

Business Protection

State of the Nation's
SMEs report

6th edition

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Introduction

Since 2009, we've undertaken research within the small and medium size business sector to understand and explore the risks businesses are exposed to.

In our 6th edition of State of the Nation, we analysed how businesses are managing their risks should something happen to one 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 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."

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.



Richard Kateley, Head of Intermediary Development, Legal & General

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?



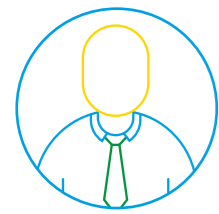
The Rough Guide to business protection in partnership with Legal & General is a comprehensive e-guide giving no-nonsense, practical and clear information on business protection. Written by financial journalist Emma Simon, the e-guide is packed with top tips and useful information to help business owners 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 government's 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%

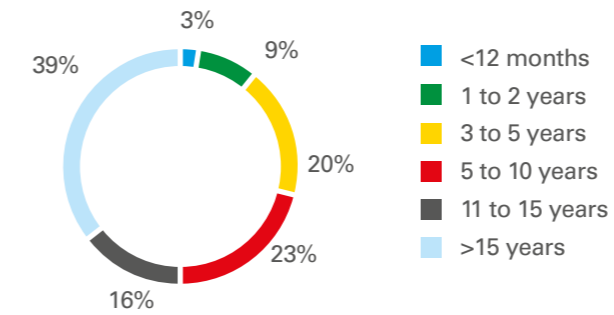
Over 40

73%

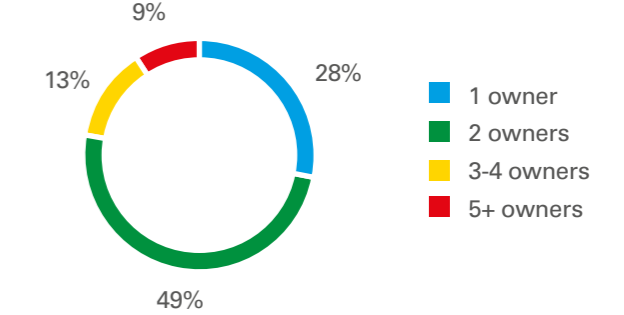
Business population estimates in 2018*

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

Years business established

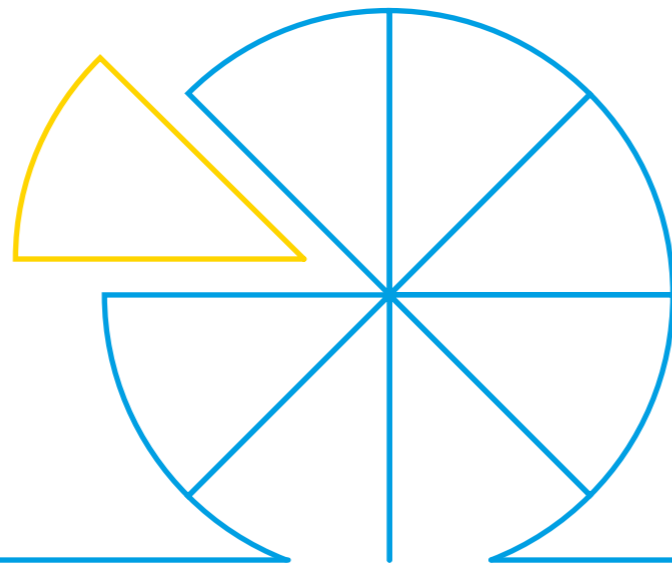


Number of business owners



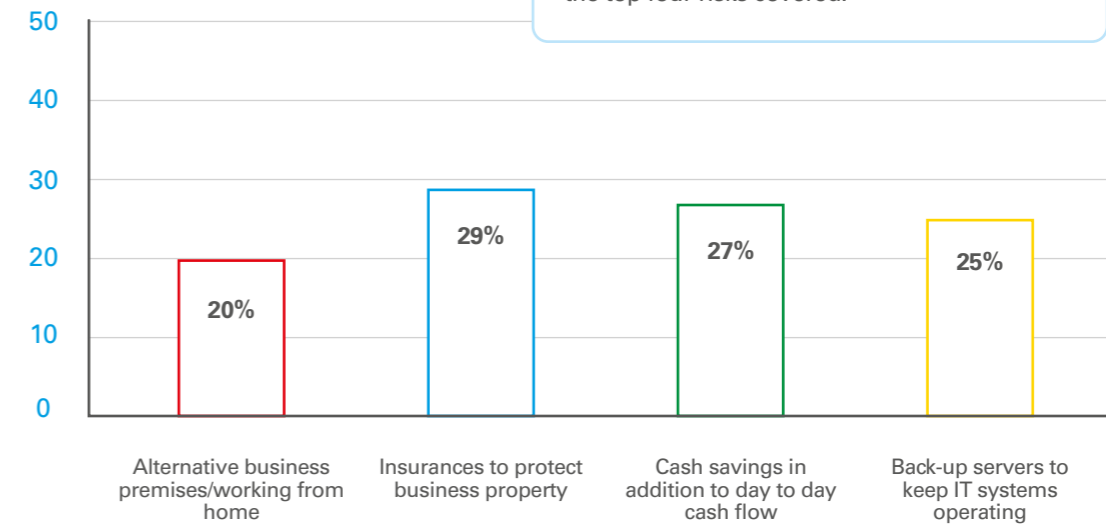
Our research segments

Every business has a lifecycle. And the better you can understand their risks and needs, the better you can give them the right advice, at the right time. Our research identified 3 major segments that businesses could be grouped into based on their age.



Business continuity planning

A business's 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. Below are the top four risks covered:



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.

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

Key questions

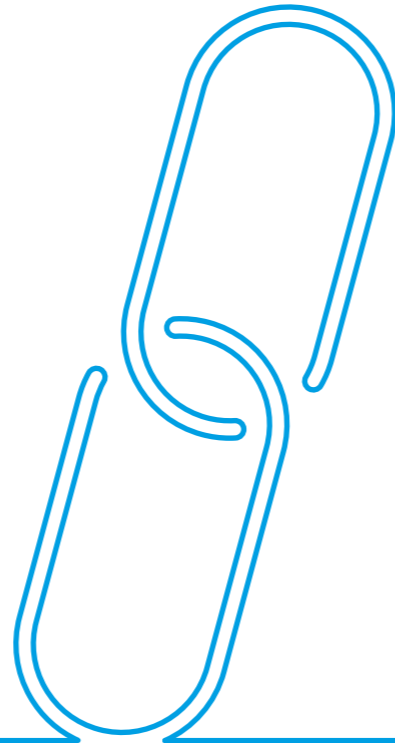
Has the business considered the risks of losing a key person or business owner?

- 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, so it's easy to take for granted the contribution your workforce puts in.

When asked, many business owners agree that the loss of a key person can have dire consequences for their business. Yet more than 50% didn't have any cover in place, and what's really worrying, 52% said 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 be the difference between the business surviving or going out of 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

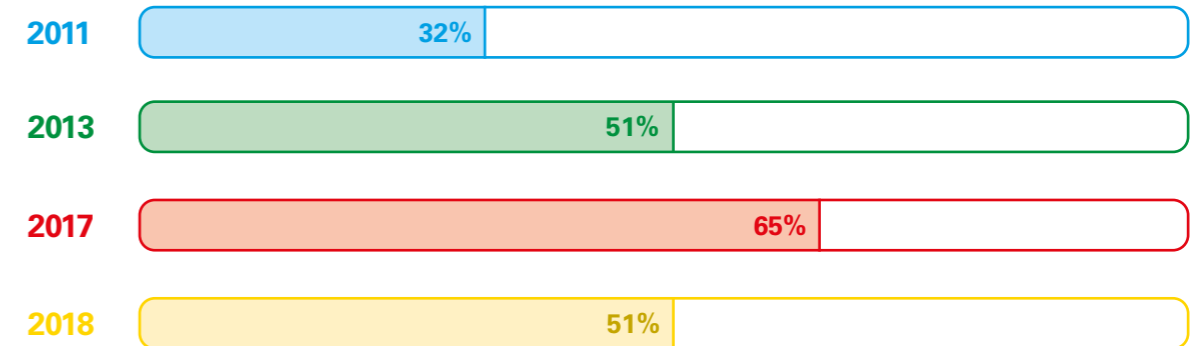
What is it and how does it work?

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 don't have cover in place to repay debt. Of those who didn't have cover, 70% didn't see the need or hadn't considered it.

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 key personnel who has guaranteed the loan?

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





Different types of borrowing

Businesses borrow various amounts of money, for many reasons and through different types of arrangements. Yet, a lot don't consider how they'd service these debts if they lost a key person.

In addition they will need to repay any outstanding amounts and many business owners are risking their personal wealth as security for borrowing.



£176,000

The average business borrowing



82%

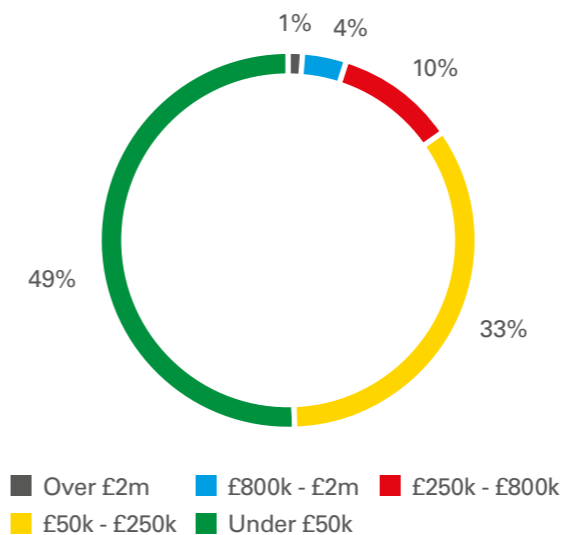
Under £250,000



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

Business loan

36%

Overdraft

37%

Director's loan account

29%

Personal loan

27%

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?

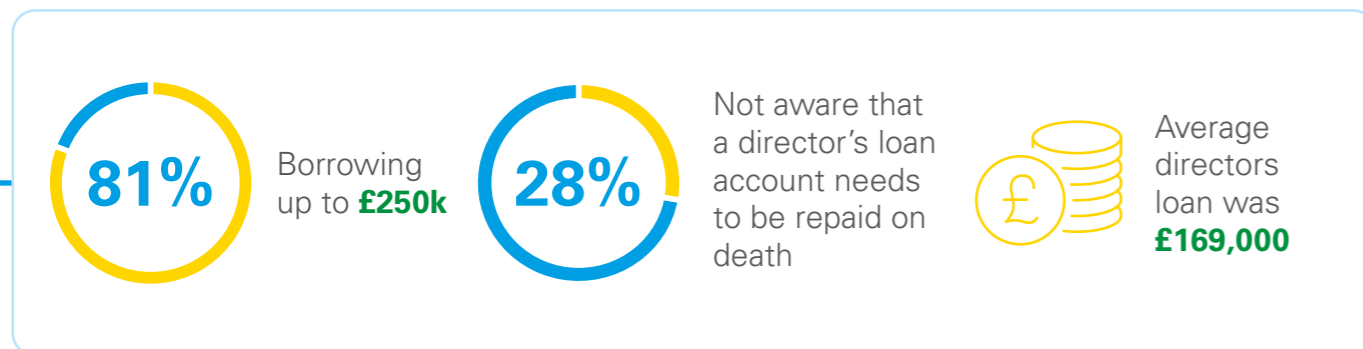
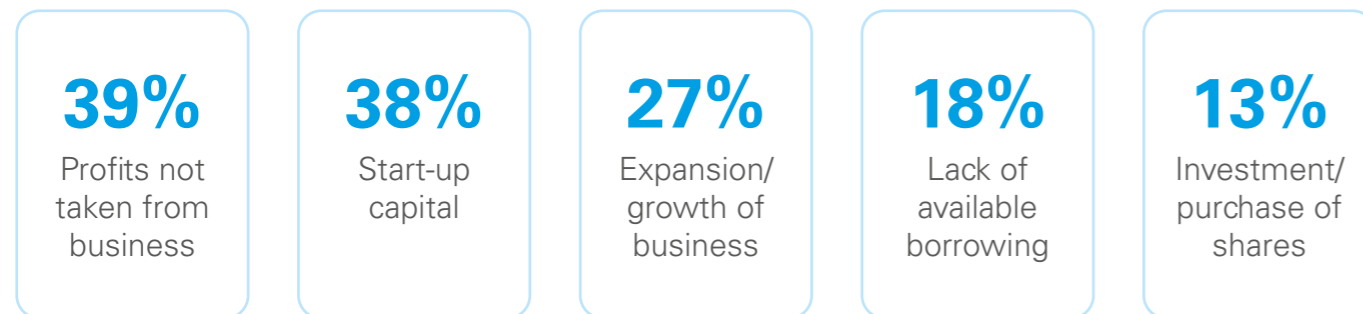
They will often provide a personal guarantee (with unlimited liability) or they may use their own assets such as their home as security.

Directors' loan accounts

It's very common for a business to have a director's loan account. This is where a director has lent money to the company to support initiatives. This could include initial start-up costs, funding expansion or where a director has left dividends within the business to be used as working capital.

Essentially, it's 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



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 number one priority for most businesses is meeting its customers' needs. It's why many owners don't have time to take a step back and consider the problems they'd 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 whose 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

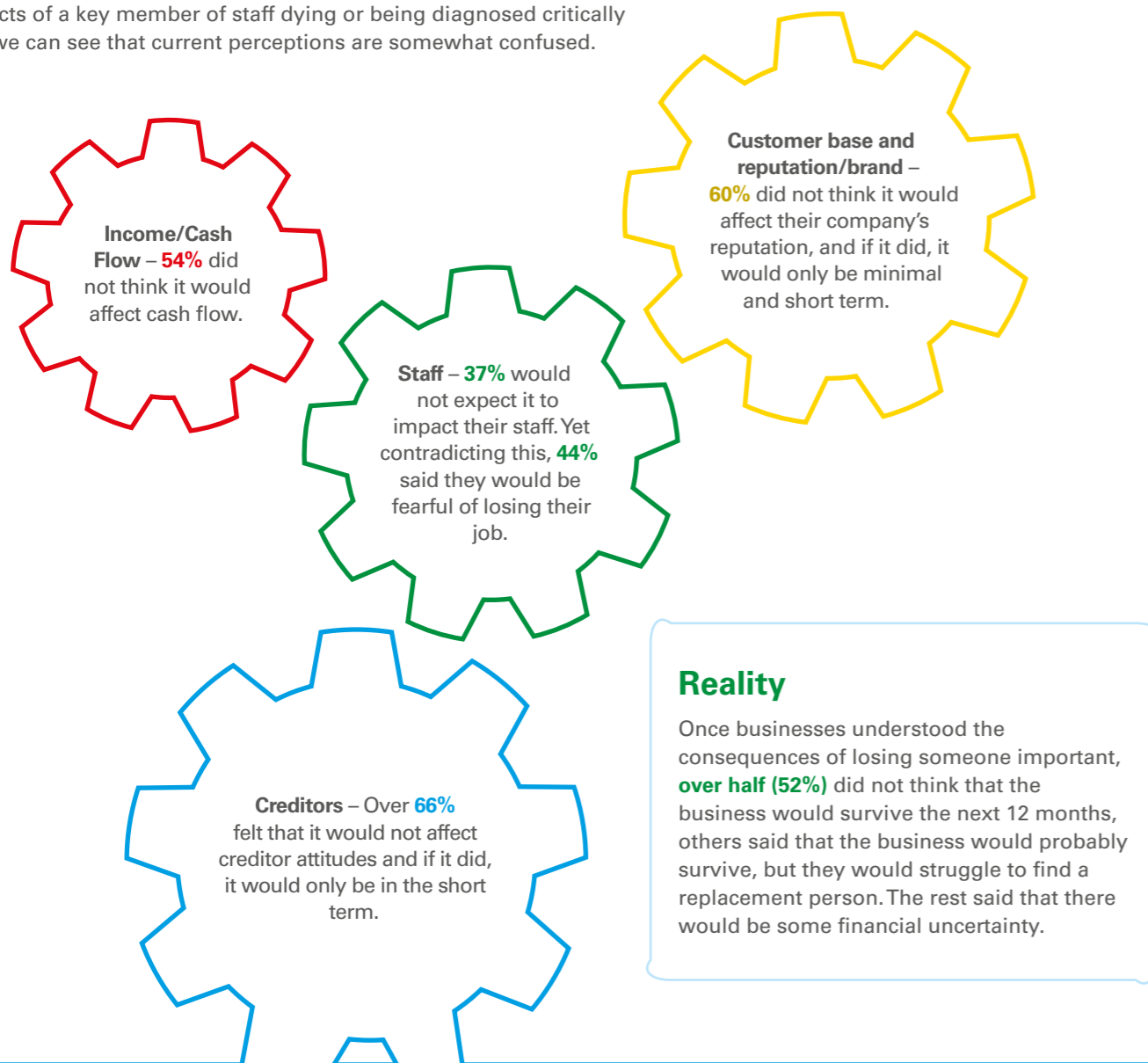
- Does the business have any key individuals who contribute heavily to profits and whose absence would affect them?
- Have they identified these individuals?

Looking beyond the perceptions

The reality is that many businesses have not considered the financial strain 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.

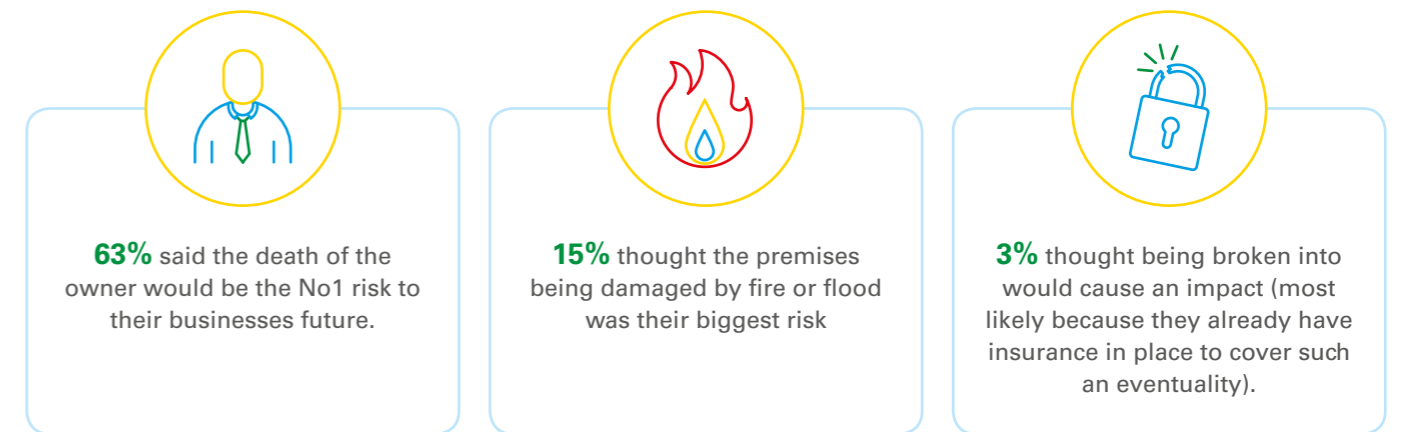
Current perceptions

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.



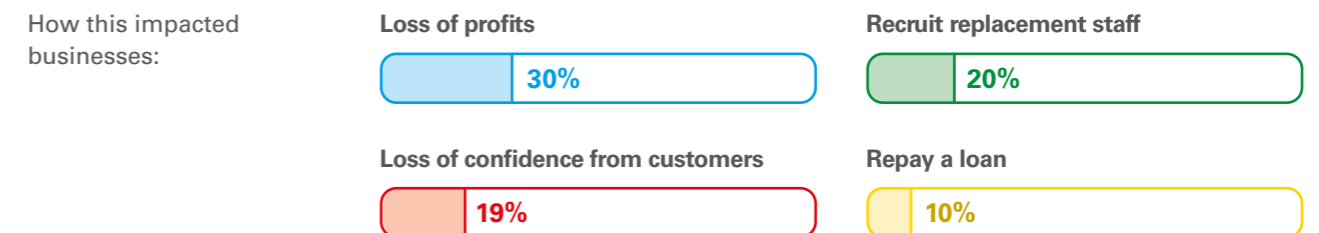
Attitude to risk and impact on a business

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 business 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.



Impact on a business

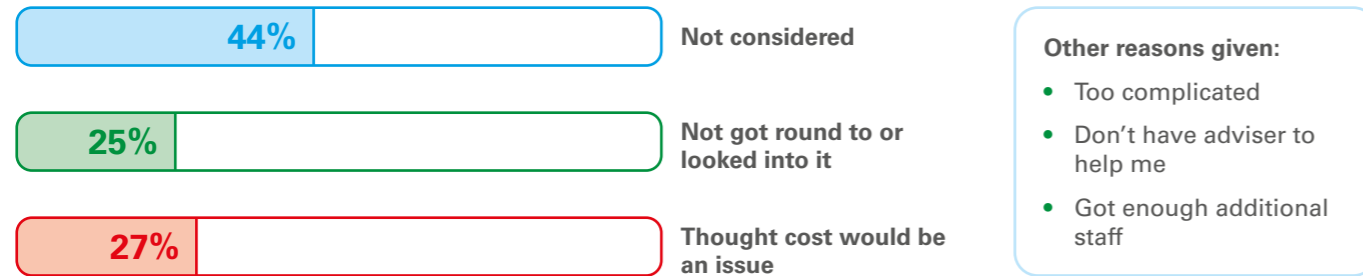
The research showed that over a quarter (28%) of businesses had in the past experienced the death or critical illness of either an owner or of a key employee. They found that there was an impact on their business in many areas, ranging from a loss of profits to an increase in their expenses to fund to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



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



Estimated costs of insurance

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

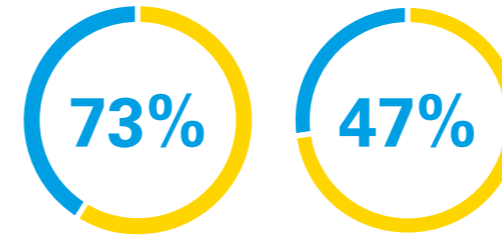


Average was almost **3 times** the actual cost



Estimated the cost would be higher than the actual premium

Who would be most affected?



Sole traders 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 key person or business owner dying or getting critically ill, 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's 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, as well as ensure that the business ownership is maintained and controlled by the surviving shareholders and the deceased's 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 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 owner'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 receive 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?

- Will there be any reserves left over?
- What value would they put on the shares?
- Will a bank loan be available?

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's designed to pay a lump sum if the person covered dies or is diagnosed with a terminal illness, while in employment during the term.

The 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's not a business protection product, it's 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 employee's taxed income compared to that of the company paying for a relevant life plan, the benefits are clear to see.

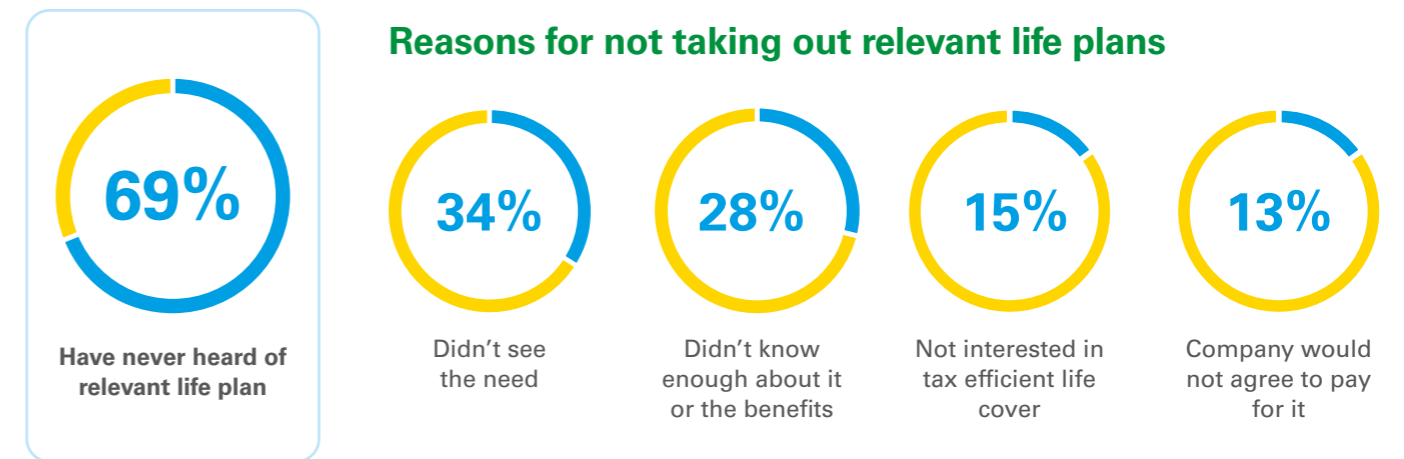
Potential savings	Non-relevant life plan policy	Relevant life plan
Annual premium	£1,000	£1,000
Employee national insurance contribution (assuming 2%)	£34.48	None
Income tax (assuming 40%)	£689.65	None
Dividend tax	None	None
Gross earnings needed	£1,724.13	£1,000
Employer national insurance contribution (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.

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 benefits of the plan are clearly explained to companies, around half of them take out the policy. The ones that don't are because they either didn't understand the product, or didn't know enough about 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

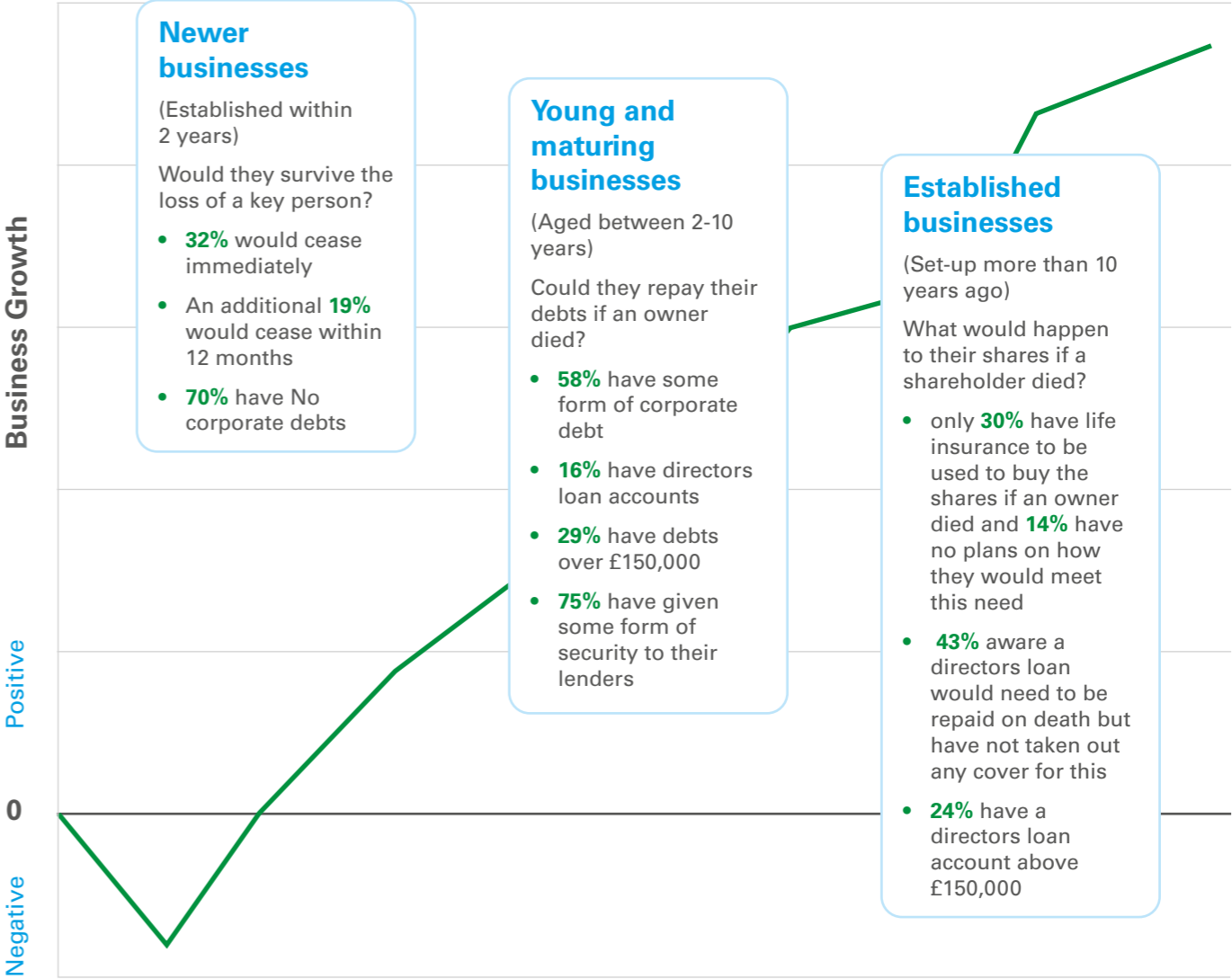
- Is there an opportunity to provide family protection life cover for the owners, directors, senior members of staff, or for all their employees?
- Do they wish to make a significant cost saving when taking out life insurance for their families?



Changing needs

As a business grows, the needs for protecting it will change. Early on, 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 maturity then the continued ownership and value of the business will be a point for consideration.

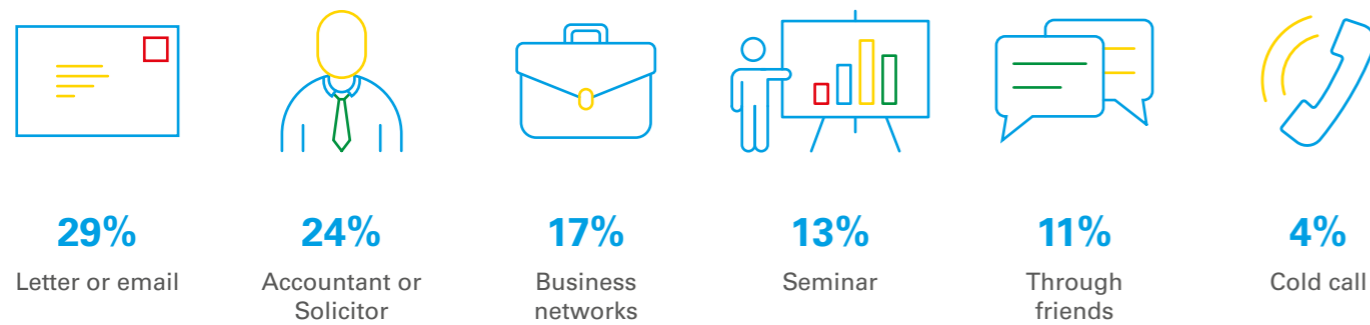
Our research below highlights the changing needs and helps businesses identify their likely risks.



Financial advice

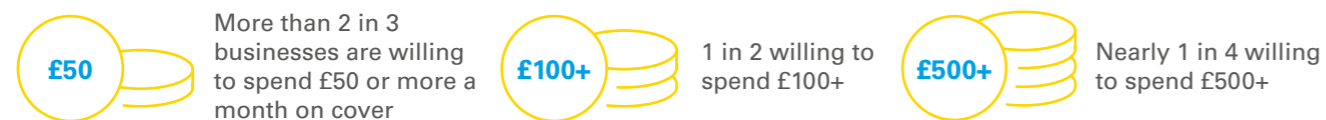
Financial advisers and accountants play an important role in prompting businesses to consider the benefits of business protection and the risk of not having cover. To demonstrate this, of those with any business protection, 73% had taken out the cover following advice. Of our sample, only 46% had an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

How businesses prefer to be contacted



Potential protection

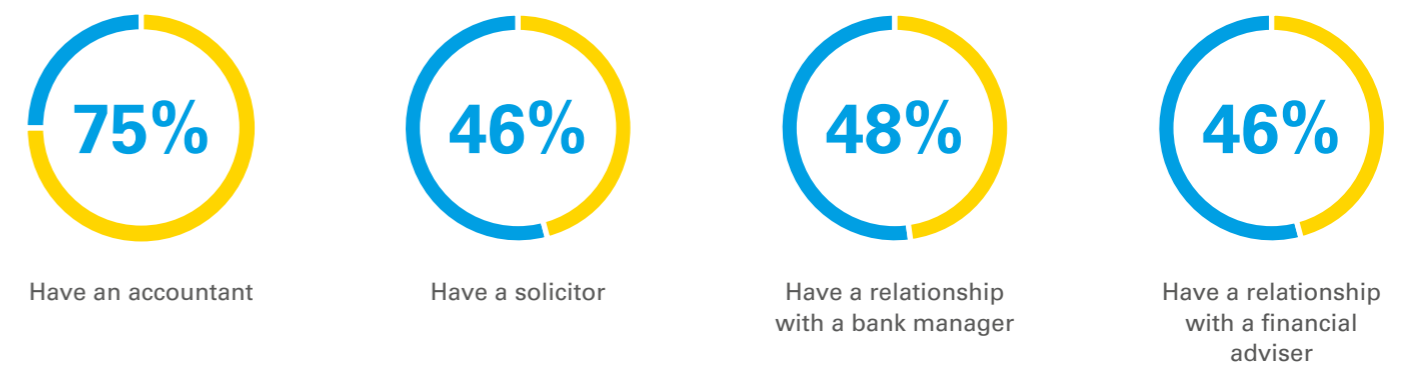
Businesses who have realised the potential risks they could face are willing to spend to provide protection for themselves and their business future.



Different types of professional advice

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

Our research shows; sole traders, business valued under £250,000, those with all female owners or who have been in existence for less than two years, are the least likely to use the professional services outlined below. All businesses are more likely to have an accountant than a financial adviser.



What does this tell us?

There are many different ways to start talking to businesses about the importance of business protection. It might be worth exploring businesses' other professional relationships, and look to collaborate with accountants.

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 repaid?

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%**).

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.

Cost

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

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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