

SCOTTISH WIDOWS

official pensions and protection provider



Scottish Widows Business Protection Report 2011





Introduction

At a time of continued economic uncertainty, it is increasingly important that UK businesses and entrepreneurs take stock of how resilient their business plans are and how well placed they are to manage non-commercial risks. The latest **Scottish Widows Business Protection Report** was carried out online by YouGov who interviewed over 500 business decision makers and senior management and above. This report assesses how well UK businesses are prepared for potentially devastating risks such as the loss of a key person or the break-up of a partnership as a result of death or critical illness.

Aside from the more familiar concerns of rising costs, cash flow and volatile markets, today's entrepreneurs must be prepared for the financial impact that a critical illness or death of a key employee could have. However our research shows that this is not always the case.

Businesses are more inclined to insure material goods like photocopiers or buildings than they are their own staff. Our findings show that more needs to be done to raise awareness of business protection as an essential investment in a business, providing a vital safety net for all types of companies.

In the last 12 months almost a quarter of business owners (23%) have invested their own money into their business, while a further 13% expect that they will have to do likewise in the coming year. Entrepreneurs and business directors are taking on a great deal of unnecessary personal financial risk to keep their business trading. If people are to put personal assets at risk then it is vital that they understand how business protection insurance can prevent a damaging impact on their business, and potentially a knock on affect on their families and personal lives.

“The loss, even temporarily, of a key staff member or other interruption is always going to hit the smallest firms the hardest. A single member of staff could be half your workforce. It is therefore vital that small businesses get their contingency plans in place now, not when trouble strikes.”

John Walker, Chairman, Federation of Small Businesses

There are an estimated 4.5 million private sector businesses in the UK which employ an estimated 22.5 million people and turnover £3.2 trillion¹. 99.9% of these businesses are small to medium sized enterprises¹. By definition a small business employs less than 49 people – 92% of all the businesses we surveyed are small businesses, 3% are medium sized and 4% are large. The SME community is the “engine room” of the UK economy and is of huge importance to the prosperity of the UK.

¹ Department for Business Innovation & Skills 2010

Business dependence on key people

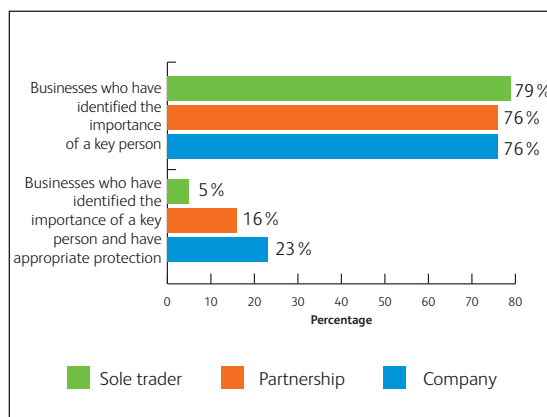
77% of businesses can identify at least one person whose loss through death, critical illness or serious illness would seriously impact the profitability or survival of the business.

Of these, only 13% have insurance that would protect the business against their loss – meaning that 85% are prepared to self insure this risk of profit loss, raising the question – can they really afford to do so? If they can, is this the most efficient way to deploy capital?

Anything that is integral to a business operating smoothly, efficiently and successfully should, where feasible, be protected. Just as businesses may insure their premises from fire or their computers from breaking down, they should also protect their greatest asset – their people.

While the reliance on one or more key person is evident across all business types, their importance is not reflected in the take up of cover to protect the business against a loss. Companies do however appear to be better prepared than sole traders or partnerships.

The mismatch between businesses who have identified the importance of a key person and those who have protection in place



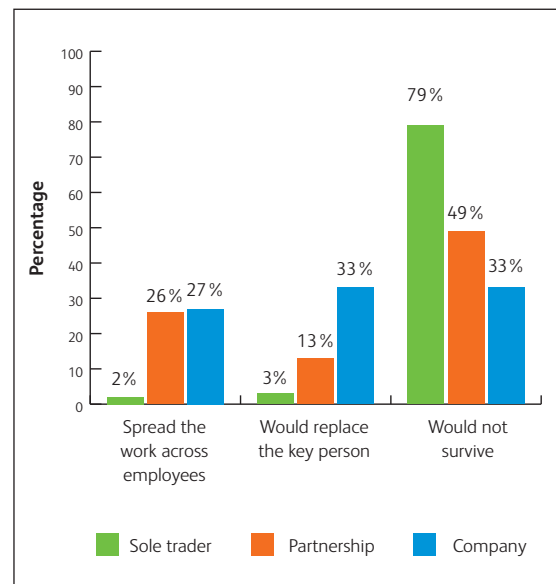
Surviving the loss of a key person

60% of businesses would not survive the loss of a key person.

When businesses were asked how they would survive the loss of a key person, almost 80% of sole traders and 49% of partnerships stated that the business simply would not survive this loss. This is a significant figure given the reliance the economy has on these businesses and it is vital that they have the means to replace key individuals and continue trading.

Quite a substantial percentage of partnerships (26%) and companies (27%) stated that if they found themselves in this situation they would spread work across employees but this is perhaps a naive approach. While it may fix the problem in the short term businesses may find themselves with overworked employees resulting in a workforce more prone to stress and lack of moral.

How businesses would survive the loss of a key person



Protection mismatch – more attention paid to insuring material goods than people

More people insure their photocopier against breakdown than they do a key person on death or critical illness.

This research has given us valuable insight into how firms make risk assessments. As you would expect, public liability, contents, and building are the main types of insurance taken out by businesses. However what is surprising, yet consistent throughout the findings is what a low priority key person insurance is. Businesses are more likely to insure office equipment such as the photocopier against breakdown than they are to insure a key person on death or critical illness.

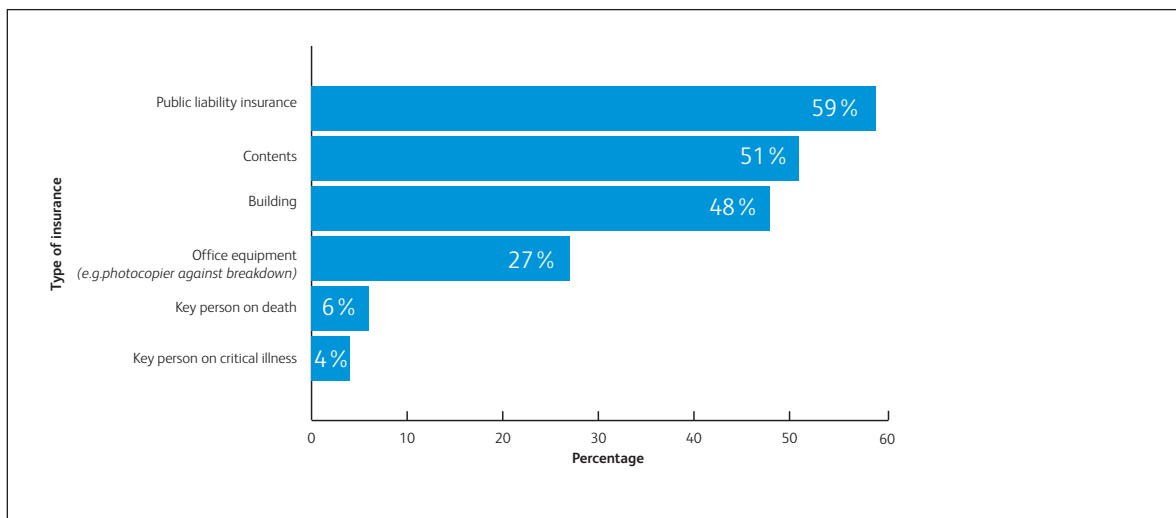
Of course it is likely that businesses will have had more experience of office equipment breaking down than of people suffering a critical illness or dying. However the impact of these events on the business is totally different.

After all, a key person dying or suffering a critical illness could actually prompt the end of the business, it is unlikely that a faulty photocopier would pose the same risk. This leads us to believe that low severity high incidence risks get insured, whereas high severity and low incidence risks go uninsured leaving businesses worryingly exposed.

Another reasonable assumption as to why business protection is not seen as a priority, is that it is not tangible – people are not insuring a physical ‘thing’ as they are with a photocopier or the contents of a warehouse. It is therefore harder to put a value on it and understand the benefits.

It is all too common for business protection insurance to be viewed as an optional extra.

The insurance businesses currently have in place



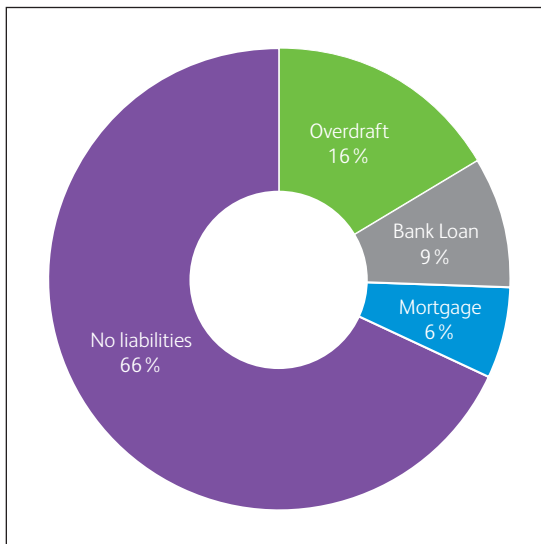
Businesses liabilities

66% of businesses say they have no liabilities.

On the face of it, this figure would appear encouraging. However is it more likely to be a case of businesses being so used to having an overdraft, commercial mortgage on their premises, stock on credit and “time to pay” liabilities that their perception of debt has shifted and they no longer see them as liabilities. Instead it is simply seen as part and parcel of running a business.

Of those that do have liabilities, one third (32%) do not have any plans in place to deal with their debts in the event of the death, incapacity or critical illness of the business owner or a key person. It is essential for the survival of any business to protect its corporate debt. Furthermore, it is worrying that 19% said that they would use their personal savings to cover these liabilities and 11% said they would sell their personal assets.

The financial liabilities businesses have in place

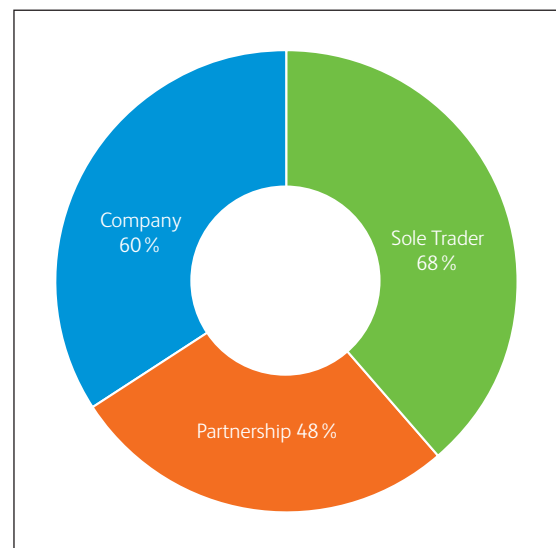


Succession planning

Over six in ten businesses do not have an agreed exit strategy.

It is good business practice to have an exit strategy and many businesses will use it to plan for retirement. Our research found that relatively few businesses have a strategy in place, stating that they either have not thought that far ahead or do not plan to intentionally leave the business in the near future. Despite not planning to leave the business there is always the possibility of an unforeseen exit due to long term illness or death. Businesses should have a plan in place for this and for the associated costs.

Businesses that do not have an exit strategy in place



Although partnerships are more likely than other business types to have an exit strategy, it remains concerning that 43% of them have no partnership agreement in place and 10% only have a gentleman's agreement in place to deal with what would happen to the partnership in the event of a death or long term illness of a partner.

Failure to have these formal agreements in place could see a partnership dissolve with far reaching implications for the remaining partner(s) and their families.

It is important that people understand the need to protect their business against failure and in such a way that they have the opportunity to buy out a shareholder, or their beneficiaries, if they were to become critically ill or they die.

Small and family businesses

63% of family businesses say their business would not survive the loss of a key person but 60% say they do not think they need a business protection policy.

According to the Federation of Small Businesses this sector contributes to more than 49% of the UK turnover making it obvious that family and small businesses are integral to a thriving economy.

By definition a small business employs less than 49 people – 98% of the family run businesses we surveyed employ 49 people or less and 92% of all the businesses we questioned are small businesses.

By their nature, these smaller businesses are more exposed to certain risks and in particular the loss of a key person. In fact 63% of family businesses state that their business would not survive the loss of a key person but despite this, 60% of family businesses and 59% of sole traders say they do not think they need a business protection policy.

While small businesses receive assistance and advice when starting up it would be prudent to encourage a holistic approach to financial planning at this stage. We know that over a third (39%) of small businesses are currently without professional accounting and financial advisers yet one in five (19%) claims that they are not confident they can efficiently manage their businesses finances with a DIY accountancy approach². While small businesses obviously have a wealth of things to consider at start up stage, the importance of adequate insurance should not be underestimated. Advice and guidance is imperative to ensuring that this is done properly.

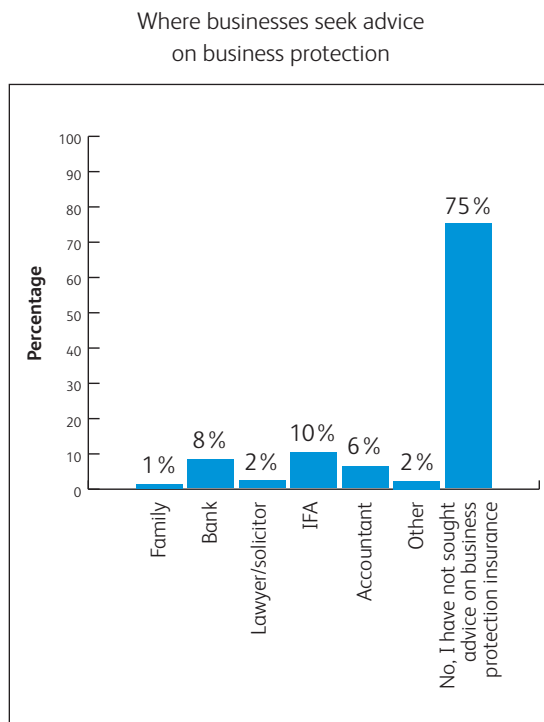
² *unbiased.co.uk June 2011*



Lack of financial advice

Only a quarter of all businesses have sought advice on business protection.

Robust financial planning for the here and now and for the future is imperative for a business to thrive. Despite the majority of businesses acknowledging that the loss of a key person would have a significant impact on their business, potentially resulting in its failure, only 29% have actually sought advice on business protection.



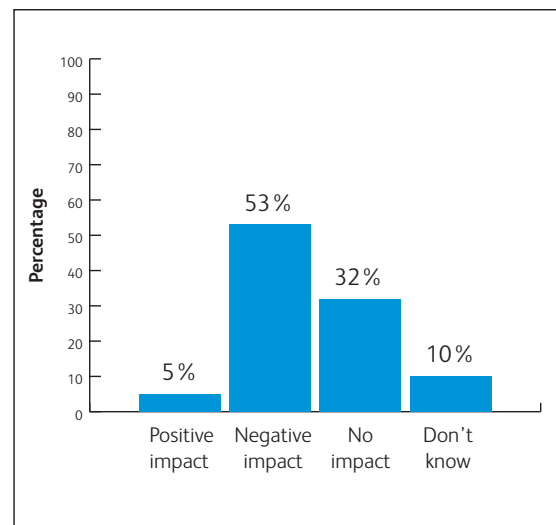
This lack of advice may also explain the low take up of government schemes available to help businesses such as deferment of Income Tax/National Insurance and VAT payments with only 7% of all businesses taking up these types of schemes.

For long term survival, businesses need to expand their risk planning and be prepared for any eventuality – including the loss of business owners or key employees whose unique skill set could seriously impact on their survival. If a business feels it lacks the knowledge to identify these risks and appropriate solutions it makes sense to seek advice from someone that does.

A challenging environment

53% of businesses feel the recent and proposed government spending cuts will have a negative impact on them.

The impact of the recent and proposed government spending cuts on businesses



The government has recently pledged to provide further support to businesses, specifically small businesses to “make it easier for new companies and innovation to flourish”³. Ways they plan to achieve this include competition reform, reducing barriers to entry in existing markets and reducing the regulatory burdens many businesses are frustrated by.

Despite this commitment and guidance promised from the government, there is no shying away from the fact that businesses are operating in a notoriously challenging environment and one that will not change overnight. This only highlights how important it is that businesses take the appropriate steps to mitigate all risks that could hamper their survival – including the loss of a key person or business owner through critical illness, long term incapacity or death.

³ Department for Business Innovation & Skills Backing Small Business 2010

Recommendations

Education around the benefit of business protection

Businesses need to understand the risks they face and what steps they need to take to put the necessary protection in place. They need to consider the very real risks that their business could face from death, critical illness or long term incapacity of a key person or business owner. They also need to understand the types of cover that are available and which types are relevant to their business's circumstances and be aware of any limitations or exclusions of the cover. This responsibility for further education and understanding sits with the industry, the government and of course the businesses themselves.

Risk assessment

Businesses are always being reminded of the importance of undertaking risk assessment reviews but it is important that they consider the role of business protection insurance in these plans.

Review governance arrangements

The failure of a Sole Trader to have a Will, a Partnership to have a Partnership Agreement or a Company to reflect its Articles of Association what happens to the business if something happens to a director, is a major risk. Without such legal documents a business might struggle to survive a major situation, such as critical illness or death of a business owner. Where a business has made plans and has protection in place to fulfill the plans, there is merit in checking to ensure that the sum assured is adequate, the type of cover is appropriate, the policy is set up correctly and placed in trust where required.

Financial review

It is important that businesses realise that their business protection needs and the solutions to address these needs will be unique to them. As a result, seeking financial and legal advice will be an important part of making sure they have reviewed and addressed all of their business's risks.

All figures, unless otherwise stated, are from YouGov Plc. Total sample size was 506 adults who are business decision makers and senior management and above. Fieldwork was undertaken between 18th and 22nd March 2011. The survey was carried out online.

Notes

Please use this space for your own notes



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