

Boosting employee retention in a competitive labor market

In a talent crisis of historic proportions, more than 50 million workers voluntarily left their jobs in 2022.¹ This pandemic-induced trend, dubbed the “Great Resignation,” has put the U.S. labor market in uncharted territory. 2022 marked the second consecutive year of record-breaking quitting, as mask mandates were dropped—and some companies began to insist that employees return to working in offices full time.

For business owners already weary of dealing with the demand for greater workplace flexibility, attracting and retaining talent has taken center stage. More than ever, business owners need employee benefit options that are affordable, flexible, and tailored to their goals.

[New research from Principal](#)² confirms that employee turnover in small and midsize businesses remains high, meaning the tight labor market has intensified the competition for talent. The success of your business depends on having the right benefits in place.

Three in four business owners said that an employee benefit package helps improve their ability to recruit and retain qualified employees, not just key employees. A majority also want to offer more but have difficulty finding the time and resources to plan for the financial health of their business.

Ninety-eight percent of business owners have at least one key employee who is critical to their success. And the majority want to offer benefits that will help retain them and recruit future talent. Of those surveyed, 87% offer key employee benefits, such as disability insurance, nonqualified retirement benefits, and bonuses. This means that competition is strong—because more likely than not—your competitors are offering or considering increased key employee benefits. Businesses that do not offer these benefits may be at a disadvantage in the current marketplace.



Businesses that do not offer broad-based and key employee benefits may be at a disadvantage in the current marketplace.

¹ U.S. Bureau of Labor Statistics, Job Openings and Labor Turnover Summary, March 8, 2023.

² 2023 Principal Financial Group Business Owner Insights, conducted by Dynata.

Let’s start by looking at your employees in two groups: the broad base of all employees and the key employees who are critical to the success of your business. Your goals for these groups will likely be different.

1 | Broad-based employee benefits

Most business owners creating an employee benefits package begin with essential needs—such as comprehensive health insurance, dental and vision insurance, disability income protection, and a qualified retirement plan. These kinds of benefits are often seen as a baseline by employees, and the potential of being able to deduct costs makes them more affordable to the business.

Qualified retirement plans, such as 401(k) plans, have the unique distinction of being the only retirement funding opportunity for business owners that offers a current income tax deduction without triggering income to the employee. The price of this characteristic is that by law, they must be nondiscriminatory, meaning they must be offered to most employees. However, the right plan design can help make the costs affordable.

A 401(k) plan allows employees to put aside a portion of their salary and delay taxation of it until retirement. It can be designed to include employer matching and/or profit sharing contributions, allow Roth contributions by employees, and give you the flexibility to promise contributions or make them discretionary from year to year.

An employee stock ownership plan (ESOP) can address both the retirement plan need for employees and the need for a business owner succession plan. An ESOP invests primarily in employer stock, creating a buyer for the business. It provides liquidity for the owners and encourages employee engagement and loyalty by making employees beneficial owners of the business.

Percentage of businesses offering broad-based employee benefits

Benefit	Currently offering
401(k) plan	64%
Health insurance	62%
Dental insurance	59%
Vision insurance	55%
Life insurance	52%
Short-term disability insurance	48%
Long-term disability insurance	47%
Nontraditional perks (like additional time off)	35%
Health savings accounts	44%
Emotional and wellness programs	39%
ESOP	21%

Source: 2023 Principal Financial Group Business Owner Insights, conducted by Dynata.

Whatever your needs and budget, a base level of employee benefits will help you attract and retain employees at all levels and help set your business apart from its competitors.

2 | Key employee benefits

Whether your business is well established or not yet ready to assume the costs of comprehensive employee benefits package—or somewhere in between—it is likely you have key employees you want to retain and reward. You will also want your benefits to help you attract top talent in the future.

Unlike some employee benefit plan types, key employee benefits can be provided to just one, or several key employees. There is no requirement of covering a certain percentage of your employees.

Bonus plans: keeping it simple

A bonus plan can be as simple as additional cash compensation, but you or your key employees might want the cash bonuses to accumulate over several years. Bonus amounts can be accumulated in a variety of investment options—including mutual funds, annuities, and cash value life insurance.

If you want to also use the bonus as an incentive for the employee to stay with your business, you can restrict the employee's access to cash values for a period of time such as 10 years.

If you want the employee to be able to receive the bonus without out-of-pocket income tax costs, you can "gross up" the bonus (sometimes referred to as a double bonus). This provides an additional bonus of the expected income tax due on the primary bonus so that the employee has no out-of-pocket costs. If a current income tax deduction for the business is a priority, a bonus plan may be the best option.

Nonqualified deferred compensation: confidence for retirement

If you already have a qualified retirement plan, your key employees are probably contributing the most into it that the law allows, but it might not be enough to replace their income during retirement. A nonqualified deferred compensation plan can help bridge the gap between the qualified plan benefits and their income needs in retirement.

When you promise a future deferred compensation benefit, you may wish to put aside contributions into mutual fund investments or cash value life insurance to help pay the benefit. Nonqualified plans are "informally funded," meaning that if you put aside funds to pay the future benefits, your contributions must remain a company asset. You are not required to make contributions to informally finance the plan. If you are confident the benefits can eventually be paid from cash flow of the business, you can simply pay them from future cash flow. Cash value life insurance is a flexible option that allows income tax-deferred growth and offers death benefit protection. Mutual funds can be an appropriate option for shorter term distribution needs, and/or when life insurance is not available. The stability of your company is important because the assets set aside must remain subject to the claims of business creditors.

When designing a plan to provide for future income, it becomes critical to identify whether the employees you want to benefit are "top hat," meaning select management or highly compensated employees. Generally, nonqualified deferred compensation designs are focused on top hat employees.

Deferred compensation can benefit non-top hat employees only under limited circumstances. A lump sum future bonus can be offered to a non-top hat employee, so long as the scheduled payout is not at or near retirement age. These "deferred bonus" arrangements pay a lump sum at a specific point in time, determined at the inception of the plan. No graduated vesting is available, but they can provide a powerful incentive for the employee to stay.

Split dollar plans

The flexibility and multi-purpose usefulness of cash value life insurance is never more apparent than in split dollar plans. In a business context, the term "split dollar" simply means that the proceeds of a life insurance policy are divided between an employer and employee or employee's beneficiary.

When would you want to consider a split dollar plan?

- When the employer wants a company-owned policy to do double duty
- When the goal is to provide supplemental benefits in the future while minimizing the current income tax impact to the employee

Endorsement split dollar

An endorsement split dollar plan is helpful when a business owns a life insurance policy and wants a portion of the death benefit to go to the insured employee's beneficiary. With an endorsement split dollar plan, a policy purchased for business use (such as key person protection or for a deferred bonus) can provide an additional employee benefit of death benefit protection. A small taxable benefit to the employee is triggered annually, but it generally results in the benefit to the employee's beneficiary being income tax-free.

An endorsement split dollar plan can benefit any employee but is often used with coverage purchased for a key person need or to informally fund a nonqualified plan. The main alternative to an endorsement split dollar plan is a death benefit only plan—which is simpler to operate—but results in a taxable death benefit to the employee’s beneficiary.

Loan split dollar

A loan split dollar plan is comparable to a nonqualified deferred compensation plan, in the sense that the objective is usually to provide supplemental income to the employee in the future. However, if properly structured, the arrangement is typically not treated as a nonqualified deferred compensation plan, because the premiums paid by the employer are a loan, subject to repayment.

In a loan split dollar arrangement, the life insurance policy is owned by the employee and premiums are paid by the employer, subject to a loan agreement. The structure resembles a bonus plan, but because the employee owes back the premiums, they are not currently taxable. Instead, the employee either pays (or is taxed on) loan interest each year. The amount of interest depends on the design of the loan.

An advantage of a loan split dollar plan is that the current income tax impact of the plan to the employee is minimal. The objective is that in the long-term, the cash values in the policy will grow to be sufficient to repay the loan (or the loan will be repaid at death, or through other means). If the employer later decides to forgive repayment of the loan, the employee will recognize the loan as income, and owe income taxes on that amount (and the employer will receive a deduction) in the year of forgiveness as part of the plan design. If the employer plans to offer loan forgiveness, the plan should be treated as a nonqualified deferred compensation plan, meaning it should be in writing and limited to top hat employees.

Lifestyle protection: designed to provide peace of mind

If your employees took the time to plan for their worst-case scenario, they might ask for a benefit that offers protection from an unexpected disability or the impact of a death in their family.

The most frequently used key employee benefit among businesses we surveyed is disability income protection, offered by 35% of surveyed businesses in 2023. Like other key employee benefits, this type of plan can be provided to a limited number of employees that you choose. Disability income protection can include salary replacement for a short-term or long-term disability and can also protect the employee’s retirement contributions.

Another cost-effective way to provide a significant benefit for your key employees is death benefit protection. Supplementing the group term life insurance you might be offering to all employees could help restore benefits to your key employees. A death benefit only plan, or an endorsement split dollar arrangement can allow employer-owned life insurance to serve multiple purposes. One policy can provide key person protection to the business while offering extra death benefit protection for the employee’s beneficiary.



More than ever, business owners need employee benefit options that are affordable, flexible, and tailored to their goals.

Key employee benefit designs

	Executive Bonus	Nonqualified deferred comp		Split dollar		Death Benefit Only	Individual disability income protection
		Deferred bonus	Defined contribution	Endorsement	Loan		
What is provided?	Annual bonus funded with mutual funds, annuities, or life insurance	Lump sum in future	Contributions that create a lump sum or stream of income in future	Death benefit protection	Future income and death benefit protection	Death benefit protection	Disability income
Who owns the policy or controls the funds set aside?	Employee, but restriction possible with life insurance	Employer	Employer	Employer	Employee	Employer	Employee or employer
Limited to top hat employees?	No	Depends on age	Yes	No	Generally, no	No	No
Employer deduction	Current	Future	Future	Limited	Limited	Future	Current
Can employees defer income into the plan?	No	No	Yes	No	No	No	No, but costs can be shared
Is cost recovery available?	No	Yes	Yes	Yes	Yes	Yes	No
Flexibility to add contributions	Yes	Yes	Yes	No	Yes	No	No
Can plan include death benefit protection?	Yes, if life insurance used	Yes, if life insurance used	Yes, if life insurance used	Yes	Yes	Yes	No

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Patti Bell specializes in key employee and owner benefit plans, business succession, business protection, and estate planning. She works with business owners and financial professionals to implement comprehensive solutions that help meet employee, business, and personal needs. A Loras College graduate and member of the American Institute of Certified Public Accountants, Patti is a frequent speaker on business planning, executive benefits, estate planning, and related topics.

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