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Your Learning Outcomes

- Greater insight into the Financial Risks for a Microbusiness
- Knowledge of a consultation process that will help you understand the situation and uncover the potential problems
- Understand a method to analyse the Financial Risks in a Microbusiness
- Greater awareness of the insurance solutions that address the insurable risks in a Microbusiness
- Insight into how you could structure a Microbusiness Risk Plan

Workshop Agenda

- Target market – what do we mean by a Microbusiness?
- Microbusiness demographics - Human Capital and Financial Risk
- Consultative Selling approach – situation discovery
- Problem and Needs discovery
- Financial analysis of business risk and personal risk
- Insurance solutions for business risks
- Risk Plan Framework

Microbusiness Definition (for the purposes of this workshop)

- Sole owner or owned between life partners where an estate plan can manage the transfer of ownership
- 80-90%+ of business revenue is generated by one person
- 1-3 people in the business

New Zealand Statistics

- 70+ % of businesses in NZ
- 350,000 entities
- 44% of Self Employed owners are over the age of 50



Risky Business

Microbusiness's typically have low resilience to Human Capital Risk.

Less than 10% have a plan in place to mitigate the negative financial effects.



Contributing Elements

- Lack of size – inability to spread risk
- Financial weakness – lack of capital/cashflow
- High dependence on key people
- High interdependence for the owners
 - they rely on the business for income
 - the business relies on the owners to provide security for debts
- Limited operational structure
- 'Informal' business procedures
- 'She'll be right' attitudes
- Lower risk awareness but higher risk tolerance

* IBISWorld 2013 Global Life Insurer Research

** Berkeley Haas Management School, University of California

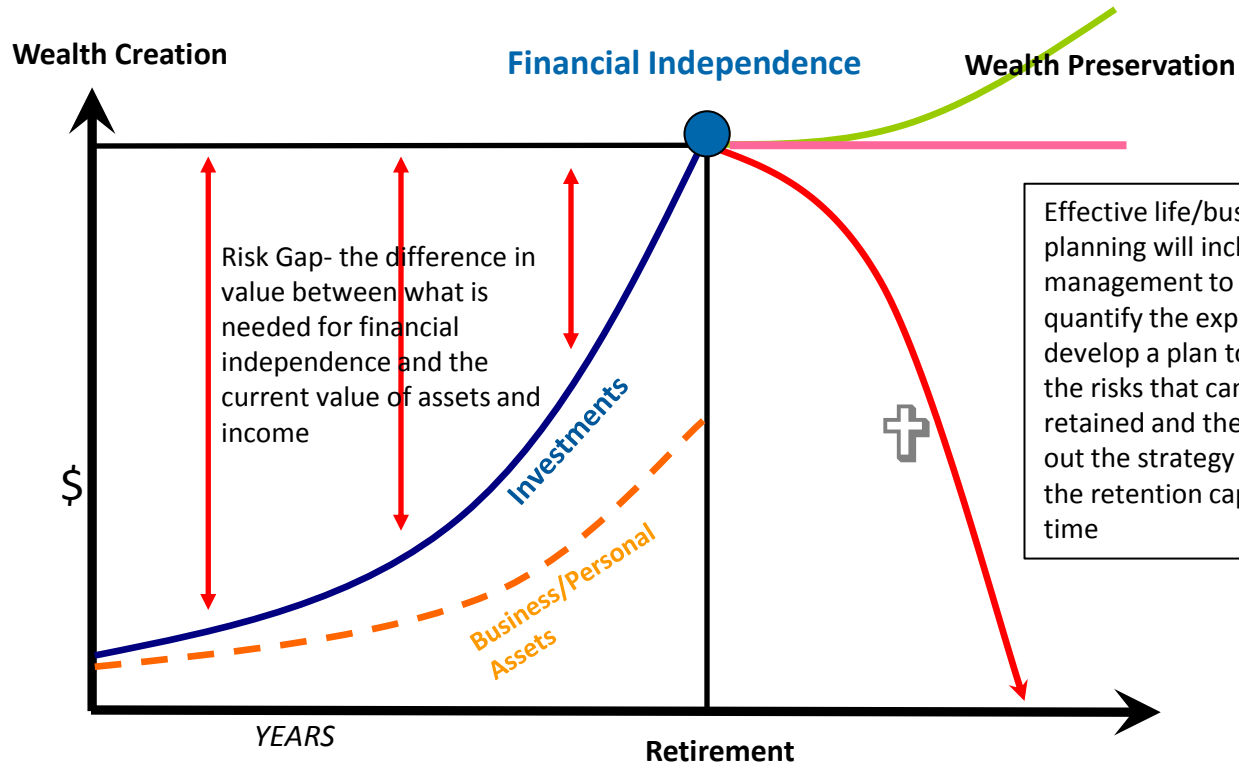
*** Zurich Research 2013

Effective Risk Management protects wealth

A family and/or business owner sets a goal for their financial independence and typically they rely on growing the value of their business and other assets including savings to realise their objective

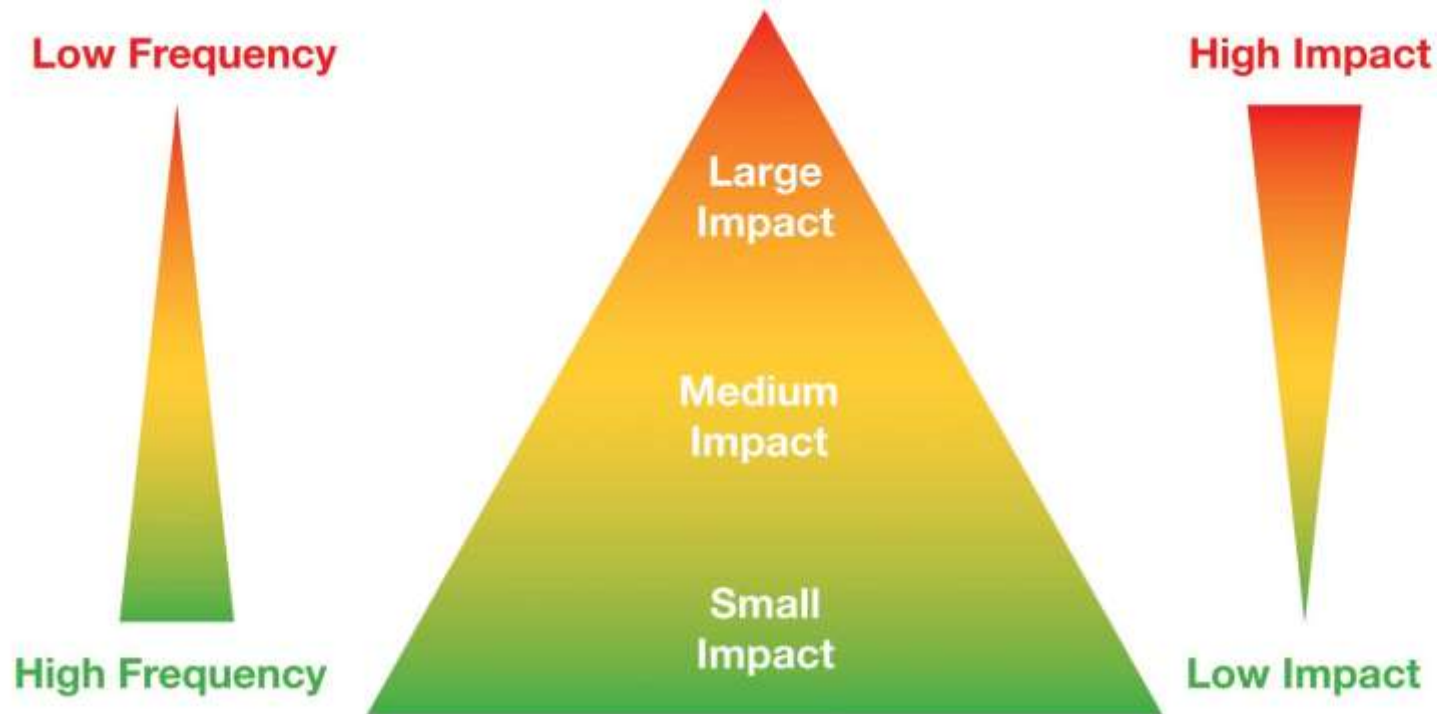
Over time as the value of the assets grow the 'risk gap' diminishes reducing the need to transfer the financial risks to insurance

Many individuals and/or business owners plan to rely on the sale of their major assets which may include their business, to help fund their retirement or provide for their heirs



Effective life/business planning will include risk management to identify and quantify the exposures and develop a plan to transfer the risks that cannot be retained and then to work out the strategy to increase the retention capacity over time

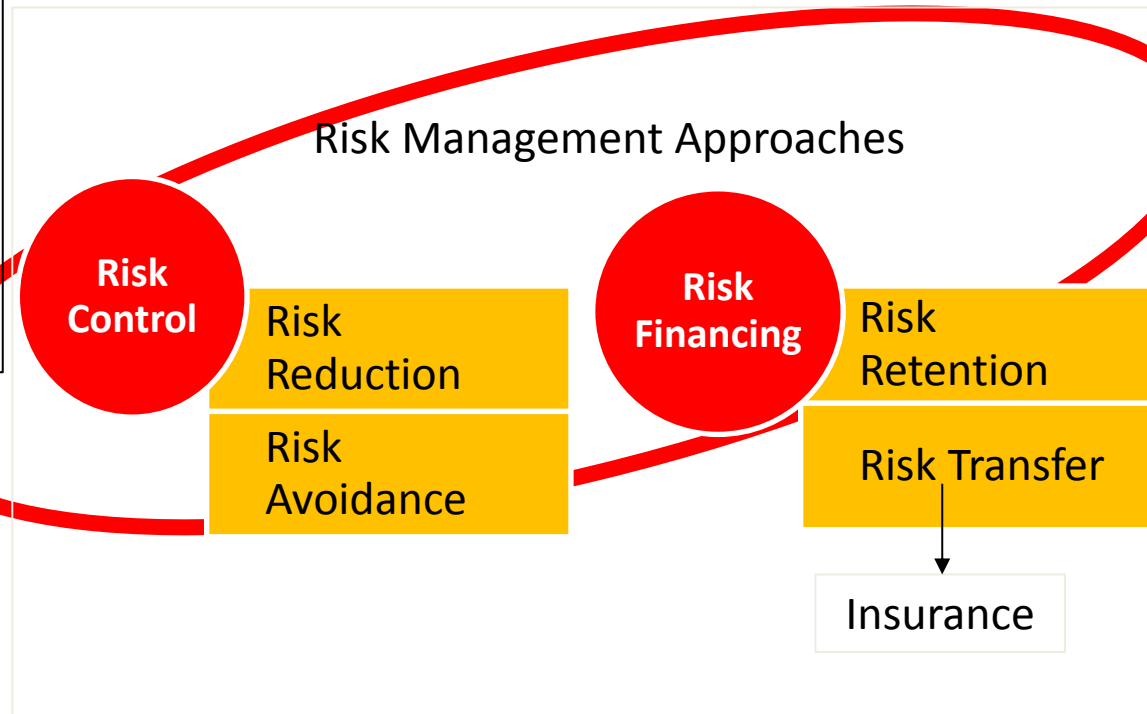
Risk Management Philosophy



- Insurance is used to manage risks that cannot be retained and would have the potential to seriously disrupt a clients financial objectives.
- The aim is to maximize retention of high frequency low impact risks and transfer (insure) risks which are less frequent but have a high impact

Risk Management Approaches

Helping businesses grow and helping families become financially independent requires advice on risks that could prevent them from achieving their objectives.



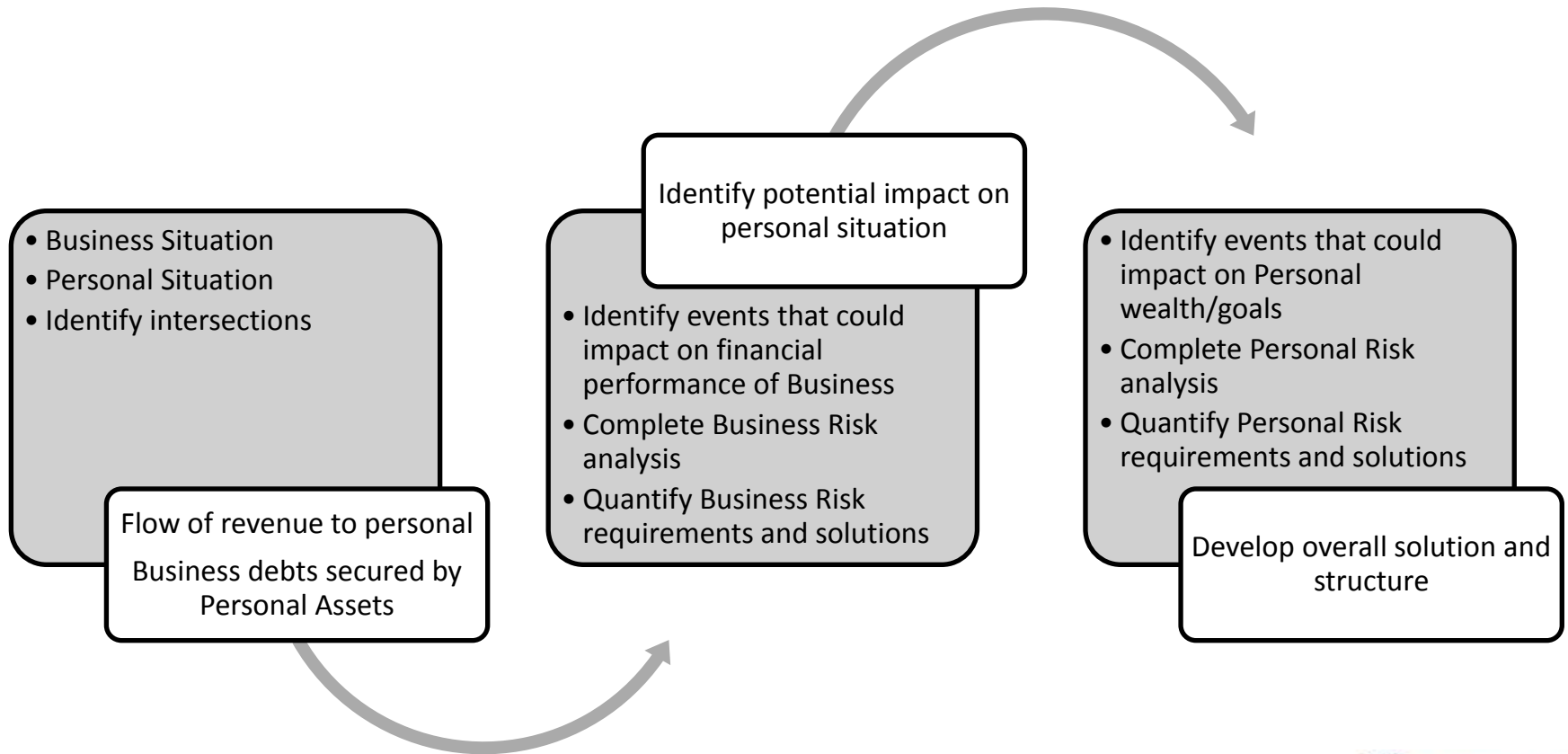
Significant risks that cannot be controlled or retained should be transferred. Directors duties include protecting creditors from losses arising from pure risks.

A risk management plan should identify the risks and financial exposure that the cash flow or balance sheet cannot control or retain and/or that do not make economic sense to retain

Consultative Sales and Advice Approach



Risk Analysis Framework



Microbusiness Situation

Business

- Business ownership structure
- Business activity
- Operational structure
- Financial information
 - Revenue
 - Expenses
 - Surplus/profit
 - Balance sheet
 - Debt
 - Finance contracts
- Key Person functions
- Owners income from business

Personal

- Family structure
- Family roles
- Personal balance sheet
 - Assets
 - Liabilities
- Asset ownership e.g. Trusts
- Household income
- Household expenditure
- Estate plan

Case Study – Gary Electrical Ltd

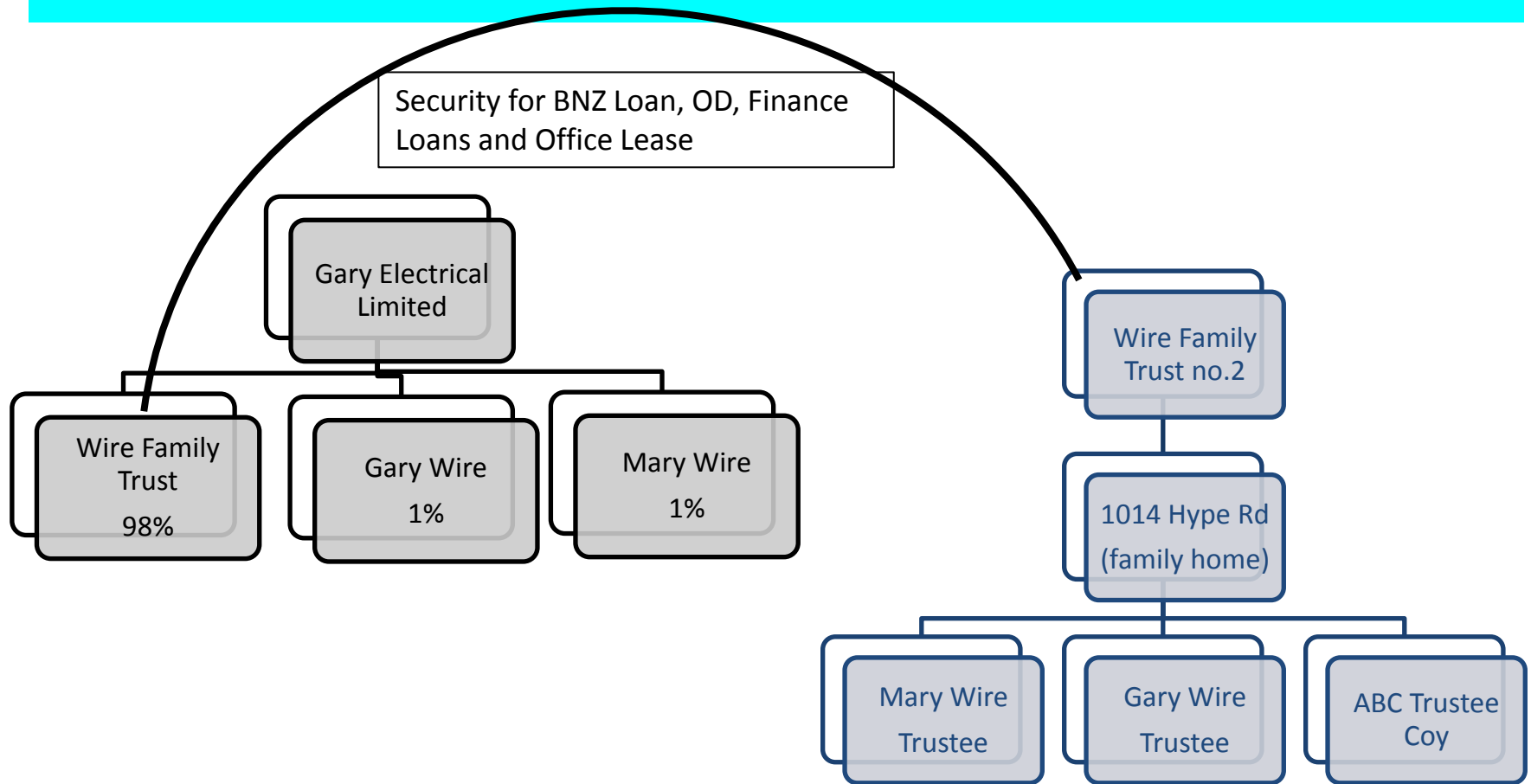
Business Situation

- Residential electrical services
- Wife does admin and invoicing 2-3 hours per week
- Word of mouth generates work
- Borrowed money to buy the business in 2011 from 'boss'
- Family home used as loan security
- Family Trust no.1 owns most of the shares
- Turnover in current year: \$178,000
- Surplus - \$67,000
- Business on target for \$220,000 T/O for 2014/15 FY
- Plenty of work available but really difficult to recruit more electrical staff

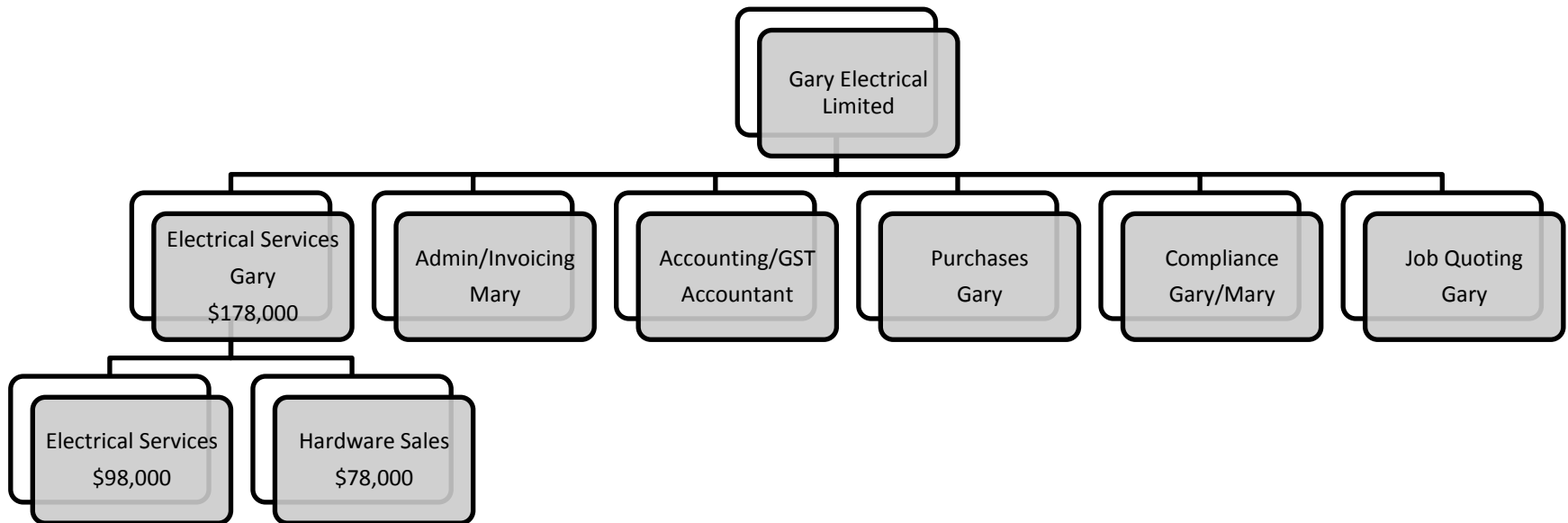
Personal Situation

- Married with 2 children 3 & 5
- Household income \$65,000
- All household income generated from the electrical business
- Family home worth \$780,000 held in family trust no.2
- Total debt over the home \$412,000 of which \$144,000 is debt related to buying the business
- Expecting growth in income as Mary returns to part time teaching work in 2016

Asset Ownership



Operational Diagram



- Identifies key functions in the business
- Identifies roles and areas of responsibility
- Helps identify where 'problems' may arise
- Helps identify what functions/resources need to be maintained to continue business activity

Financial Statements

- Profit and Loss
 - Identify expenses that will continue
 - Identify expenses that have a 'long tail'
 - Identify expenses that have penalties for early termination
- Balance Sheet
 - Identify debts that will need to be repaid
 - Identify debts with early termination penalties
 - Identify assets that can be sold or recovered
- Shareholder Advance Accounts
 - Identify amounts owing to shareholder/s
 - Identify amounts owed by shareholders
- Notes to Financial Statements
 - Identify Contingent Liabilities
 - Identify Lease Commitments

Key Person Risk Analysis post Insurable Events

- Temporary Disablement – Business Continuation Plan
 - Timing and quantum on revenue, expenses and profit/surplus
 - Impact on owners income
 - Duration of time it is possible to 'keep the doors open'
 - Ongoing costs to be met – current and new
 - Loan principal payments
- Death or Permanent Disablement - Business Wind Up plan
 - Can the business be sold – what are the realisable assets?
 - What is required to wind the business up 'gracefully'
 - What contingent liabilities could arise
 - Who will manage the process
 - What will it cost to complete the process

Exercise

- Refer to the Operational Diagram for Gary Electrical Ltd
- Brainstorm 10 open questions you could use to gain a deeper understanding of:
 - Gary's day to day role in the business
 - What would happen to revenue if Gary was disabled
 - What other problems the business would face if Gary wasn't at work in terms of its operations

Key Person Analysis - Continuation

- New revenue ceases immediately Gary can't work
- Can collect debtors but matched by accounts payable
- No ability to immediately reduce business expenses
- Need to maintain bank loan principal repayments to avoid default (compare balances from past to current year to ascertain annual principal)
- Need to maintain finance loan repayments
- If Gary wants 6 months recovery time he needs:
 - \$4583 per month to cover operational costs and interest
 - \$5400 per month to cover the salaries to him and Mary
 - \$1,300 per month to cover finance loans

Wind Up Analysis - Assets

WIND UP ANALYSIS FOR	insert entity name		insert date
WIND UP ANALYSIS	Book Value	Realised Value %	Realised Value \$
Current Assets			
Cash on Hand	\$ -	100%	0
Accounts Receivable (debtors)		70%	0
Inventory		70%	0
Work In Progress	\$ -	50%	0
Shareholder Current Accounts		100%	
Non Current Assets			
Land	\$ -	80%	0
Buildings	\$ -	75%	0
Plant and Equipment		75%	0
Motor Vehicles		45%	0
Furniture and Fittings	\$ -	65%	0
Computer Equipment	\$ -	70%	0
Leasehold Improvements	\$ -	70%	0
Other	\$ -		0
Other	\$ -		0
Intangible Assets			
Goodwill		50%	
Total Realised Assets			\$ -

Disclaimer: The realised value percentage is a guideline only. Each business needs to be assessed based on its characteristics and circumstances. It is recommended you discuss this with client's accountant to confirm the appropriate percentages for each particular client.

Wind Up Analysis - Liabilities

Current Liabilities	Current Value	Amount Payable %	Amount Payable \$
Bank Overdraft		100%	0
Accounts Payable (creditors)		100%	0
Shareholders Current Account		100%	0
Holiday Pay Accrual	\$ -	100%	0
GST		100%	0
Credit Card		100%	0
PAYE Accrual	\$ -	100%	0
IRD - Company Tax	\$ -	100%	0
Non Current Liabilities			
Bank Term Loans		100%	0
Non Bank Loans		100%	0
Hire Purchase	\$ -	100%	0
Shareholder Loans	\$ -	100%	0
Other	\$ -	100%	0
Other	\$ -	100%	0
Total Realised Liabilities			\$ -

Disclaimer: The realised value percentage is a guideline only. Each business needs to be assessed based on its characteristics and circumstances. It is recommended you discuss this with client's accountant to confirm the appropriate percentages for each particular client.



Wind Up Analysis – Other Costs

Other Wind Up Costs	Amount	Amount Payable %	Amount Payable \$
Unexpired Building Lease		100%	0
Accrued Redundancy Pay	\$ -	100%	0
Legal		100%	0
Accounting		100%	0
Wages	\$	100%	
Contracts Early Termination		100%	0
Loans	\$ -	100%	0
Hire Purchases	\$ -	100%	0
Business Credit & Debit Cards	\$ -	100%	0
Moving	\$ -	100%	0
Debt Recovery	\$ -	100%	0
Other	\$ -	200%	0
Total Wind Up Costs			\$ -
Realised Value			
Assets - (Liabilities + Wind Up Costs)		Net Position	\$ -
Sum Required under Wind Up		Shortfall	\$ -

Disclaimer: The realised value percentage is a guideline only. Each business needs to be assessed based on its characteristics and circumstances. It is recommended you discuss this with client's accountant to confirm the appropriate percentages for each particular client.

Exercise

- With reference to the Gary Electrical Financial Statements:
 - 1) enter the assets into the Wind Up analysis table that could be sold or obtained on a wind up
 - 2) enter the liabilities that would need to be repaid to wind the business up
 - 3) enter the other wind up costs that would have to be met
 - 4) calculate the net position
- Discussion: when could this business get value from the goodwill?

Wind Up Requirements

			802111
WIND UP ANALYSIS FOR	Gary Electrical Ltd		31-03-13
WIND UP ANALYSIS	Book Value	Realised Value %	Realised Value \$
Current Assets			
Cash on Hand	\$ -	100%	0
Accounts Receivable (debtors)	\$ 10,857	70%	7,600
Inventory		70%	0
Work In Progress	\$ -	50%	0
Shareholder Current Accounts	\$ 31,908	100%	31,908
Non Current Assets			
Land	\$ -	80%	0
Buildings	\$ -	75%	0
Plant and Equipment	\$ 7,428	75%	5,571
Motor Vehicles	\$ -	45%	0
Furniture and Fittings	\$ -	65%	0
Computer Equipment	\$ -	70%	0
Leasehold Improvements	\$ -	70%	0
Other	\$ -		0
Other	\$ -		0
Intangible Assets			
Goodwill	\$ 171,435	50%	85,717
Total Realised Assets			\$ 130,796

Wind Up Requirements

Current Liabilities	Current Value	Amount Payable %	Amount Payable \$
Bank Overdraft	\$ 21,407	100%	21,407
Accounts Payable (creditors)	\$ 6,330	100%	6,330
Shareholders Current Account	\$ 1,615	100%	1,615
Holiday Pay Accrual	\$ -	100%	0
GST	\$ 7,853	100%	7,853
Credit Card	\$ 20,802	100%	20,802
PAYE Accrual	\$ -	100%	0
IRD - Company Tax	\$ -	100%	0
Non Current Liabilities			
Bank Term Loans	\$ 145,511	100%	145,511
Non Bank Loans	\$ 23,627	100%	23,627
Hire Purchase	\$ -	100%	0
Shareholder Loans	\$ -	100%	0
Other	\$ -	100%	0
Other	\$ -	100%	0
Total Realised Liabilities			\$ 227,145

Wind Up Requirements

Other Wind Up Costs	Amount	Amount Payable %	Amount Payable \$
Unexpired Building Lease	\$ 30,000	100%	30,000
Accrued Redundancy Pay	\$ -	100%	0
Legal	\$ 2,000	100%	2,000
Accounting	\$ 3,000	100%	3,000
Wages	\$	100%	
Contracts Early Termination	\$ 13,774	100%	13,774
Loans	\$ -	100%	0
Hire Purchases	\$ -	100%	0
Business Credit & Debit Cards	\$ -	100%	0
Moving	\$ -	100%	0
Debt Recovery	\$ -	100%	0
Other	\$ -	200%	0
Total Wind Up Costs			\$ 48,774
Realised Value			
Assets - (Liabilities + Wind Up Costs)		Net Position	\$ (145,123)
Sum Required under Wind Up		Shortfall	\$ 145,123

Note:

If there is no Goodwill e.g. a wind up with no buyer then shortfall is \$230,840

If the wind up is orderly and there are sufficient funds so that the shareholders current account isn't called up the shortfall is \$262,000



Insurance Requirements

Benefit Type	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Key Person	11,283	11,283	11,283	5,883	5,883	5,883
Income Protection (insured benefit)				3,375	3,375	3,375
Long Term Disablement Lump Sum						260,000
Life Cover	260,000					

Insurance Solutions

- Business Expenses – why wouldn't it work for this customers needs?
- Locum Cover – why wouldn't it work for this customers needs?
- Total and Permanent Disablement – what gaps would it potentially leave if you relied on this as your solution to fund the wind up requirements?
- Lump Sum Trauma – what gaps would it potentially leave if you relied on this as your solution to fund the wind up requirements?

Assessing Owners Income

- Many Microbusiness owners will receive financial benefits from the business which are legitimately not included in their personal taxable income but which can be included in the assessment of their earnings for Income Protection
- Examples of ‘Allowable Add-backs’
 - Payments to spouse
 - Portion of home office expenses/rent
 - Interest on portion of personal mortgage
 - Management fees charged to the business by owner
 - Depreciation

Assessing Owners Income – example template

Year ending:	31 Mar ____	31 Mar ____
A - Profit / Loss		
Income/Gross Profit	\$	\$
Less Total Expenses	\$	\$
Total A - Profit / (Loss)	\$	\$
B - Income -Add backs <i>(Complete relevant fields)</i>		
Salary/Wages (from the business)	\$	\$
Home office/Rent	\$	\$
Home office expenses (portion of phone, internet etc)	\$	\$
Management Fees	\$	\$
Professional Fees	\$	\$
Depreciation	\$	\$
Interest	\$	\$
Total B	\$	\$



Income Protection - Drawings

- True drawings are not income – they are an advance from the business from its capital not its income
- They may be taken without the business having the income to support them, i.e. it doesn't make as much profit as is drawn
- Creates a shareholder current account owed to the company
- Tax is not paid on these drawings by the person taking the advance of funds
- Generally insurers will not cover drawings for IP in this form
- If the client takes a regular 'drawing' which is then assigned to a shareholder salary and tax is paid on that salary then it is income



Income Splitting

- Less common now than 5-10 years ago due to changes in IRD's position and changes to tax rates for trusts
- Total income can be recognised as the insured provided
 - Income is earned solely by personal exertion
 - Spouse does not perform any duties in the business
- Distribution to Trusts
 - Income distributed to trust can be recognised if from personal exertion and the trust is a non-trading entity

ACC

- Understanding ACC policies and advising on this is an key element of risk management in the microbusiness sector
- Many small business owners will not have an optimal ACC structure especially following the implementation of Income Protection
- Your advice may enable them to save money on their ACC premium and reduce duplication of cover
- Key areas for advice are:
 - their occupational classification
 - ACC benefit type: Work Place Cover, Cover Plus, Cover Plus Extra
 - setting the sum assured for agreed value ACC

Recap – Microbusiness Risk Analysis

- Understand the income the business generates to the household
- Understand the debts/obligations that have been guaranteed using personal assets
- Ascertain the Key Person risk
 - Business Continuation requirements
 - Wind Up outcomes
- Quantify potential insurable income
- Identify if advice is needed on ACC structure

Personal Risk Analysis

- Based on Personal Situation identify the events that could cause financial risk and need to be assessed to quantify insurance needs
- Consult with customer to understand their objectives following each type of event
- Apply Personal financial analysis process to calculate insurance requirements taking into account the income that will flow from the business or business insurance and the capital that will flow from the business or business insurance

Life Time Calculator Approach

- Maps client's expected cashflow needs over lifetime for death and permanent disablement (PD)
- Maps client's expected income flows (earned and passive) over lifetime following death or PD
- Calculates the annual gap
- Takes the future value of those sums and converts it to present value based on key assumptions and annuity formulas
- Offsets capital and assets that are sold on event to give final insurance requirement

Gary and Mary's Personal Needs

Calculation Summary - Insurance Requirement

	Gary Watts		Mary Watts	
Life	\$ 588,000	More...	\$ 516,000	More...
TPD	\$ 275,000	More...	\$ 618,000	More...

Key Assumptions

- Business debt and wind up costs are covered under business risk plan
- Gary keeps working following an event to Mary (after a 3month break on death and 1 year on TPD). Costs for home help and childcare are factored in until youngest child is 15
- Mary returns to part-time teaching following an event to Gary and once both children reach school age and then goes full time once the youngest is 15
- Remaining mortgage is repaid
- The current level of lifestyle is maintained – net of debt repayment household outgoings are \$30,000 pa until children are independent at age 21
- Pre-retirement lifestyle -\$25,000 for couple
- Post retirement income of \$25,000 for couple and \$20,000 for single – assumed Govt Super
- Gary's earnings are protected with Income Protection

Total Insurance Requirement

Gary	Benefit	Sum Assured	Owner	Mary	Benefit	Sum Assured	Owner
Business Continuation	Key Person	\$11,283 3mths \$5,883 3 mths	Gary Electrical Limited				
Business Windup	Long Term Disablement and Life Cover	\$260K	Wire Family Trust				
Loss of Income	Income Protection	\$3,375 per month	Gary Watt				
Death	Life Cover	\$590K	Wire Family Trust No.2	Death	Life Cover	\$516K	Wire Family Trust No.2
Permanent Disablement	Permanent Disablement Cover	\$275K	Wire Family Trust No.2	Permanent Disablement	Permanent Disablement Cover	\$618K	Wire Family Trust No.2

Estate Planning

- Appropriate Estate Planning is a key element of any Risk Plan
- Achieving the objectives of the insurance cover will be to some extent reliant on the estate plan
 - right hands, right time, right place
 - certainty from unforeseen events
- It avoids a person dying intestate or becoming incapacitated without some-one chosen with authority to administer affairs
- Key tools:
 - Wills
 - Trusts
 - Memorandum of Wishes
 - Enduring Powers of Attorney – health and wealth
 - Child Guardians

Risk Plan Framework

Objectives of the Risk Plan

1. Ensure the customer understands the purpose of the plan and any relevant limitations
2. Demonstrate that you understand the customers current situation and are aware of relevant facts – know your customer
3. Demonstrate that you understand the customers needs and to show how these have been taken into account to analyse their financial requirements
4. Explain how the recommendations you are making are suitable for their needs

Microbusiness Risk Plan 'sections'

1. Purpose of the Risk Plan
2. Executive Summary
 - Overview of Business and Personal situation
 - Summary of findings
 - Summary of recommendations
3. Business Risk
 - Ownership and Operational Diagrams
 - Key Person Description
 - Key Person Problems
 - Key Person Financial Analysis – Continuation/Windup or Sale
 - Key Person Requirements – financial and insurance solutions
4. Personal Risk – each event should have explanation for the basis of how the requirement was calculated and your recommendation on the insurance
 - Death
 - Disablement – Loss of Income
 - Disablement – Permanent
 - Trauma
 - Medical Costs
5. Estate Planning
6. Appendix
 - schedule of insurance, insurance product comparisons

Microbusinesses Need our Advice

