

# Business Interruption



## What have you got to lose?

Imagine a company whose results at the end of a financial year could be expected to look like this:

<b>Turnover</b>		\$1,000,000
<b>Charges which may vary with Turnover</b> (Purchases, Carriage, Power etc.)	\$450,000	
<b>Non-variable/standing charges</b> (Rent, Rates, Salaries etc.)	\$150,000	
<b>Productive Wages</b>	\$300,000	
<b>NET PROFIT</b>	\$100,000	
	\$1,000,000	\$1,000,000

But a fire occurs which reduces production by 50% for a period of 6 months.

Although some employees are laid off, it is not possible to reduce wages proportionately because of the liability to make Redundancy Payments. And, of course the non-variable charges do not reduce at all.

But even to maintain 50% of production during the period of interruption, it is necessary to spend \$15,000 on emergency measures.

The actual results therefore will look like this:

<b>Turnover</b>		\$750,000
<b>Charges which may vary with Turnover</b>	\$337,500	
<b>Non-variable/charges</b>	\$150,000	
<b>Productive Wages</b>	\$282,500	
<b>Additional Expenditure</b>	\$15,000	
<b>NET LOSS</b>		\$35,000
	\$785,000	\$785,000

**So a 25% reduction in turnover has not merely reduced Net Profit – it has turned it into a Net Loss.**

## How would a business interruption policy help?

Suppose that this company had the foresight to insure. It would have a policy covering Gross Profit, which would be defined and calculated as:

<b>Turnover</b> (i.e. Sales after adjusting for Opening and Closing stocks)	\$1,000,000
<b>Less Variable Charges</b> (i.e. Purchases, Carriage, Power etc.)	\$450,000
<b>GROSS PROFIT</b>	\$550,000

for a Maximum Indemnity Period which we recommend to be not less than 12 months.

## This policy would pay-

i) for the reduction of turnover –

The normal ratio of Gross Profit to Turnover	x	The reduction in Turnover during the Indemnity Period	less	Any saving in charges due to the damage
(55%	x	\$250,000)	less	\$17,500 saved on wages
<b>= \$120,000</b>				

ii) for the additional expenditure –

The amount of that expenditure (\$15,000) provided that it has avoided a loss of Gross Profit of not less than that amount. It has, in fact, avoided a loss of 55% of \$250,000, and the policy will therefore pay it in full,
<b>= \$15,000</b>

**So the total payment will be \$135,000 and if this is added to the actual results shown above it will be seen that the expected Net Profit of \$100,000 is now achieved, and the firm has been able to meet all of its continuing expenses and pay its full wage roll...**

**and that's good business!**

# Business Interruption Calculation of Gross Profit Sum Insured



Insured  Date  /  /

## Part 1

Indemnity Period (longest period you might need to claim) Months   
 Date last financial year ended:  /  /

## Part 2

1. Annual Turnover (money paid or payable to the Insured for goods or services sold by the business)  \$
2. Plus Closing Stock (value of stock on the last day of the Insured's financial year)  \$
3. Less Opening Stock (value of stock on the first day of the Insured's financial year)  \$
4. Less Specified Expenses mentioned below. These expenses would reduce in same ratio as turnover during the period of interruption.

(a) Purchases	<input type="text"/>	\$ <input type="text"/>
(b)	<input type="text"/>	\$ <input type="text"/>
(c)	<input type="text"/>	\$ <input type="text"/>
(d)	<input type="text"/>	\$ <input type="text"/>
(e)	<input type="text"/>	\$ <input type="text"/>

Totals  \$  (B)  \$  (A)  
 Historic Gross Profit = (A) above less (B) above  \$

## Part 3

+ Allowance trends (increase should be compound):

- a) Growth between end of last financial year and the start of the insurance year (less than 12 months) +  % =  \$
- b) Growth during period of insurance (generally 12 months) +  % =  \$
- c) Growth during period of indemnity (up to 12 months) +  % =  \$

Adjustment for Indemnity Period that exceeds 12 months eg. 18 month Indemnity Period x 1.5 or 24 month Indemnity Period x 2 +  % =  \$ (C)

Suggested Gross Profit Sum Insured  = (C) above (rounded)  \$