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Business Interruption

...Essential insurance for any business

Business interruption insurance is not widely understood by many business owners. Perhaps the best analogy is to consider the cover as a form of personal accident insurance for the business.

There is much more to protecting the investment that the business is to you, than simply insuring the physical assets of the business. The owners, shareholders and/or those that have provided investment finance, expect an income stream that will cover the financing costs, the costs of operating the business and an acceptable level of net profit. The net profit and ongoing expenses, including payroll, management and other staff bonuses, as well as financing costs, are all regarded as insurable Gross Income that needs to be protected.

In the event of a fire or other insured peril occurring at your premises, a reduction in insurable Gross Income can occur through two possible causes. The first is a reduction in turnover. In other words, a drop in sales will naturally lead to a loss of insurable Gross Income. The second cause of a loss of insurable Gross Income can be from increased costs of working being incurred by the business that are over and above the norm, to keep production happening and your customers with stock. For example, a manufacturer who cannot produce may decide to outsource production in the short term to another firm so that they can maintain supply to their customer-base. A retailer may incur additional freight charges or rent temporary premises to allow them to continue to trade.

Interestingly, while full Interruption Insurance covers both forms of loss of insurable Gross Income, not having the cover can often lead to a much greater monetary loss compared to the property loss. For example, the interruption of a public utility may not cause any damage to property, but could result in a significant loss of insurable Gross Income.

Many businesses do not believe that a loss will ever happen to them. The reality is that losses occur every day to businesses just like yours. Those that do not have full business interruption insurance have far less chance of surviving. My own research suggests that the survival rate of a business without business interruption insurance is less than 1 in 10. Business owners invest a great deal in their business - it can be a major investment, the mortgage over their home and/or their superannuation. It is vital that they protect themselves not only against the potential loss of cash flow, but the very survival of their business in the event of an insured peril.

Have You Considered...

Below are just a few questions to take into account when considering the insurance program for the business.

- ***In the event of a major loss, do you have the cash reserves to meet the ongoing expenses of the business while the damaged assets are being replaced or repaired?***
- ***How much money would you need to have available to carry you through the re-establishment phase?***
- ***How would your customers react to your being closed or unable to supply?***
- ***Would your bank or other financiers expect loan repayments to be made even when you are not able to trade?***

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***Loss management, risk assessment and technical advisers
to the general insurance and business communities***

- **What is the lead-time on replacement equipment and stock?** Do not forget to allow for research, manufacture, delivery and installation.
- **How long do you think it would be to have your property claim assessed and paid?** Consider police investigations, assessors, forensics, agreeing a scope of repairs/replacement, obtaining tenders, repair period, etc. In a major loss, 3 months is not unusual. Having Interruption Insurance in place assists in keeping this timeframe to a minimum, and allows you to claim for loss of insurable gross profit during this period.
- **What could be done to speed up the recovery process? How much does it cost, and can you afford to fund this expense yourself?**
- **How would your lease respond to a major loss?** Are you locked into paying rent again as soon as the landlord's building is repaired and ready for occupancy? If you have temporarily moved to new premises, how much will it cost to move back? How much further disruption to the business will there be?
- **If you lost a customer or customers during the period of disruption, how long would it take for you to replace them?** Interruption Insurance, subject to the length of cover you chose to take, will continue to pay any loss of insurable gross profit and increased costs of working until the business is fully returned to normal trading levels.
- **What would you do with your staff?** Many people simply say they would dismiss their staff. However, after a loss occurs, you may well need them to assist in the recovery process. Can you do it all on your own? Can you continue to fund the wage costs? There are numerous issues to consider. For example, employees are generally the most important assets of the business. Have they served the business well? How would you like to be treated if the situation was reversed? What is the cost of recruiting and training new staff? Do not forget the current level of low unemployment! Would your competitors have a double win by recruiting your staff with all the training and knowledge you have imparted? Can you fund the retrenchment program, including the outstanding annual leave and long service leave entitlements? The reality is that most losses are partial losses, and businesses often need more staff, not less, to keep the business going as a work-around for the loss of the machinery. With a well designed Interruption Insurance policy, the cost of continuing to employ staff or paying out the severance pay ('time in lieu of notice' component) is covered.

What Every Business Owner Needs to Know...

After 35 years handling insurance claims and studying the effect of the level of insurance on business survival – this being the subject of my doctoral thesis – there are three things I would like to share with every business owner.

The first is that the chance of a business surviving a major loss is greatly increased with an adequate insurance program. No one ever remembers the premium saving they made when the business is a pile of ashes; everyone just wants to be fully insured with the very best insurance policy available. Regrettably, most find they have no insurance or, nearly as bad, they are under-insured.

When it came to converting my research to a book, I called it '*It will Never Happen to Me!*'. The common thread was that while the fire, storm, burglary, or other insured loss would never happen to them, these people all bought a lottery ticket each week, believing just as passionately that they were destined to win. The harsh statistical reality is that many more business owners lose everything due to under- or non-insurance, than win the lottery!

The third and final point I wish to emphasise is that despite what some marketing campaigns suggest, insurance is not easy. Insurance is not like a washer or a toaster - you should never buy on price. You need good advice from a qualified and experienced insurance adviser that you can trust. Such a person is just as important to the business owner as the lawyer or accountant. If the worst does happen, the insurance adviser is the most important of all!

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