

Unlike a qualified retirement plan, such as a 401(k) or profit-sharing plan, non-qualified retirement plans like SERPs don't have to be offered to everyone. In fact, tax law generally identifies them as being for "a select group of highly compensated, key management employees." Because determining which employees fit into this classification is not always entirely clear, you should consult with professional advisors and attorneys before establishing such a plan.

An alternative incentive plan exists. Restricted executive bonus plans can use life insurance to build cash value for employees, with restrictions on when they can use it. You can determine the time or age that the cash value is available to them (although it's generally best to have any restriction terminate well before the employee retires). The employee owns the policy, but the company pays the premiums on the insurance, which are taxable to the employee, but deductible by the company. Should employees leave, they can take the policy with them but the company stops paying the premiums. For smaller companies, these plans can be easier to administer.

Other options for retaining your best workers include:

- Bonus/incentive plans-monetary bonuses encourage all staff to perform at their best; however, without the vesting options set forth in non-qualified plans, less focus is on the future and, therefore, less glue holding employees to their jobs.
- Broad-based benefits plans-health, dental, qualified retirement planning and other benefits are always important to employees.
- Continuing education opportunities-the chance to learn more and advance in knowledge can pay off as an employee climbs the career ladder.
- A clear-cut career path-the knowledge of where they'll be in the next 10, 15 or even 20 years gives employees piece of mind and helps ensure they stay with the business.

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