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BUSINESS INSURANCE 101

A No-Nonsense Guide To Managing Your Business Insurance Costs

By Michaela Cavallaro

Scott Simmonds has worked in the insurance industry for 20 years, most of them in Maine. That means he's seen the business insurance market go from hard to soft to hard again. Although he says the market was dismal immediately following Sept. 11, Simmonds is seeing signs of better days ahead for business.

These days, Simmons runs Insurance Consultants of Maine, a Saco-based one-man consultancy that helps businesses analyze their insurance needs and purchase the appropriate coverage. Simmonds works on a flat fee-basis, believing that any other fee structure would affect his ability to provide impartial insurance advice. His clients include Delorme in Yarmouth, Gorham Savings Bank and the Dingley Press in Lisbon.

Mainebiz recently spoke with Simmonds about how businesses can manage their insurance costs.

My sense is that small business owners often feel like all of the changes in the insurance market happen externally to them, and that there's not much they can do to control their costs. I've read some articles recently that suggest that's not the case.

It is not the case at all.

So what can businesses do on their own?

The first thing that they need to do is to start early. If your policy's coming up for renewal next month, you're limited in what you can do. You need to be looking a minimum of four months out, starting to have conversations with your agent and trying to get a feel for what's going to happen with your particular policy — how is your insurance company responding to the market? What's going on relative to you? Certain companies are doing things, and your agent will be able to say, gee, company X is generally doing this with your kind of business, so we're going to respond in this way.

Take a look at what's really important to the business relative to protection. If we go back five or six years, insurance companies were throwing coverage onto policies at no premium. If it's free, it's worth it. But now we're in a marketplace where the insurance companies are saying, okay, we want five grand for that. At five grand, you've got to make some value decisions. Just because you had the particular coverage last year doesn't mean you need it this year.

And every year, I advise my clients to take a look at the value that you're receiving, the risk that you're facing, and make some decisions, making sure that you're putting the money, the premium dollars, where the real hazards are. Deductibles are a perfect example of that. There are many businesses out there that have a $1,000 deductible on a property insurance policy. Well, bumping that up to $5,000 is going to save them a couple hundred dollars in their premium, perhaps. And a $5,000 bill is not going to break a lot of businesses. If we take that $200-$300 [saved] and we increase the liability coverage from half a million to a million, or we get an extra layer on the umbrella, now we're talking about things that could put somebody out of business. If they have an automobile accident and they only have $500,000 of liability coverage, and the lawsuit against them is for $1,000,000, that could put you out of business.

Competition is a very important part of the insurance business. And sometimes it's just the threat of competition. It isn't right, and it isn't wrong, it's just the way business is. So competition is very healthy, and it does help for a business person to keep from losing coverage, and it will moderate some of the price increases. Even in this marketplace, insurance companies still don't want to lose every piece of business they have. Again, it isn't a negative in an insurance business; in every business it's that way. So competition is an important part of what folks should look for.

They have to be comfortable with the person that's providing them with insurance advice. Back when I first started in the insurance business, somebody told me that the most important part of the insurance transaction is a relationship that an agent has, or an advisor has, with their client. It's absolutely true. If you don't have a high confidence level that your agent is really doing the job for you, find somebody else — because it's not working for him or her, either. It's got to be a close working relationship. And if there are questions or concerns, have frank discussions about what's happening — what are they doing for you, what do they plan to do for you and how the whole thing's coming together. And don't be afraid to bring in some other people if that's what you need.

People talk a lot about risk management. Can you explain that? Does it mean looking at the value of one coverage versus another, or is it more specific?

That's part of it. And the term risk management is getting thrown around more and more. To an insurance person, risk management is a process of how to address a particular risk. You identify exposures. You look at an operation, you look at an organization, and you say basically, 'what can go wrong that will have consequences?' You identify the exposures, you look at the processes, you look at the holes in the process, you look for things like reliance upon a single supplier. If you're manufacturing widgets and there's a component of the widget and the only place to get that is from one source, that's a weakness in the process. Because if their plant burns, even though your factory hasn't burned, you've been impacted. So the first step in risk management is to analyze the risk.

Then you take those risks and you look at the ways that you can treat them. You can retain the risk — you can say okay, I'll deal with that. If you have a laptop computer that you use in your home-based business, and you take it out onto the street, you are retaining that risk because your insurance policies aren't going to address that. So you can take the risk and realize that if something happens it's going to cost you.

You can transfer the risk. Insurance is a transfer mechanism. Rather than my being on the hook if my car is damaged in an automobile accident, I transfer that to an insurance company. You can also transfer risk in a non-insurance way. I'm a landlord, you're the tenant. I can transfer my risk of the building burning down to you, my tenant, contractually. So now I don't have to buy insurance, but you do. So I'm still transferring the risk, but I'm not using insurance to transfer. You are. I transfer the risk to you, you transfer it to the insurance company.

You can separate the risk. I have one big warehouse. If that warehouse burns, I'm in trouble. So as a risk management tool, I buy two warehouses. And I take half my stuff and I put it in the other warehouse, which is across town. The chances of both burning down are very, very slim.

You can avoid the risk. I'm not going to have inventory anymore. Right now I have half-million dollars of inventory, but I'm going to set up a system with my suppliers so that they're going to deliver the stuff that I need, right when I need it. Just in time. So now I don't have a warehouse, now I don't have the exposure of the inventory. I may look at a line of business. I make clips for men's belts, ladies' belts, and I also do parachute clip belts. Little exposure, big exposure. I can avoid the risk by saying, 'I'm not making clips for parachutes anymore,' and go out of that business. Or you go out of business completely. That's another way to avoid the risk.

We've talked about analyzing the risk and treating the risk. Then you implement the treatment — you buy the insurance, you implement the contract. So you've made a decision how you're going to implement that plan, and then the fourth step is always to go back and make sure what you did was right. Monitor the system so you've got a loop that's happening. Just because all of the exposures have been identified today doesn't mean that a branch manger is all of a sudden going to take on an exposure next week that he doesn't think is a big deal. So you have to continually be looking at and going through those four steps.

So when you work with clients, you have to be cognizant of what their business entails. I can't just call you up and say, 'I run a bike manufacturing shop and I need some insurance.'

No. I need to come out and sit down and talk. We need to talk. And we're not going to talk about insurance, we're going to talk about your business. Where do you get the stuff? What do you do with it once you get it? What do you do with it once you're finished with it? How does it get into the customer's hands? Who owns it as it's being shipped from A to B to C to D? What's coming at you competitively? What properties do you own? I review financial statements. That helps me identify some exposures that we haven't talked about. I'll do some research into the industry to find out what trends are going on. So yeah, it's not slap-dash, but the same thing is true of an agent. An agent can't just dash out and say, yeah, that's what we're going to do. There are some industries that you almost can.

Because one shop is so similar to another?

I mentioned I do a lot of work with banks. Well, to some extent a bank's a bank's a bank's a bank. But, there are still curves out there, and it's easy to sit back and say, 'I don't need to visit all the branches.' Well, yeah, you do. You need to go out and take a look at what's there, how it's set up, what the issues are.

My practice is heavy on the insurance side. There are some people that are risk managers, and most of what they do is non-insurance work. In the Maine marketplace, with the size of businesses that we have, very few businesses can go off and say, 'I'm going to start a captive insurer and own my own insurance company.' For the most part, the best way for businesses in Maine to treat risk is to actually insure the risk. For some it's to set up a form of self-insurance, but think of that as a big deductible. So the people in Maine that have self-insured workers' compensation plans, they're putting money into a bank account to pay claims, and if the claims are bigger than what that bank account is, there's another insurance policy sitting next to them to take care of that. Now over time, with management and with loss-control work, that pot of money grows so the amount of insurance you need shrinks. But there still is an insurance component that may not exist for larger companies.

What trends do you see happening in the industry, whether specific to businesses in Maine or that may have a wider impact?

We're moving in the right direction. The marketplace is softening. [Insurance companies] are starting to talk about again going out and getting new business. I'm not sure if that's six months away or two years away, but I feel a whole lot better now than I did three months ago, when there was absolutely no light at the end of the tunnel.

[Also,] many businesses don't use the resources that are available to them to help them manage their risks. Insurance comes in after the fact many times. A building's burned, an employee's been injured, the damage has been done. Insurance companies have a lot of resources available that can help somebody prevent those from happening, be it videotapes, training programs, brochures.

I work with a client who's having some problems with losses on their workers' compensation. Well, let's get the insurance company in here to help you. Some companies have the resources and, frankly, some companies don't have the resources to do that. Part of what I do is say, 'Look at who you're dealing with here.' Liberty Mutual has the horses to help a large manufacturing organization with workers' comp claims problems. A company like Middlesex Mutual, while they're a fine insurance company to insure apartment buildings, they may not have the real resources to take care of what you need. There's a marrying that goes on in an appropriate match [between an insurance company and a client]. To some extent, it happens almost automatically.

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