

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:

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

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

Turnover (i.e. Sales after adjusting for Opening and Closing stocks)	\$1,000,000
Less Variable Charges (i.e. Purchases, Carriage, Power etc.)	\$450,000
GROSS PROFIT	\$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
= \$120,000				

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,
= \$15,000

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 \$

(b) \$

(c) \$

(d) \$

(e) \$

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) \$