

## The Importance of Buying Insurance for your Company

### INTRODUCTION

Business Insurance is purchased to protect a company against:

- Physical loss or damage
- Loss of income consequent upon physical loss or damage (Loss of Profit)
- Legal liability to third parties

to ensure the continuing operation of the business.

### WHEN YOU ARE HIT BY A LARGE LOSS

When a company is hit by a physical loss or damage, interruption of operations consequent upon such loss or damage and third party legal liability, it has to repair or replace the loss or damage, pay the wage bill and other standing charges and compensate damaged third parties. Let us call these 'Loss.'

For a company to be able to continue its operations it must have the resources to cover the Loss. To do so, the company can rely on:

- Operating income (but if the loss is large this income will not be enough)
- Taking a bank loan (but this might not be readily available as a company that has suffered a large loss would not be an attractive borrower or the terms of the loan are onerous)
- Contingency or special fund (but many companies do not set aside such funds for financing loss)

To safeguard against Loss it would be simpler and economical to set aside an annual budget for purchasing insurance protection against Loss. Thus, the problem of financing Loss is transferred from the company to the insurance company providing the protection.



### UNINSURED AND INSUFFICIENTLY INSURED COMPANIES

A company that is uninsured (does not buy insurance) or underinsured (does not buy sufficient insurance) is severely at risk of an insurable peril crippling its ability to conduct business on a daily basis or even wiping the company out of business altogether.

# UIB GROUP

Unfortunately, insurance is often a second thought for many companies but the result of overlooking not just buying insurance but overlooking buying the correct insurance could be catastrophic.

State-owned companies, as a last resort, can fall back on the government to bail them out, although the hundreds of millions of dollars potentially required to do this has to be taken from other areas of the government budget. Such a diversion of financial resources has a knock on effect on other areas of government expenditure, e.g. financing new social projects or public services. This transfer of funds can lead to political pressure if the money is taken from projects with a lot of public support.

The private sector does not have the luxury of a government bailout and without insurance can only rely on the strength of its balance sheet. If the cash and assets on the balance sheet are not sufficient to pay for the loss or damage then the business collapsing becomes a reality.

## WHAT DOES AN INSURANCE POLICY PAY?

Insurance will pay for the physical repair or replacement of property, buildings and equipment.

Insurance will compensate a business for the lost gross profit in the event of physical damage stopping a company from carrying out its activities for a certain period.

Insurance will compensate a company if it is legally liable for injury or death to individuals.

Insurance will compensate a company if it is legally liable for loss or damage to other people's property.

Insurance is a mechanism to protect a business from financial loss following a physical loss or damage event.

## OBLIGATORY INSURANCE

Most companies are legally obliged to purchase certain insurances such as employer's liability, motor third party liability and fire insurance for their property. This will vary from country to country but the legal requirement is usually the minimum levels of insurance to be purchased rather than the specifically tailored levels to meet the particular exposure that each company faces.

In this case, companies believe they have insurance and feel safe but are generally underinsured in that they have not purchased sufficient amount of insurance or have not bought insurance to cover all of the perils they are exposed to.

Other companies can be contractually obliged to purchase insurance by their Lenders who will impose strict conditions to protect a business and ultimately protect the Lenders' investment/loan. The insurance requirements under this basis are normally wider in terms of the amount of cover purchased and the perils insured against but the requirements are often governed by non-insurance specialists and are therefore not always accurate.

## RISK ANALYSIS

The only true way to purchase insurance cover is to analyse the exposures that each individual company faces.

The type of insurance a company purchases will vary according to the particular risks it is exposed to and the amount of insurance a company purchases will depend on how much risk it is prepared to bear for its own account. Type and amount of insurance purchased will also vary depending on how much premium each individual company is prepared to spend.

Improved risk management practices can help in reducing a company's exposure to risk, which will ultimately result in reducing the premium charged by the insurers. Risk improvement can also benefit industries as a whole, which has been seen in areas such as oil refining. Thanks to risk management visits by qualified chemical engineers employed by insurance companies to refineries and other industries, it is widely considered that the collation and sharing of worldwide practices by these engineers has helped reduce the number of major explosions and fires at refineries.



## HOW TO PURCHASE INSURANCE

There are 3 main steps to purchasing the correct level of insurance cover.

### 1) *Choose an Insurance Professional*

In the same way a company will choose a law firm or accountants, the appointment of an insurance broker should be taken very seriously. The right insurance broker will be able to advise a company on the level and type of all insurance that should be purchased. The insurance broker will also act on the Insured's behalf to place the insurance requirements with the best security and at the most competitive price.

Many companies buy the cheapest insurance but this is not always the best deal. Insurer security especially in today's financial world is something that should be considered. In the event of an insurance claim, the company purchasing the insurance wants to be sure that the insurers they have used will still be around to pay any such claims.

### 2) *Analyse your business*

Using the skills of the insurance brokers and their risk management department each company should take time to analyse the perils it faces and the scale of its exposure. Each company will have its own individual requirements and it is only by analysing the exposures can a company identify the insurance cover it needs.

### 3) *Learn about the types of coverage available*

By appointing an insurance broker, each company would be able to discuss the various types of insurance that are available to cover the exposures it faces. The insurance broker should also give the company regular updates on new insurance products that are generated and on important developments in the insurance market in general.

# UIB GROUP

## SUMMARY

With the help of a professional insurance broker, companies can tailor their insurance policy to cover all of the potential risk they are exposed to.

The insurance industry is constantly evolving to meet the ever changing demands of worldwide business. Wherever there is risk the insurance industry needs to react and provide solutions.

The solutions are in place so it is imperative that all companies look at the benefits that can be obtained by utilising the insurance industry.

Too often insurance is deemed to be an additional unnecessary expense and this is where the danger occurs because not buying the correct insurance can result in companies being caught out when they are hit by a major loss that they cannot finance from their operating revenues.

We have seen in the last few years billions of dollars having taken off the balance sheet of companies worldwide via the disposal of assets and funds that would otherwise have been used to develop and grow a business. This subsequently can reduce the profit margin and the dividends paid to the shareholders who protest at the way the business is being managed and the company as a whole finds itself in turmoil.

All this can be avoided by purchasing the correct insurance policy.

The staff of UIB produced this paper. The paper is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Specific questions relating to this paper should be addresses directly to Mark Ritson.

**Mark Ritson**  
Associate Director

[mark.ritson@uib.co.uk](mailto:mark.ritson@uib.co.uk)

**Non-Marine and Energy Division**  
United Insurance Brokers Ltd  
+44 (0)20 7488 0551 (switchboard)  
+44 (0)07825 571 676 (mobile)  
+44 (0)20 7480 5182 (facsimile)

[www.uibgroup.com](http://www.uibgroup.com)

© 2011 UIB GROUP All Rights Reserved