Business Planning

Key-person insurance: A valuable and important tool for business owners.

By Arthur Reed Snyder, Jr., JD

As a business owner who knows who your key people are, you know why their involvement in your business is so important. You also know what might happen to your business if they leave unexpectedly. But do you know how key-person life insurance can help mitigate those risks?

As you think about the hardships your business might suffer if a key person is unexpectedly lost, consider the following ways key person insurance can be a valuable addition to your business planning strategies.



What is a key person?

For business owners, a key person is basically an employee who is critical to the continued success of your business. He might be the creative inspiration behind your business's success. That thinker who creates products, recipes, processes. A key person's loss may tie directly to your business's ability to generate future revenue from those ideas. She might be that gregarious person that brings new clients through the door, a sales manager who's never met a stranger. The loss of that person can tie directly to your business's ability to generate new clients and customers and derive revenue from those connections. Your key person might possess rare knowledge or a unique skill set, and if that employee is lost, your business's ability to perform a critical process may be impaired, resulting in a loss of revenue.

What is key-person insurance?

Key person insurance is simply a term of art used to describe the purpose or use for which a life insurance policy has been earmarked. Key person life insurance is the most immediate, efficient, and responsive tool that your business can implement to help it bridge the gap of uncertainty that arises after losing a key person.

The death of a key employee

The death of a key employee can result in a time of uncertainty and chaos throughout your entire organization. The death benefit paid from a key-person life insurance policy can provide a financial cushion for your business. The proceeds of the policy can be tasked with serving many purposes as your business tries to find its way forward. The death benefit can facilitate the search for new ideas. It can provide a resource to help with the loss of customers or supplement lost revenue until new customers can be secured. It also can help with the process of replacing knowledge or skills.

If the loss of a key person is not immediately critical to business operations, the death benefit from key person insurance can be earmarked to facilitate the process of securing the key person's replacement. Market demand for the replacement your business needs may cause the cost of replacing the key person to increase sharply. The death benefit is an excellent resource that can be allocated towards that increased replacement cost and cover other expenses as you integrate a new employee into your business. Your business may also find it needs to pay a higher salary to secure a qualified replacement. The death benefit can ease the increased burden of these costs. The death

benefit also can be used to mitigate the cost to your business if the first replacement isn't suitable in the short term and you need to start your search all over again. You might find that you can't replace that key person with just one new employee. You might need to find two or more people just to replace that one key person's unique skill set.

The loss of a key person can also have an impact on your business in significant but intangible ways. The loss of a key person can weigh heavily on your business's employees as they come to terms with the loss. Your business's momentum can be dampened while your employees grieve and come to terms with uncertainties tied to both the loss and the changes your business must now face. The vision for your business's future can be impacted by the loss as well. Motivation and focus will likely suffer during this period of uncertainty. The death benefit from the life insurance can provide a helpful financial cushion during this time of uncertainty as the business finds a new path forward. Regardless of where that path forward leads, whether from refocusing and motivating employees or redefining the business's vision, a key-person insurance policy can provide breathing room.

Along with the intangible effect the loss of a key person may have on your employees, it's also possible that the key person is part of your family. At a time when your business is on uncertain ground, you may be dealing with personal loss. When that happens, you may not be in the best frame of mind to handle the day-to-day affairs of running your business. It is at this time that the death benefit provides a much needed financial cushion that can help ease some of the burdens you must face while you and your family begin the process of recovering from your loss.

The departure of a key employee

In the ordinary course of your business's life cycle, you've likely lost a key person for reasons having nothing to do with death. At some point your key person may choose to leave your business. While your business finds itself in the same position of uncertainty, no death has occurred to trigger a death benefit payment. At these times, the value of whole life insurance becomes clear. At the time of need, given a sufficiently mature policy, cash value in the policy can be used to address many of the uncertainties discussed above.

As time marches on and the uncertainty of a key person's departure has been resolved or its significance is lessened with time, the life insurance policy does not necessarily need to be surrendered. It can be maintained and then earmarked for new purposes. The cash value and death benefit can be tasked to fulfill any number of new objectives. The cash value stands as a ready reserve and can be utilized to satisfy cash needs outside of the avenues ordinarily available to your business. When ultimately paid, the death benefit can be allocated to any number of purposes to facilitate the growth of your business. The value of the policy remains intact even though the specific purpose for which it was originally earmarked may have evolved or become irrelevant.

In summary

These are just a few of the ways that key-person insurance can play a role in supporting your business through the uncertainty of losing someone you feel is critical to your success. The financial impact of losing a key person can be mitigated, the costs of replacing them can be supplemented, the impact on your business from losing momentum or focus can be cushioned, and you and your people can be given breathing room to grieve and recover from loss.

Talk with your financial professional to learn more about how this valuable tool can play an important role in your business planning strategies.



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