

HOW LIFE INSURANCE CAN KEEP A BUSINESS AFLOAT WHEN IT MATTERS MOST

Man Overboard!

Insurance plans can be used to reward loyal employees, compensate a company for the loss of key people, and ensure continuity following the death of one of a company's founding partners. After all, business owners never know when they might need a lifeline.

By Nicholas Briggs

The loss of the services and the expertise of a founding partner, whether through death or disability, can be devastating for a small or medium-sized business, as can the loss of a senior director responsible for devising and articulating a company's vision and direction.

But while most businesses appreciate the need to insure against fire damage, loss of inventory, or liabilities that derive from work-related accidents, few realise how life insurance can be used to protect against the loss or impairment of human capital, which is often the most vital element of a growing or thriving business.

In fact, any company – whether it employs a staff of five or five hundred – is vulnerable if knowledge, skills and contacts are concentrated in a small and select group of people, whether they be product developers or sales executives.

Still, mention business insurance and most people will think automatically of general insurance policies. Raise the topic of life insurance, meanwhile, and business owners naturally assume that you are talking more about personal financial planning.

“So many business owners need to learn about the opportunities available to them for using life insurance for business purposes. The fact that so many do not know about it isn't their fault – I guess if there's someone to blame, it's the industry's fault,” says David Pierce, vice president of marketing at AIA Singapore.

That's because insurance agents or planning representatives are more accustomed to selling products to people on an individual and family basis, not to business owners. Agents conduct ‘personal financial reviews’ that discuss and analyse personal priorities and preferences before making tailored recommendations based on individual situations. But for business owners?

In fact, says Mr Pierce, there is no standard industry-wide business financial review, so AIA has developed its own business fact-finding document and procedures to deal with specific areas such as succession planning, deferred compensation, key person insurance and credit protection.

“The life insurance industry in Singapore has only scratched the surface in this market,” Mr Pierce reiterates. “There's so much more to business insurance than a group term plan.” Much more, in fact, but before a financial consultant can recommend a product as a solution to a business planning need, they must



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conduct a thorough fact-finding session. Needless to say, the most obvious aspects of business insurance deal with the things that company owners and directors hope will never happen, but smart business owners realise the need to plan.

BRIDGING THE GAP

"A business owner might realise, for example, that in the event of their death or disability, in order to fulfill their personal needs they need a smooth legal agreement to transfer the value of the business to their heirs, or to transfer the business to a partner and guarantee the value of the business to their heirs," explains Mr Pierce.

This could take the form of a buy-sell agreement that is fully funded with a life insurance product. The surviving partner can use the sum assured to buy the deceased's share of the business, which of course helps to transfer its value to the deceased's spouse and children.

Key person insurance, meanwhile, is designed to cover the damage arising from the loss of important company personnel. "The loss could be major, so the company can purchase insurance with benefits that fund the replacement of a key person like a managing director, or financial controller," says Mr Pierce. "It might include headhunters' fees and an indemnity against business income losses during the replacement period."

This type of insurance can also be designed to cover recruitment, hiring and training fees, not to mention the costs involved in reassuring customers, employees and creditors – Mr Pierce thinks of it as insuring the life of the company itself, because the loss of a key player can spell death for a business that is not properly prepared.

SETTLING DEBTS

Another aspect of business continuity is credit protection insurance, which can help business owners to pay off debts if a company's guarantor should die or become disabled. A credit protection plan can be used to pay off debts owed to banks, suppliers, and other creditors, something that helps to protect the deceased partner's estate.

This could be vital. Although entrepreneurs and business consortiums often take out loans on behalf of their business, the guarantee is typically offered by people behind that business – owners, partners or directors. A guarantor can be held personally responsible for an outstanding loan, but a credit protection plan can provide the insurance cover to pay back the money to the bank.

Not only does this sort of policy help to protect the estate of a guarantor, credit protection can also form an integral part of a company's risk management. Customers and creditors are bound to be reassured when they find out that a business has contingency plans to maintain continuity in the event of an unfortunate occurrence or unexpected departure.

Credit protection policies and business continuity strategies can be used to prepare a company for what may be just around the corner, and the cost of coverage is typically just a fraction of the potential liability. "It's pretty straightforward," says David Pierce. "Life insurance can be used to pay off outstanding business debts, even if those debts were guaranteed against personal assets."

ADDITIONAL PERKS

Insurance policies can also be used by companies in a more positive way to reward loyalty. If a carriage clock or a new driving iron doesn't seem sufficient recompense for 20 years of service, a company can set up a deferred compensation plan, or what Mr Pierce says is often referred to as "the golden handcuffs".

Such plans help companies to keep hold of their most valuable employees by establishing a "promise to pay" if the employee in question serves the company for a predetermined period. In addition to salary increments, end-of-year bonuses, stock-option schemes and medical benefits, a company can choose to set up a deferred compensation or retirement gratuity plan and fund it with a life insurance policy owned by the company.

The main advantage of such a set-up is that it guarantees that key employees will get the payout they deserve and have been promised. "The other benefit is that, in the event of death or total and permanent disability, the commitment can be transferred to the spouse in the form of a lump sum", adds Mr Pierce.

In other words, business insurance works in much the same way as the personal life insurance policies that most of us already have, or are at least considering, except that the coverage itself is designed to cover the costs of specific company-related outcomes. Solving business continuity problems or rewarding outstanding, long-serving employees does not require a different kind of life insurance policy, just a unique and (for some) new planning approach that adapts familiar insurance policies and principles to a business context.

Appropriate insurance coverage can provide a business owner with the peace of mind that their family will be provided for in the event of an accident, but it can also provide the same sort of reassurance where a business is concerned. Someday you may be grateful when your insurance company throws your business a lifeline. **si**