remedy
taking care of business

Key man insurance - is it for small businesses?

Key man insurance is often seen as only being necessary for big companies and as a result only one in five SME's take out this type of cover. A contingency plan is not enough to protect your business from the prolonged absence of a crucial person.

Key man insurance is a form of life insurance, and covers the loss of profits if a business loses a key employee due to serious illness or death. It provides a payout to cover temporary staff, recruitment, or an injection of cash into the business. To decide whether to take out key man insurance on an employee, consider the impact on your business if they were absent for a length of time, and unable to impart their particular expertise.

Often when providing finance, a bank will insist on Key man cover for the most important people as a condition of the deal to protect your ability to repay them. Replacing a key individual is costly and the business will suffer in the short time, and it always takes longer than expected to get someone else in, and up to speed.

Who should be covered?

To identify your key employees, and to decide if you need key man insurance, assess how a person's absence would affect you by going through different scenarios. If one employee does all the company selling, but they have skills that can be found easily elsewhere, key man insurance won't be particularly valuable.

However, if you have one person who is the technical brains in the company and the business would suffer badly if they weren't able to work, you should consider taking out key man insurance. In many SME's, the business owner is the key person, so without them there is no business. You should also consider key man insurance if an employee has a specific network of contacts or unique skills, experience or knowledge.

Create a contingency plan

You should avoid being overly reliant on any one person, but in small companies this can be difficult. As far as possible you should ensure the employee shares their skills through internal training, or if they are the only person who has certain data, ensure that they make it accessible to everyone. This won't cost your business anything but time. Consider training staff to multi task so that all key jobs can be covered at all time.

If your key employee co-owns and invests in your business, share protection insurance could be more appropriate. If the business wouldn't be able to continue without someone, key man insurance might not have any value. It isn't easy to extract money that's tied up in a business, so share protection insurance at least allows the partner's widow or widower to buy out the deceased's share.

The cost

The cost of key man insurance depends on your business value, but it is difficult to predict the profit the firm will make, and how much is generated by the key person.

Life insurance products such as key man cover tend to be cheap, although the older the employee is, the more expensive it is. The employees' health will also influence the premiums and they will be considerably higher if, for example, they smoke. Talk to an independent adviser or your current business insurance provider about how much cover to take out. Most businesses can decide if key man insurance is worth the cost based on how much of a problem losing a particular employee would cause.

REMEMBER

If the business treats key man premiums as a tax deductible expense, any payout will be treated as income to the business and will be subject to Corporation Tax.