

Matching Contributions

401(k) plans may offer a company match, which means your company makes a contribution to your plan whenever you do, usually about 50 cents on the dollar (depending on your plan). This is like a huge year-end bonus, and it is doubly valuable because matching contributions (and your investment earnings on them) are tax-sheltered within your 401(k) plan.

How much of a benefit is a 401(k) match? It's bigger and better than you think. Fifty cents for every dollar you contribute may sound like spare change, but over the years it really adds up. Then factor in that you will receive investment returns on the money you've invested and the money your company has added. These two benefits together help your 401(k) account grow by leaps and bounds.

Remember Pat and Gerry? Let's say they are still earning a starting salary of \$25,000 and contributing 6 percent of pay, or \$1,500. They are still earning an 8 percent rate of return, they can expect a 2.5 percent salary increase every year, and their time horizon is still 30 years. In this example, however, they are both putting their money away pretax in a 401(k). The big difference in their plans is that Pat receives a company match of 50 cents for every dollar up to 6 percent of pay, while Gerry's plan has no match. Gerry will have as much as she did in our previous example (\$225,195 after 30 years), but Pat's company match has catapulted him past Gerry to a retirement account of \$337,792. That's a \$112,597 difference for merely receiving the employer's matching contribution. Figure 2.4 shows the results of both plans.

Figure 2.4 Difference in Retirement Savings with a Company Match

Assumptions:

Pat: 401(k) with 50 percent match on first 6 percent of pay

Gerry: 401(k) with no match

Starting salary: \$25,000 Contribution: 6 percent of pay

Time span: 30 years Rate of return: 8 percent

Salary increase: 2.5 percent per year

