For Adviser use only

Business protection

State of the nation's SMEs report

Sixth edition

Contents

CII 2016 WINNER

WINNER FOUR TIMES Investment Life & Pensions Moneyfacts Award 2014-2017 Best Business Protection Provider

Asset TV 2016 Video Awards WINNER Most Watched Company on Akademia

LifeSEARCH 2019 Business Protection Brilliance Award

COVER CUSTOMER CARE AWARDS 2019 WINNER Best Business Development Team

Introduction

Welcome to our 6th edition of our State of the Nation SME research.

Since 2009, we have undertaken research within the small and medium size business sector to understand and explore the risks that these businesses maybe running if life was to happen to any of their key people or owners.

"Small and medium size businesses form the backbone of the UK economy and make up approximately 99% of the number of UK private sector businesses. In addition 60% of employment in the private sector is reliant on SMEs so they really are vital. Many are aware of the risks to their business, such as changes in the economy, competitor activity and their profitability. Many also cover other risks which may affect their business such as buildings, machinery and computer systems.

This research explores the risks that businesses may not be aware of. We've found that year on year there is a lack of awareness of business protection, showing that businesses have not evaluated all the potential risks. For instance, the research shows that;

52% of businesses would cease trading in under a year if a key person died or became critically ill.

Key questions

- **What would happen to a business if the owner suddenly died?**
- **What if the majority shareholder was diagnosed with cancer?**
- **Is the business able to repay any debts if an owner or key employee died?**

This report is designed to help business owners and their financial advisers discuss the potential unforeseen risks. With the right knowledge, businesses are better placed to make the right decisions in protecting themselves against certain unexpected and in many cases unforeseen events. You will find a combination of research data and key questions to act as conversation starters to ensure together we can help Businesses to Get Business Assured."

Richard Kateley, Head of Intermediary Development, Legal & General

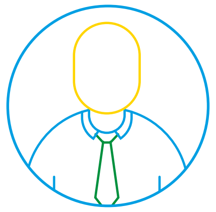
The Rough Guide to Business Protection in partnership with Legal & General is a comprehensive e-guide giving no-nonsense, practical and clear information on Business Protection. Written by financial journalist Emma Simon, the e-guide is packed with top tips and useful information to help business owners understand the risks their businesses may face and the types of insurance products available.

Download your copy today from our adviser centre.

Who did we speak to?

We spoke to a range of businesses in the UK – from limited companies and sole traders to partnerships and limited liability partnerships. Sectors include health, retail, financial services, public sector, IT and construction. The businesses we spoke to also varied in stages of their development, as well as being a mixture of solely male owned, female owned or with a combination.

We can see from the research sample, 91% of SMEs have 4 owners or less, and from the Governments figures 95.6% have less than 10 employees. This could perhaps indicate that their businesses are the ones that could be at risk in the event of a death or critical illness of a key person(s).



43% All male owned

19% All female owned

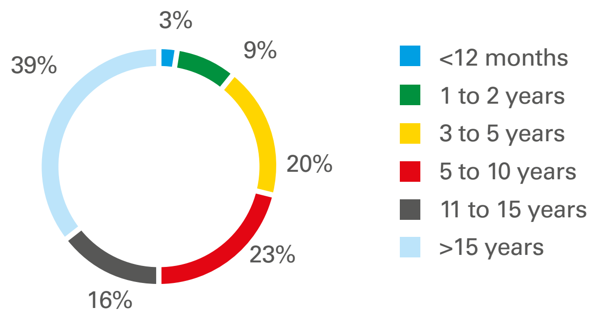
38% Mixed sex ownership

Average age of business owners	50	Under 40	16%	Over 40	73%

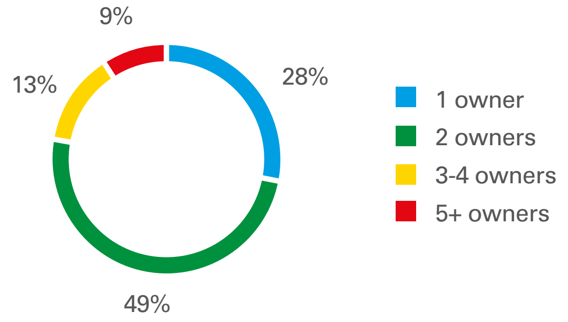
Business population estimates in 2018*

- There were 5.7million private sector businesses and 96% have less than 10 employees
- 99% of these were SMEs with 1.9 million Limited companies companies and 405,000 ordinary partnerships

Years business established



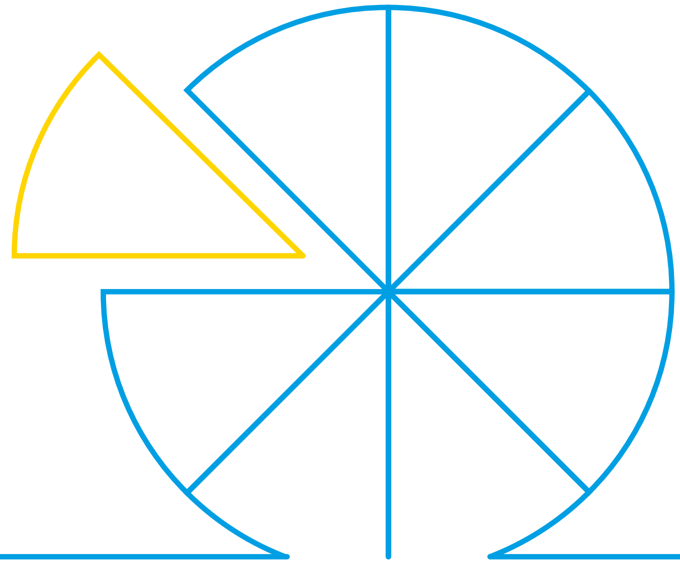
Number of business owners



*Source: Department of Business, Energy & Industrial strategy

Our research segments

The business lifecycle can help us to understand the different needs and risks a company may have depending on its age. Of our research sample, 3 major segments were identified that businesses could be grouped into based on their age. These segments can then help us understand the different needs, make up and risks. This can then help direct the advice that they may need possibly more so than the industries that they operate in.



Newer businesses

(established within last 2 years)
12% of the total

More likely to be small businesses

- **51%** have less than £50,000 net profit
- **72%** with less than 10 employees (average number of employees is 17)
- **64%** value the business under £250,000

Mixed range of ages of owners

- **58%** are aged over 40

Most likely to have given security to a lender to cover their borrowings

- Only **21%** use an insurance policy

Maturing businesses

(aged between 3-10 years)
42% of the total

Business are starting to grow

- **44%** have profits over £100,000 with average £261,000
- Average of 27 employees

Large proportion of younger age owners

- **29%** under age 40

Most likely to have a directors loan account

- Least likely to be aware it needed to be repaid on death as **39%** not aware

Established businesses

(set-up more than 10 years ago)
46% of the total

More likely to be limited companies

- **53%** are limited companies
- A smaller proportion of sole traders at **17%** compared to **21%** overall

Are larger with more profit

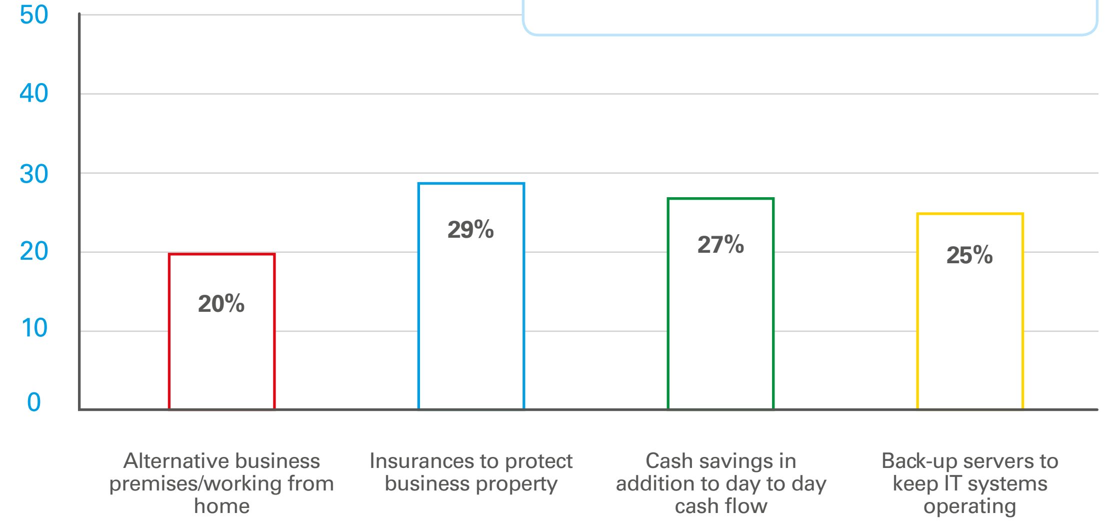
- **24%** over £250,000 profit with an average of £342,000

More likely to have older owners

- **87%** over age 40
- Average age 53

Business continuity planning

Within the research a businesses attitude to risk can vary depending on its size, length of time it has been trading and the gender makeup of the board. Just 60% of businesses have a Continuity Recovery Plan in place and the top four risks covered were;



Only 18% had considered cover for the illness or death of a key person and no mention was made about life cover to protect debts or loans.

Key questions

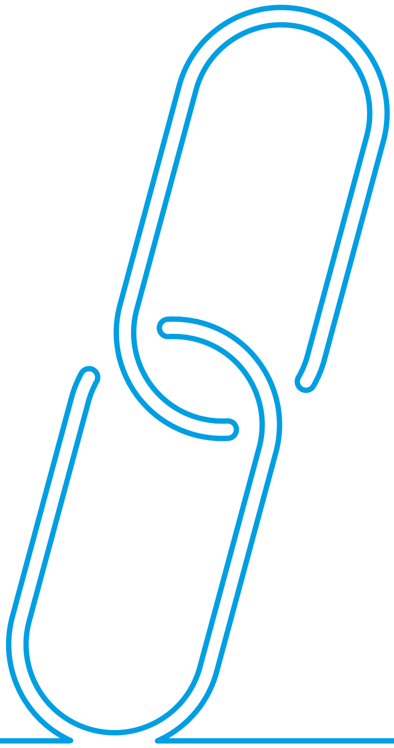
Have the business considered the risks to the business or losing a key person or business owner?

- **How would their creditors react to such a loss?**
- **How would their suppliers and or customers view this loss?**
- **How could a loss of this nature affect their staff?**

Companies need to assess the risk that the loss of a Key Person could have on their business and consider how long it might take to replace them. Yet businesses are more likely to insure their 'things', rather than people.

About Business Protection

Many businesses across the UK take the time to consider employment benefits, pension schemes especially with the introduction of Auto Enrolment in recent years and even staff protection in the form of group schemes, yet the business itself can be overlooked. However, the business is pivotal to everything else. Without it, none of the other components would link together.



Benefits of business protection

Running a business is a huge commitment of time, skill and energy and it is easy to take for granted the contribution of the people that make it work.

When asked many business owners agree that the loss of a key person can have dire consequences for their business, yet more than 50% do not have any cover in place in case anything happened to them. What is really worrying is that 52% say they would cease trading within one year.

Business protection can help businesses continue to trade if an owner or other person key to the business dies or becomes terminally* ill or is diagnosed with a specified critical illness. Proceeds from the policy could help ensure that key individuals are replaced, debt is protected and shares from the deceased partner's/shareholders estate are purchased. It can make the difference between the business surviving or going out between business.

Many people think that arranging business protection is a lengthy, complicated process. In fact, the principles are similar to most other types of protection. The main difference is that business protection generally involves higher sums assured.

> **"You can take my factories, blow up my buildings, but give me my people and I will build my business right up again."** Henry Ford

*Terminal Illness Cover: Automatically included if life expectancy is less than 12 months unless term is less than 2 years for business protection and Relevant Life Plan policies.

Business Loan Protection

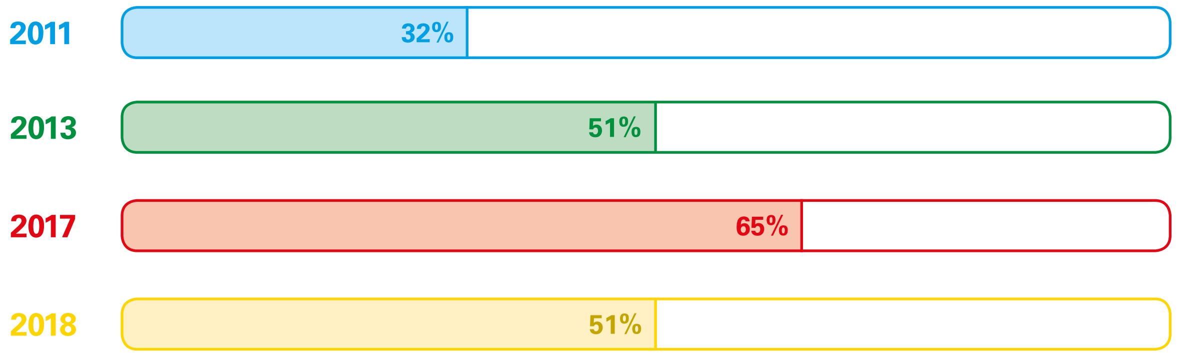
What is it and how does it work?

The loss of the person who has guaranteed a loan is particularly serious for a business. Business Loan Protection helps a business pay an outstanding overdraft, loan or commercial mortgage, should the person covered die or is diagnosed with a terminal or critical illness (if chosen) during the policy term. When a valid Business Loan Protection claim is made, a sum equal to the outstanding debt could be paid to either the business or directly to the lender.

Increasing awareness

Although awareness is getting better and more people are considering cover, a large proportion of businesses do not have cover in place to repay debt. Of those who did not have cover, 70% did not see the need or hadn't considered it. This shows that an education piece has to be done.

51% of businesses have some form of business debt



Key questions

- **Does the business have any unprotected loans or debts?**
- **How would they repay these following the death of a key person?**

Business debt can take many forms, from bank loans to overdrafts from credit cards to director loan accounts. To assess their total debt look further than their formal debt like mortgages.

Different types of borrowing

Business borrowing has a large range of reasons, amounts and through many different types of arrangements. All of these different types of debts will need servicing by the business. Have they considered how they would achieve this if they lost a key person?

In addition they will need to repay the lender any outstanding amounts. Many business owners are risking their personal wealth to support their business.

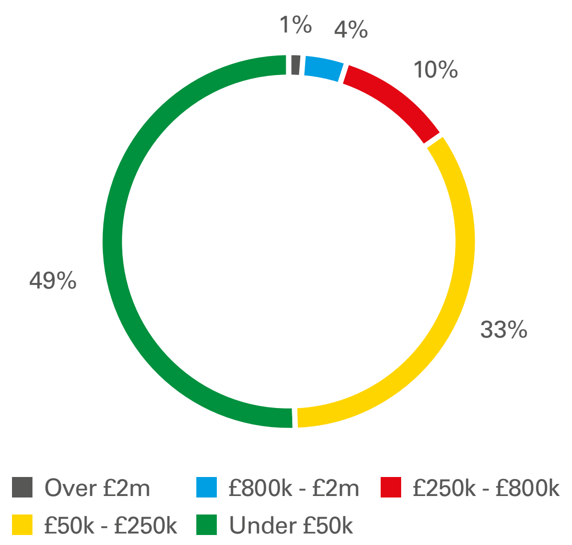
£176,000
The average business borrowing

82%
Under £250,0000

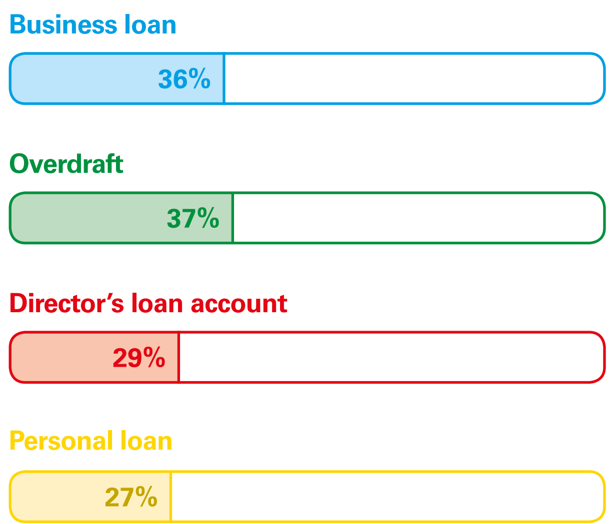
Key questions

- **Do they need to expose their personal wealth to this level of risk?**
- **Would using an insurance policy be a simpler solution?**

Value of business borrowing



With borrowing over £50,000



What security have they given?

Only 2 in 10 use an insurance policy as security for their borrowings.

Many businesses will provide the lenders with security for any borrowings they take, more than likely it will be a condition of a large proportion of loans. However, have the business owners now put their personal wealth at stake?

They will often provide a personal guarantee (with unlimited liability) or they may use their own assets such as their home as security.

Directors' loan accounts

It is very common for there to be a directors loan account within a business. This is where a director has lent money to their business such as may be needed in the initial start up of the business or to fund the expansion of the business.

Alternatively it could arise where a director is due a dividend from their business but chooses to leave it within the business as working capital. It is essentially a debt owed by the business to the director and would need to be repaid on the directors death if demanded by their estate.

Top 5 reasons for directors' loan accounts

38% Start-up capital

27% Expansion/ growth of business

13% Investment/ purchase of shares

39% Profits not taken from business

18% Lack of available borrowing

81% Borrowing up to **£250k**

28% Not aware that a director's loan account needs to be repaid on death

Average was **£169,000**

Key question

A director may have borrowed the money to then invest into their business. It is useful to know where the funds have been raised to then identify their overall exposure to risks, and where protection would be needed.

Did they raise from savings or did they re-mortgage their home, as each could pose a different risk?

Key person protection

The day to day running of a business often demands that the needs of the customers is the number one priority, with many business owners not having time to take a step back and consider the problems the business could face if they or somebody key died or were to become critically ill.

Almost all businesses (99%) had at least one key person in their business. Almost 4 in 10 businesses (38%) said they had 3 or more key people.

About key person protection

Key Person Protection is a life insurance policy written on the life of the key person but owned by the business. Critical illness cover can also be added to the policy at outset. The business pays the premiums. Key person cover could provide a cash injection into a business when somebody dies or is diagnosed with a critical illness (if chosen). The policy payment can be used to cover the business debts, profits and recruitment of new staff.

Who is a key person?

A key person is somebody who's skills, if lost, would have an impact on the finances of the business, either directly or indirectly. It is probable that a business could have numerous key people, each with differing responsibilities and skills that may need protecting i.e. managing director, sales person, analyst, specialist software developer, engineer, finance director.

Key people are those that, if lost, would directly or indirectly cause a financial issue for the business, such as:

- Loss of revenue and profits
- Cost of recruiting new staff to replace the skills lost
- Loss of client and supplier confidence
- Rebuilding client base confidence

A Key Person Protection policy can help protect the profits of a business directly attributed to one or more individuals if they were to die or be diagnosed with a terminal or critical illness (if chosen) during the policy term. This may allow a business to continue without financial hardship while a replacement is found, or members of staff trained. It gives them breathing space to make the right decisions – not rushed ones.

The loss of just one person in a small business can have a massive impact. Creating increased workloads, loss of skills, potential loss of profits, and as our research has shown, termination of the business altogether.

40% of business have no continuity plan

18% have any insurances to cover Key people

Key questions

- **Does the business have any key individuals who contribute heavily to profits and whose absence would affect them?**
- **Have they identified these individuals?**

Looking beyond the perceptions

The reality is that many businesses have not considered the financial strain that their business could be put under if they suffered the death or critical illness of an owner or key member of staff. The research reveals that their perception of what could happen has never really been considered in any depth.

Current perceptions

After speaking to a number of businesses about the negative effects of a key member of staff dying or being diagnosed critically ill, we can see that current perceptions are somewhat confused.

Income/Cash Flow – **54%** did not think it would affect cash flow.

Customer base and reputation/brand – **60%** did not think it would affect their company's reputation, and if it did, it would only be minimal and short term.

Staff – **37%** would not expect it to impact their staff. Yet contradicting this, **44%** said they would be fearful of losing their job.

Creditors – Over **66%** felt that it would not affect creditor attitudes and if it did, it would only be in the short term.

Reality

Once the financial impact and potential consequences of a key persons death or critical illness had been considered, **over half (52%)** did not think that the business would survive the next 12 months, others said that the business would probably survive, but they would struggle to find a replacement person, and the rest that there would be some financial uncertainty.

Attitude to risk and impact on a business

Many businesses consider the risks they could face and will often have insurance for various events. Half thought an owner suffering a critical illness and unable to work would be one of the top 3 risks for a business - with almost 2/3 saying the death of the owner would be their No1 risk to their businesss future. More than double the things which they have probably insured against such as major contract loss, IT security breach and building being broken into.

63% said the death of the owner would be the No1 risk to their businesses future.

15% thought the premises being damaged by fire or flood was their biggest risk

3% thought being broken into would cause an impact (most likely because they already have insurance in place to cover such an eventuality).

Impact on a business

In the research over a quarter (28%) advised that in the past they had experienced the death or critical illness of either an owner of the business or of a key employee. They found that there was an impact on their business in many areas ranging from a loss of profits to an increase in their expenses to fund to cost of replacing their staff.

The reality of this situation impacted the business in many different areas:

Area	%
Loss of profits	30%
Recruit replacement staff	20%
Loss of confidence from customers	19%
Repay a loan	10%

Better knowledge, greater awareness

More than half of the businesses did not have Key Person Protection – In many cases it was not something they had ever thought about.

Reasons for not having key person protection

- 44% — **Not considered**
- 25% — **Not got round to it or looked into it**
- 27% — **Thought cost would be an issue**

Other reasons given:

- Too complicated
- Don't have adviser to help me
- Got enough additional staff

Estimated costs of insurance

We asked business owners to estimate the cost of life insurance:

Average was almost **3 times** the actual cost

80% — with **80%** estimated the cost would be higher than the actual premium

Who would be most affected?

73% — **Sole traders**

47% — **New businesses**

Think they would cease to trade within six months if they were to lose a key person

Key questions

In the event of the death or critical illness of a key person or business owner, could a cash injection help secure the future of the business?

- **If a cash injection is needed, has the business thought where this money would come from?**
- **Would a bank loan be possible?**

The business should consider the timing of any finance which could be required in the future. the following things may need to be considered.

- **Will market conditions dictate the lending policy?**
- **What is the credit rating of the business if it has just lost a business owner or key employee that plays a key role in profits?**
- **What personal security may apply to any borrowing?**

Share or Ownership Protection

Nearly half of businesses have no specific arrangements for their shares and the owners rarely have provision or direction for them in their personal wills.

Why consider share protection?

The death of a business owner or diagnosis of a critical illness is likely to have a major impact on a business. It could lead to serious financial uncertainty.

Share Protection allows the remaining partners, shareholders or members to remain in control of the business following the death of a business owner. If there is no share protection in place, the owner's share in the business may be passed to their family. This means that the surviving business owners could lose control of a proportion or, in some circumstances, all of the business.

The family may choose to become involved in the ongoing running of the business, or could even sell their share to a competitor.

A properly written share protection arrangement can minimise the risk and ensure that the business ownership is maintained and controlled by the surviving shareholders and the deceased family is fairly financially compensated for the value of the shares. This gives the business a better chance of a secure future.

Key questions

1. Would your business clients want their estate to receive the value of their shares in the business in the event of their death?

Share Protection could help cover your business owners for the value of their shares in the business and give the other business owners the cash to buy the shares from the deceased shareholders family or beneficiaries.

2. If a business owner died would the other owners want to retain total control of the business?

Share Protection is written in trust, so that should one owner in a business die or be diagnosed with a terminal illness, the remaining owner(s) would receive a lump sum of money. This could enable them to buy the shares from the deceased owner's estate and so maintain ownership of the business.

Addressing uncertainty

The research highlighted a level of uncertainty when it comes to share protection and what would happen if a shareholder died.

37% **Partners/Shareholders would buy this business owners's shares**

16% **The business would cease to trade**

15% **Any beneficiaries of this business owner would become active in the business**

Other answers were:

- The beneficiaries would retain ownership
- The shares would automatically pass to the other business owners and the beneficiaries would recieve nothing

Partnership agreements and limited companies articles of association

Another area where companies are leaving themselves exposed to unnecessary risk is their legal agreements such as a partnership agreement, or in the case of a limited company their articles of association.

There are many documents relating to businesses available in the public domain, including the articles of association for limited companies. You can review a client's latest information and see the last time it was changed, helping your discussions on potential risks.

37% of partnerships have not reviewed their partnership agreement since the business started.

43% of limited companies have not reviewed their articles of association since the business started.

Key questions

In the event of the death of a business owner what would the surviving business owners need to consider?

- **Would they have enough personal wealth?**
- **Will a bank loan be available?**
- **Will there be any reserves left over?**
- **What value would they put on the shares?**

Relevant Life Plan

A Relevant Life Plan is a term assurance plan available to employers to provide a lump sum benefit for their employees. It is designed to pay a lump sum if the person covered dies or is diagnosed with a terminal illness, while in employment during the term.

A Relevant Life Plan is paid for by the employer. As with all insurance plans, limitations and exclusions apply. Relevant Life Plan is not a savings or investment plan and has no cash in value at any time. Although it is not a Business Protection product it is a valuable area to discuss with many business owners as it could enable them to make a large saving on the cost of their life insurance , as opposed to buying personal cover themselves from their taxed income.

This plan is aimed at:

- Directors wishing to provide their own individual 'death in service' benefits in a tax-efficient manner.
- Employers looking to provide lump sum benefits for their employees.
- Those with too few employees to set up a group scheme.
- High earning individuals, such as directors, who are looking for lump sum benefits without affecting their Pension Lifetime allowance.

Did you know?

A Relevant Life Plan is a personal life insurance policy which can be treated as an allowable business expense, so the business would qualify for Corporation Tax Relief. There's no additional Income Tax or National Insurance to pay.
If you compare the cost of buying life assurance from an employees taxed income compared to that of the company paying for a Relevant Life plan the benefits are clear to see.

Potential savings:	Non-relevant life plan policy	Relevant life plan
Annual Premium	£1,000	£1,000
Employee National Insurance Contribution (assuming 2%)	£34.48	None
Income Tax (assuming 40%)	£689.65	None
Dividend Tax	None	None
Gross earnings needed	£1,724.13	£1,000
Employer National Insurance Contribution (assuming 13.8%)	£237.93	None
Total gross cost	£1,962.06	£1,000
Less Corporation Tax (assuming 19%)	£372.79	£190
Tax-adjusted total cost	£1,589.27	£810

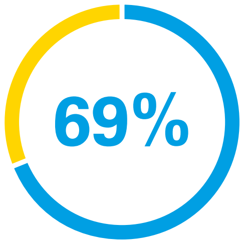
A saving of £779.27 which is a saving of almost 50%

This example is fictitious and provided for illustration purposes only. Actual premiums will depend on individual circumstances. As with all insurance policies, terms and conditions apply.

Business Protection State of the Nation's SMEs report – Relevant life plan

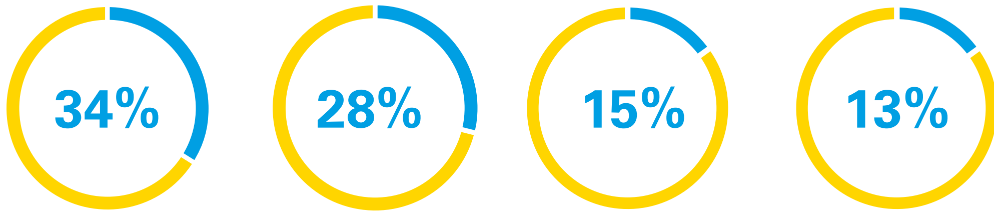
Awareness of Relevant Life Plans

There is a large opportunity to increase the awareness of Relevant Life Plans and it can prove a useful way to open the discussions with a business. Once the plan is clearly explained to companies, they do start understanding the benefits, with around half of them taking the policy out. Of those who haven't taken one, it's often because they either did not understand the product or did not know enough about it.



have never heard of relevant life plan

Reasons for not taking out Relevant Life Plans



didn't see the need

Didn't know enough about it or the benefits

not interested in tax efficient life cover

company would not agree to pay for it

There is an opportunity

Of those who had not heard of Relevant Life Plans, **70%** were receptive to the product after it was explained to them. Only **18%** said they would definitely not take out cover.

A missed opportunity for Advisers?

60% of those who hadn't heard of Relevant Life Plans had actually taken out some form of business protection.

Is there not an opportunity to provide advice regarding a tax efficient way to protect their families?

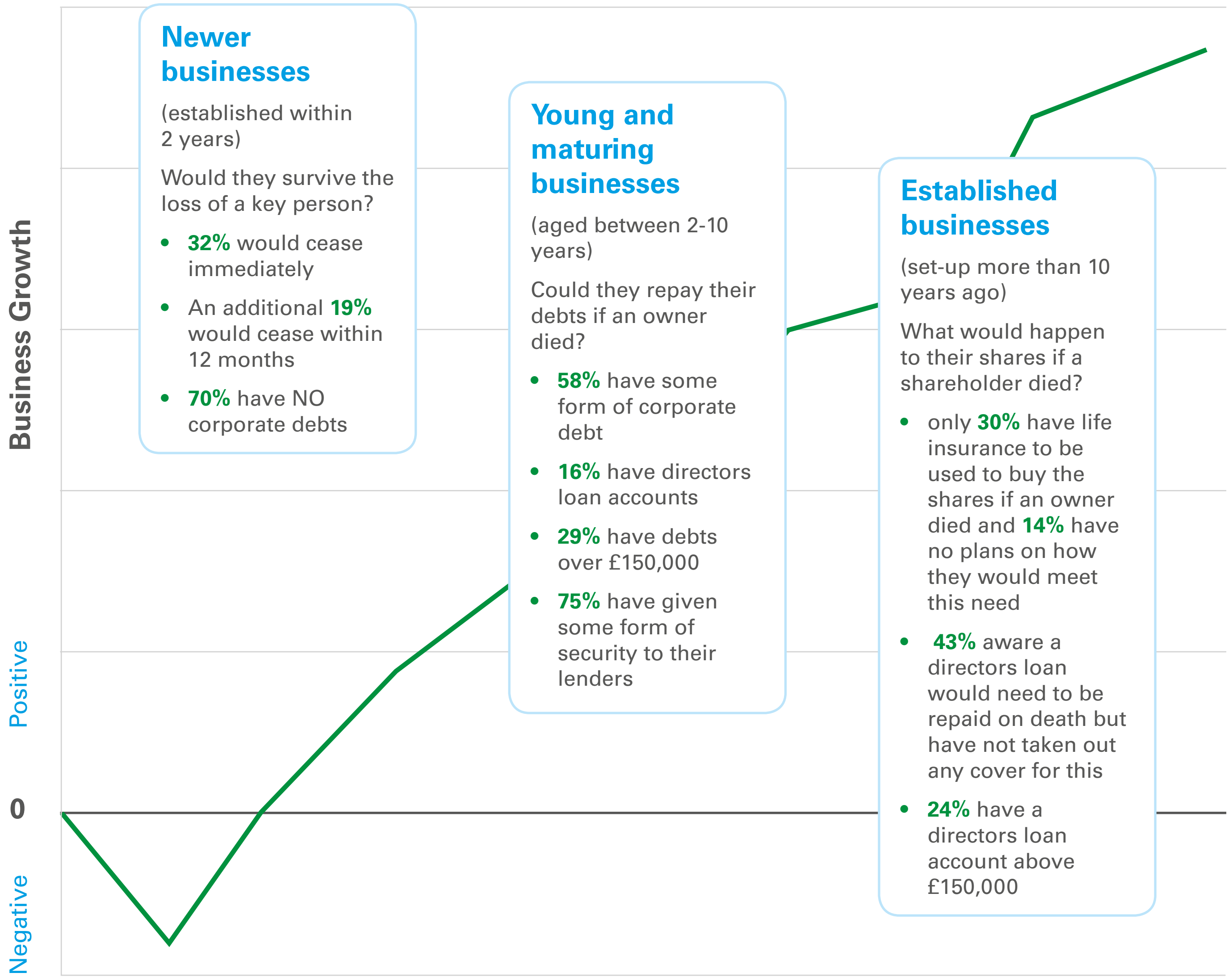
Key questions

- **Is there an opportunity to provide family protection life cover for the owners, directors, senior members of staff, or for all their employees?**
- **Do they wish to make a significant cost saving when taking out life insurance for their families?**

Changing needs

As a business grows and goes through various stages of development the needs for protecting it will change. In the early stages of initial development it may be reliant on just a few key people but not have a high value yet. However, as it becomes more established then the use of loans may play a bigger part. Finally, as it moves to an established position or towards maturity then the continued ownership and value of the business will be a point for consideration.

Our research has highlighted the changing needs (below) which can help businesses to identify their likely risks.



Financial advice

Financial advisers and accountants play an important role in prompting businesses to consider the benefits of business protection and the risk of not having cover. To demonstrate this, of those with any business protection, 73% had taken out the cover following advice. Of our sample, only 46% had an adviser; although most confirmed they would be happy to be contacted by one.

How businesses prefer to be contacted

4%	13%	24%	29%	11%	17%
Cold call	Seminar	Accountant or Solicitor	Letter or email	Through friends	Business networks

Potential protection

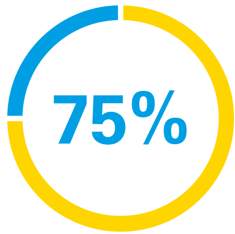
Businesses who have realised the potential risks they could face are willing to spend to provide protection for themselves and their business future.

- **£50** – More than 2 in 3 businesses are willing to spend £50 or more a month on cover
- **£100+** – 1 in 2 willing to spend £100+
- **£500+** – Nearly 1 in 4 willing to spend £500+

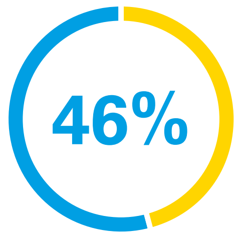
Different types of professional advice

The use of professional financial advisers varies by business type, value, tenure and gender mix of the business owners.

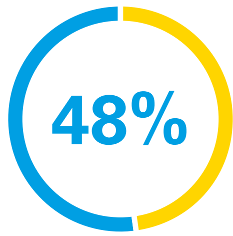
For example, we can see from our research that sole traders, those businesses valued under £250,000, those in existence for less than two years, or those with all female owners, are the least likely to use professional services outlined below. All businesses are more likely to have an accountant than a financial adviser.



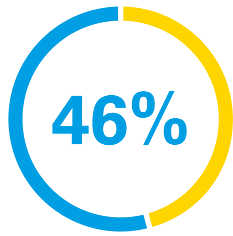
Of businesses have an accountant



Of businesses have a solicitor



Have a relationship with a bank manager



Have a relationship with a financial adviser

What does this tell us?

There are many different ways to start talking to businesses about business protection. It might be worth exploring businesses' other professional relationships, and look to collaborate with accountants, for example, as a way in to speak about this important cover.

At a glance

Business loan protection

Over half of businesses have some form of borrowing, increasing over time - average £175,000.

Most common types of borrowing over £50,000 are business loan, overdraft and Directors' Loan accounts.

Of those who haven't protected their loans, around **44%** didn't see the need

- **17%** have never thought about it.

28% did not know a Directors Loan Account needs to be repaid so need advice.

72% know a Director's Loan Account needs to be repaid on death.

- But do they know how it will be repayed?

Share protection

47% have left no instructions in their Will or special arrangements regarding shares in their business.

- Many have never thought about it.
- **37%** of shareholders would buy owner's shares.
- Have they considered how they would raise the funds?
- Many say that they would use personal wealth to do this but could they at any time in the future?
- Only a third of limited companies (**34%**) and a quarter of partnerships (**26%**) have reviewed their partnership agreements or articles of association in the past year.
- Around 4 in 10 have never reviewed them (**38%**).

Cost

- Business owners think life cover is 3 x more expensive than it is.
- 2/3 of business owners are willing to spend £50 per month or more on on protection for their key people.

Key person protection

Business owner and/or key person dying/being diagnosed critically ill would have most impact on business

52% of businesses would cease trading if they lost a key person in under one year (especially sole traders and new businesses).

Yet **99%** recognise they have at least 1 key person:

- Have they considered what would happen to their business?
- Have they truly considered the effects on creditors, customers, staff and cash flow?
- **73%** of those who do have cover were advised to take it out.

Relevant life plan

A Relevant Life Plan is a valuable area to discuss with many business owners as it could enable them to make a large saving on the cost of their personal life insurance, yet only **31%** have heard of a Relevant Life Plan:

- Of those who didn't, most lacked knowledge/ information
- When it was explained **70%** were receptive to the product.

Among those who haven't heard of a Relevant Life Plan, **82%** said that they would be interesting in knowing more.

There is a large opportunity to increase the awareness of Relevant Life Plans and it can prove a useful way to open the discussions with a business.

Find out more

Should you wish to know more about our range of Business Protection products, please speak to your usual Legal & General contact, or visit our Adviser site:
legalandgeneral.com/business

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