

## Examples of business losses

### Property losses

Property losses will stem from one of the following:

- Physical damage to property.
- Loss of use of property.
- Criminal activity.

Property damage can be caused by many of the common perils such as fire, or lightning, or vandalism. It is a rare business that does not buy insurance to protect against these.

To cope effectively with the possibility of physical damage to property, the business owner should consider more than just damage to or destruction of the building itself. Contents may be even more susceptible. Manufacturers might lose raw materials and finished goods that were ready to be shipped out. Merchants may lose valuable stock and fixtures. Any business might lose valuable accounting records. Machinery or equipment may become inoperable because of fire and, if replacements cannot be found and installed immediately, the business may be forced into a temporary shutdown.

The business could lose the use of property without suffering any physical damage. A government agency can close a manufacturer for violating health and safety regulations. The Health Department may close a restaurant because of unsanitary conditions. Small businesses may also be open to crimes committed by others, such as burglary and robbery. There is also the possibility of white-collar crime and employee theft or embezzlement.

### Business interruption losses

You have already seen how a direct loss from fire can shut down a business temporarily. Although property insurance provides money for repairing or rebuilding physical damage that is a direct result of a fire, most property policies do not cover indirect losses such as the income that is lost while the business is not operating.

A special kind of insurance will cover indirect losses that occur when a direct loss forces a temporary interruption of business. Business interruption insurance reimburses the business for the difference between the normal income and the income that is earned during the enforced shutdown period.

Not only is income reduced or cut off completely during interruptions, but also many business expenses continue as usual. These could include taxes, loan repayments, salaries to employees, interest charges, depreciation and telephone charges. Without income to pay for these expenses, the business is forced to dip into its reserves and, if it does not have any reserves, then it can run into major problems.

## Liability loss

Every business also faces exposure to liability loss. A business may become legally liable for bodily injury suffered by another person or persons, or for damage to property of others. This liability may be the result of a court decision (for example, when someone brings a law suit charging negligence); statutory provisions (for example, workers' compensation law) or violation of contract (a contract that makes one party responsible for certain kinds of losses).

## Public liability

A business may be held liable for injuries or other losses suffered by a member of the public as a result of the firm's or its employee's negligence or fault. For example, a customer trips on a broken step, or a defect in the product causes injury to the user, or a workman who installs a ceiling fan fails to secure it properly and it falls, injuring a customer. The possibilities are limitless.

A firm that is found legally liable for harming a third party will have to pay damages to compensate the injured party. Compensation can run into many thousands of dollars and can hurt the business, or even put the business out of action. Regardless of who wins or loses such a legal action, litigation is still time consuming and very costly.

## Key person losses

What would happen to your business if an accident or illness made it impossible for you to work? What if one of your partners or your sales manager was to die suddenly? Most of us would rather not think about such a "what if?" Nevertheless, it is important for you to prepare your business for survival long before a person, who could be called a key person, dies or is disabled, or resigns. It is a step that most businesses overlook. The following are the questions that need to be answered with the help of a financial advisor:

- How will the business survive if the owner becomes ill or disabled?
- What will the owner's source of income be?
- How will it be treated for tax?
- Who would take over so the business could continue?
- What if that person is not qualified or is a minor?
- Suppose the owner dies?
- A will is not in place before the owner's death, what happens to the business?
- Does it close?
- Does someone inherit it?
- If the owner's life savings have been invested in the business, will the surviving family have to watch those savings go down the drain because no one knows what to do or how to do it?
- What will the surviving family's source of income be while the future of the business is being decided?
- If the business has to be sold, where will the working capital come from?
- How is the fair market value of the business going to be determined?
- Would the fair market value of the business change because of the loss of a key person?
- If the business forms the bulk of the estate, what are the tax implications for the surviving family?
- Is there some pre-death strategy that could minimise a tax liability?



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Suppose the business is a partnership and one of the partners dies? Unless the partner has prepared some other binding arrangement, the partnership is resolved when one of them dies. The duties of the surviving partner are limited to winding up the affairs of the partnership. The surviving partner will be personally liable for losses that the business assets are insufficient to cover.

The partners may have set up agreements that provide for the surviving partner's purchase of a deceased partner's interest at a prearranged evaluation. Business life insurance of each partner could provide for the survivor's need to purchase the deceased partner's interest.

What if the business is incorporated? In most small incorporated business (companies) there are only a few shareholders and most of them take an active part in running the business. The death of a major shareholder could throw the spotlight on the survivors' differences. Conflicts or major personality clashes can seriously threaten the continuing survival of the business. If the major shareholder is deceased then his share of the business will form part of his or her estate.

- If those shares are passed on to their heirs, how will things work?
- What if the heirs decide to get involved in the business?
- What if the heirs decide to sell out their share?

It is essential, therefore, for a plan to be put in place early. This planning should be discussed fully with your advisers and solutions put in place at the earliest.

Don't overlook what would happen if you were to suddenly lose the services of a key person (a person who is not the owner or partner, but who has expertise in a particular area).

- What impact would that person's absence have on sales, costs, or productivity?
- How would you reassign duties to cover the missing person's functions?
- What extra costs would have to be incurred to recruit a replacement?
- How long would it take to get a replacement trained?

## Further information

The following fact sheets provide further information on these issues:

- Develop a succession plan
- Insurance
- Reduce your exposure to losses
- Risk management