

# BMGT 299: Entrepreneurship Capstone

## Unit 6 Course Materials



### Business Insurance

#### Insurance Considerations for Small Business

A small child walks into the store with her father - touching everything as she goes. Then it happens, the child screams! \* having just touched an unprotected spot light located within the backside of the window display. No one even thought of the risk when the display was installed, yet the customer is suing. Ouch!

An employee' small dog, allowed into a retail store, usually friendly, bites a customer. The customer sues!

An employee working in the kitchen of a small restaurant is diagnosed with Hepatitis C, and the health department requires that you provide medicine to every employee and customer who had contact with food. A class action lawsuit follows: Ouch again!

Liability lawsuits are settled everyday, sometimes involving millions of dollars. How well prepared you are will determine whether you just lost everything or are able to “*weather the storm.*” Two things will have the greatest impact to your survival; 1. Did you select an LLC or Corporation as a form of business ownership? 2. Do you have insurance?

Forms of business ownership were discussed in our Unit 3 Course materials covering “Legal Forms of Business Ownership.”

Insurance we will cover here. Let’s begin with a few concepts to consider. Remember, your individual situation always is the final arbiter of what you specific needs will be....This is a general list to begin with:

1. **Insurance is for large losses, not small ones.** You will never insure everything, nor could you possibly afford to – but balancing costs is critical in buying smart. Higher limits cost comparatively little to lower deductibles. You don’t want to make multiple small claims for small dollar amounts – and the insurance company may cancel you anyway. Some loss to companies are factored into the prices charged and must be borne by the business – not an insurance company. Ask yourself what would close your doors? What kinds of losses, and for how much, you need an extra layer of protection. High Theft losses, (more on this soon) – fire, liability should a customer use your product in a way you didn’t anticipate and they experience an injury. (Also, see case studies above to imagine any number of risks)
2. **You can’t “profit” from an insurance claim – so don’t try to “over-insure” to create a windfall in the event of the loss.** (Often called “Insurance Fraud” and can hold high criminal penalties)

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- 3. Be honest with your insurance agent.** Getting a policy that best fits your needs requires that you are open and honest about all related issues.
- 4. Don't buy by price alone.** It is tempting to create a false sense of security by getting a policy at the lowest possible rate- BUT, when you experience a loss, all insurance companies are valued on how quickly and completely they pay claims. This is their reputation and should be the primary question you research. Talk to other entrepreneurs, ask them who they buy their insurance from, if they have had a claim, and how quickly did they (Insurance Company) pay the claim?
- 5. Insurance is based upon "the odds."** Thousands of statistics are analyzed and allows an insurance company to determine the risk of any given loss. They build in a house advantage and charge you the premium.
- 6. Be careful of "All Risk" policies.** These policies often write their policies based on what they don't cover, than what they do....sometimes in strange combinations (Left foot and middle right hand pinkie finger" – etc...) Ask about some specific case studies of similar businesses and pose the question of coverage to your agent. Remember, you should be interviewing the agent to hire, not have them decide solely whether you might have the opportunity to do business with them. Ultimately an underwriter will determine coverage – but how well you can communicate and understand your agent is critical.
- 7. Make your business SAFE!** Invest in things that make your business safe. It is always far less expensive to prevent a claim than to make one. Have fire alarms, illuminated exit signs, proper training, clear directions to follow in the case of an emergency.

### Selecting an Insurance Agent

The agents' role in your coverage is of special significance as they are the experts in the industry. The knowledgeable ones know the right questions to ask and the best product for your unique business. They will need to tailor and interpret your policy to you so you don't end up with a "false sense of security."

Words of advice:

1. Interview several agents to find someone with experience in your specific type of business. You want an agent for a long-term relationship and someone whom you can trust. This is often times not a family member! Look for nationally recognized awards such as: CPCU (Chartered Property and Casualty Underwriter)

### Selecting an Insurance Company

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Look for a company with the specific types of products you need. (For example, a life insurance salesperson may not be the best person to purchase business insurance – or at least make sure they are experts in the field.)

Look for a company with a good reputation for service. (Again, seek the advice from other business owners in your type of business)

Look for a company with financial stability. An important note here: There are companies who you have never heard of before that are solid, and some you know as household names that are in trouble financially. The state of Montana Insurance Commissioner tracks unethical practices – or you can research a company online or at the library – seek a publication called A.M. Best – who rates the management and stability of the nations' insurance companies.

### Types of Insurance

Companies are constantly revising and customizing new products to sell in the marketplace. Often the products are so differentiated from one company to another, they are impossible to compare for price. The devil is in the details, so read the small print carefully!

### Categories

Insurance is divided into two main categories, **Property and Casualty** and **Life and health**.

Casualty means “liability.”

### Property and Liability

The insurance you will need the most in business is property and liability. These policies are most often sold as “packaged Policies” – even referred to as “all risk” policies – but be careful. There is never an “All Risk” policy. (Flood insurance for example can only be offered by the federal government- albeit sold through riders)

Property risks run the gambit from fire, explosion, flood, earthquake and so-forth. Crimes such as theft and burglary – even employee theft. (I had an employee steal \$26,000 from me – but no insurance to be had. Each theft (Embezzlement) had a separate deductible applied, and after three claims within 6 months, the company would cancel me... Ugh!

### Liability

What damages might you be responsible if “others” are injured? Defective products, food borne bacteria, injury during a robbery....? If you delivery guys damage the property while delivering a product, a lawsuit may follow. There are almost too many to

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contemplate – additionally, not having it is trouble. This is a part of doing business – give it your highest consideration.

### **Replacement Cost or Actual Value?**

This one is a bit confusing depending upon how it is phrased. The short answer is as follows:

**Replacement Cost (Most Expensive)** – covers the cost of a “new” replacement.

**Actual Value:** Covers the cost of the object at a depreciated value. For example, what would a relatively, new sofa cost at a garage sale? Often there is some “book value” involved, but that’s not available for most claims. You should negotiate the settlement with any insurance company who is undervaluing the “depreciated cost.” It’s normal insurance, but less valuable to you in the event of a claim than “replacement cost” insurance coverage.

### **Types**

There are companies in the world that provide insurance for just about anything you can imagine. If you wanted to hold a photo contest for the best photograph of Big Foot – there is a company who will underwrite a policy for it. This is often employed in gold contests holding high value “hole-in-one” prizes, like a new car or \$1,000,000 dollars! (I.e. Lloyds of London)

### **Business Interruption Insurance**

This provides a benefit if the business experiences an “interruption” of business out of the direct control of the business. For example, if a fire closed down the shopping center you have a store located in for 3 months, you would not be able to pay your employees, rent, vendors, etc....in this case, business interruption insurance could provide relief. Say a new road was being built in front of your business, rerouting vehicles around your business, this could provide relief.

### **Marine and Inland Marine Insurance**

This can also be confusing: - this covers your product during transportation to and from customers or vendors. Say a road closure caused a load of fresh lettuce to rot, or the truck got into a damaging accident en-route.

### **Professional Liability**

Imagine a doctor today not involved in a liability lawsuit. A baby is born with serious defects, the mother claims caused by poor or negligent care. (The annual premium for liability insurance for an OB/GYN can exceed \$60,000 per year!) – Expensive, but impossible to practice medicine without it!

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### Motor-Vehicle

Remember that if you experience a house fire, and your attached garage burned with the family vehicle parked in it – your homeowner’s insurance won’t cover the cost of the lost car. Your vehicle insurance covers the car. Also, if you use a personal vehicle for business use, say delivering pizza’s without notifying, and paying for business use insurance, they won’t pay a claim in the event of you being involved in an accident during business use.

### Closing comments:

There are numerous other special policies and riders available to the entrepreneur. These include, credit insurance, title insurance, aviation insurance, cast insurance (for actors in movies), crop insurance, etc....

Again, you can insure everything, so you need to calculate, to the best of your ability, the greatest needs. (Bet the odds only)

### Employee Insurance

#### Health and/or Life Insurance

This goes beyond the scope of our unit today, but it should be worth noting that coverage can be broken down in a few distinct areas.

1. Benefit packages offering group discounts, or subsidized premiums. This attracts and retains the best workers.
2. Insurance demanded by law. Workers Compensation.
3. Life insurance used between two business partner which serves to “buy out” the now deceased partner’s share to his/her family. This allows you to hire out the now needed skills once provided by your partner.

### Closing Note

It is worth the effort to evaluate the requirements needed, should a claim arise, to receive prompt and full payment. For example, if you experienced the loss of your business in a fire, do you have records of receipts for purchased items to establish ownership and claim amount? Was it stored “off-site” to avoid losing the paperwork in the fire?