

YOUR MONEY

JULY 7, 2011



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A different kind of business insurance

Consider your key people

Experienced personnel are the building blocks of a successful organization. Their knowledge and skills drive profitability; their relationships and reputations generate goodwill; and their experience ensures sound decision-making. Therefore, their loss affects the business negatively.

Due to size and succession planning, large businesses should be equipped to handle the loss of a key person. But small enterprises have limited resources, and are often built around a handful of people with unique expertise or knowledge, so the impact of such a loss is greatly magnified. It can mean the demise of the business.

When death or disability takes such people out of the mix, the small business faces financial and operational instability. In addition to losing important skills inside the company, the loss may cause nervousness outside. The result can be credit sources drying up, loans being called, and customers looking elsewhere. It takes time to find and train a suitable replacement. Meanwhile, competition may see the temporary weakness as an opportunity to be predatory.

To guard against such catastrophes, many small businesses purchase insurance to protect the business in the event that key expertise or knowledge are lost through death or disability.

The business purchases a policy on the life of the person(s) most important to the company. If death occurs, the life insurance pays tax-free proceeds to the business, which can use the funds to meet immediate cash needs while looking for the person's replacement.

Leftover money can be used to fund other business activities including buy/sell agreements.

In the case of private corporations, proceeds over the adjusted cost of the policy result in a credit to the capital dividend account, in turn allowing for the potential for tax-free capital dividends to shareholders.

Key person protection can improve relations with lenders, suppliers and creditors as they are assured the business will continue unhindered. It can improve morale by allaying the concerns of employees who may otherwise worry about the future of the business, or improve the ability of the business to retain key personnel when used as a perk. For example, a business owner could agree that the key employee receives the cash value of an unused policy on retirement.

According to Manulife Financial, insurance companies generally underwrite coverage amounts up to five times the key person's salary but special cases may warrant higher multiples. Although the coverage may be called life or disability, its primary purpose is to protect the business. Therefore, in determining adequate coverage for the loss of key employees, it is important to assess the business plan thoroughly.

That means determining to what extent cash flow will be impacted and how long the expected disruption might last. Analysis should be done to establish how business credit would be affected. Training and recruiting costs should also be assessed.

Robbie Burns said, "The best laid plans of mice and men oft go awry." That thought certainly applies to

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businesses but prudent planning can help reduce the impact of the unexpected. The small business owner should think about key person insurance, but there are intricacies so it is advisable to consult with an insurance professional.

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