Small Business Success Podcast:

Cash Flow and Inventory Control

The **SCORE Small Business Success Podcast** features interviews with the best and brightest in the world of small business, covering topics such as business plans, financing, marketing, human resources, SEO, social media and more. In this podcast, SCORE mentors chat with Jami Schwartz and Allison Boswell.

As the head of community programs at Kabbage, Jami Schwartz educates small businesses about financing options and the benefits of online lending. Before Kabbage, Jami worked for Intuit. Jami holds an undergrad degree in finance from the University of Pittsburgh and an MBA from Boston University in marketing and international finance. Kabbage is an online lender offering lines of credit up to $100,000 for companies that have been in business for at least one year. Since its inception, over 100,000 loans have been made in excess of 2 billion dollars to small businesses.

Allison Boswell started her retail consulting business in 1985. In 2010 she joined Management One, a part of the Reedy Consulting and analysis team. In addition to planning, Allison worked with her clients on employee compensation, training, social media, marketing, and vendor relations. She has been working with clients for as long as 27 years. Reedy Consulting has won a number of awards, including best client retention and highest annual sales.

Fred Dunayer: Welcome to the SCORE small business success podcast, Been There, Done That. To get free mentoring services as well as to see the wide variety of resources available for small businesses, visit our website at www.score.org or call 1-800-634-0245, and now, here's your host, Dennis Zink.

Dennis Zink: Episode number 42. Cash flow and inventory management. Fred Dunayer joins us today in our studio as co-host, score mentor, and our audio engineer. Good morning, Fred.

Fred Dunayer: Good morning, Dennis.

Dennis Zink: Our guests today are Jami Schwartz and Allison Boswell. Welcome to Been There, Done That.

Jami Schwartz: Hi, guys. This is Jami. As a partner of SCORE, we're very happy to be here.

Allison Boswell: Thanks so much for having me.

Dennis Zink: Let's start with the most basic question. What is cash flow?

Jami Schwartz: Cash flow is the actual amount of money coming in and out of the business, and here at Kabbage we actually use that information to determine the credit worthiness of our customers.

Dennis Zink: What do you look for as far as credit worthiness?

Jami Schwartz: We're looking at positive inflows and outflows of cash, so obviously the more cash you have coming into the business that covers your overhead expenses, the better.

Dennis Zink: Jami, when I run a business I look to have my cash flow at a ratio of about 2 to 1 where I had about twice as much revenue coming in as expenses. Does that number make any sense or does it depend on the business?

Jami Schwartz: It definitely depends on the business. Obviously, the higher your ratio, the better, but here at Kabbage we're looking for healthy cash flow, which is the consistent inflow of cash that is covering your day to day expenses.

Dennis Zink: When a business grows, one of the things that stresses is cash. The more you grow, the more successful you are, the more it stresses your cash. How does Kabbage get involved with that?

Jami Schwartz: If businesses grow, they sometimes outgrow their needs. Here at Kabbage, we provide a smaller credit line up to $100,000, so at that point if you're needing more then there are other options available, but here at Kabbage if you're growing into a new space, trying to cover your inventory costs, et cetera, then Kabbage could be a good fit.

Dennis Zink: What's the most common mistakes that you would say that small businesses make when it comes to cash flow?

Allison Boswell: Hi, this is Allison Boswell. For new business owners, it's being under-capitalized, because they don't estimate their expenses accurately. If you're in a new business, you give your best shot at your expenses and you usually start with a finite amount of money and sometimes it's really not enough to do what you need to do. For established stores, it's not having an accurate forecast. I hear all the time from clients, "Oh, I've only been in business one year, two years, three years. I can't really predict what my sales are going to be," but really if you have 12 months worth of sales, you do have a benchmark.

There are many different ways of planning. You can at least take a look at last year and decide, well, am I looking for an increase? You have to remember that hoping for an increase is not the same thing as planning for an increase, and you need to have a strategy for what you're going to be doing differently than last year if you're planning to grow. Is that for inventory, promotions, fresher merchandise? If you don't have a plan, then you can't, for one, estimate what your cash flow needs are going to be.

Dennis Zink: Many businesses strive to have recurring revenue streams as opposed to selling onesies and twosies. I mean, when you can start your month and know you've got so much booked in the bank that should be coming in, does that help in the lending process? There's a guaranteed cash flow that's coming in as opposed to a business that's just dependent upon people walking in and selling one thing here, two things there.

Jami Schwartz: It's always better to have an understanding, like Allison mentioned, of what your expected cash flows are going to be. With that being said, there are a lot of businesses that are seasonal, and no, they don't do as well in certain months as others, and that's a perfect example of when you could use a financing option, so if you know that the summer is your dry season then you want to plan ahead and make sure you have something that'll cover your costs, so a lending option like Kabbage, and then when you're expecting your revenues to occur in the fall or winter season, then you're prepared to be able to pay back that loan.

Dennis Zink: What kind of tools would you say are important when planning cash flow?

Allison Boswell: Well, for one, having an up to date profit and loss statement so you know what your average expenses are, excluding merchandise. I'm speaking mainly of retail here, but this applies to a lot of businesses that carry inventory. You want to look at your income statement. Have your accountant set it up so you're looking at your expenses as a percent of your sales. For instance, if your sales are $100,000 and your payroll is $20,000, then your payroll is 20 percent of your sales. This makes it easier to see the consistency of your business. High expenses jump off the page so you can say, "Wait a minute. I'm spending a lot of money on payroll. Is this really what I need to be doing?" When you look at just dollars, it's very hard to make sense of it. When you look at the percentages, it makes it a lot clearer.

It also gives you the opportunity to compare yourself to like businesses. If you can get a hold of industry standards, you can say, "Okay, well the average rent should be under 10 percent. Then I know whether I'm high or low."

Fred Dunayer: One other thing, and this applies especially to very small businesses that are just getting started, is to actually plot your cash flow on a calendar to actually look and see what dates cash is coming in and what dates cash is going out and to get a real feel for what the ebbs and flows of your cash flow are all about.

Allison Boswell: Absolutely. It's also important to have your sales planned out 12 months so you know, and most businesses do have an ebb and flow. Some people have huge Decembers, but that's not true for everybody. Often stores that have a big December business or businesses that have a big December business tend to have a really poor January, so that really can put a pressure on cash flow.

Dennis Zink: What's a common misconception about profit and cash flow?

Allison Boswell: Well, that they are the same thing. I see a lot of businesses that show profit but are strapped for cash. Typically that profit is tied up in excess inventory. The calculations on your P&L do not necessarily reflect your bank balance. You can also have great cash flow and no profit. It just depends on your capital position that you start with. If your profit is tied up in inventory, you need to take a look at the value of that inventory. If it's older merchandise, it's probably not doing you any good. You'd be better off liquidating and taking the cash. Sometimes people stockpile inventory. They say, "Oh, gosh. We use this year round. We get a price break if we buy a lot ahead of time," but it puts a lot of pressure on your cash flow then it's not really best use of your money.

Getting inventory in smaller amounts more frequently is much better for your cash flow, and that also gives you the opportunity to change your inventory mix as you see trends in the marketplace.

Dennis Zink: Would you be referring to Just In Time inventory, JIT?

Allison Boswell: Not necessarily. It depends on the kind of business you have in retail, clients can spend money for immediate within the 30 day window all the way up to 6 to 9 months out, and the closer to the season you buy your merchandise generally speaking the better buy you're going to make.

Dennis Zink: What's more important to a business? Should it be their cash flow or their profit?

Allison Boswell: Again, it does depend on where you are, but cash flow is king, so the more cash flow you have, the more opportunity you have to grow your business.

Dennis Zink: You know, I couldn't agree more. I think a lot of businesses, they have their P&L, and they have their balance sheet and they really ignore their cash flow. When you're out of cash, you're dead, basically. You're out of business, so I would agree. That's incredibly important, but let me ask you, what should a business owner do if a business has trouble paying their bill seasonally?

Allison Boswell: If a business has a lot of seasonality due to sales, I mean, some months are dramatically higher than others, chances are they will feel strapped at certain times of the year. This is the best reason to have a line of credit when you have a temporary dip in cash flow. I plan cash flow for many of my clients, and they often have a few months each year where they're in the red, and that's really okay as long as we're not seeing a trend spiraling downward. If you typically pay your invoices within 30 days and two or three times a year, you're in a 60 to 90 day range, you're probably doing better than a lot of businesses, but this is a perfect reason to have a line of credit so you don't even have to do that.

If you're increasing your debt every month, then you have a problem that you need to address immediately. It's not going to resolve itself, and you need to change what you're doing and be realistic about the future.

Dennis Zink: Jami, does Kabbage set up a line of credit when let's say a business needs $75,000, is the money available and have to take it all at once or is it available as a line of credit where they are charged interest when they draw it down?

Jami Schwartz: It is a traditional line of credit, so just because you have an amount available to you doesn't mean you have to take all of it. You'll only have to pay for what you take out. It's a monthly payment based on what you take out. It's either a 6 month term or a 12 month term, and it's also a revolving line. Something unique about Kabbage is we're looking at your business data in real time, and so we're able to see those ebbs and flows in your cash flow and perhaps extend your line of credit or lower your rate depending on what's going on in your business.

Dennis Zink: How do you do that real time?

Jami Schwartz: It's all connected through your online accounts, so when you sign up for Kabbage, we're actually sending a direct API directly into your online bank account, any other online bank account that you have associated with your business, so your payments account, your Quickbooks account, anything that you have online, and we're able to look at that data in real time.

Dennis Zink: Allison, how does turnover impact cash flow?

Allison Boswell: It's very important. As I was talking before about businesses that stockpile inventory, the more often you turn your merchandise, the better your cash flow is. If you're buying inventory twice a year, turning your inventory twice a year, that means you've got six months worth of inventory that you're hanging onto. If you turn our merchandise four times a year, then you only have merchandise for three months. In retail businesses, the faster the turn, it usually translates into higher sales as well, because fresher merchandise is more exciting to the customer and sells faster. The older the goods are the less attractive they become.

Dennis Zink: Is there an ideal number of turns or does it depend on the industry? I mean, is there a range that if I'm selling gifts merchandise, is there an x amount of turns I should be looking to have per year?

Allison Boswell: It's actually got quite a wide range. In some businesses a two turn is an acceptable ratio. When we plan our clients' businesses, we don't plan it on the store level. We actually plan it on the classification level, so we would plan gifts differently than we would plan shoes differently than we would plan apparel. It really does change dramatically within the industry.

Dennis Zink: What do you think about using credit cards to fund inventory? Small business owners has got to use every method they can to do whatever they have to succeed, and certainly I know I've done that over the years. What do you think about using credit cards?

Allison Boswell: Well, it's not something that we recommend. The most common reason I hear for doing it is miles, and when you use credit cards to fund inventory, you lose control over the transaction. The vendor can charge you whenever they want and it limits your ability to cancel goods or turn goods, negotiate markdown money, and refuse late deliveries. Line of credit is a much better way of handling inventory purchases and will help you establish credit with vendors, which credit cards will not do.

Dennis Zink: I have to tell you that I absolutely agree with your answer, but my dentist was very, very successful and he never paid to fly anywhere. He had more miles. He bought all his dental equipment and fillings and whatever he bought using a credit card, miles card.

Allison Boswell: We have clients like that. I have a client who does $12 million in sales. They get free everything.

Fred Dunayer: Of course you might be paying 18 to 24 percent interest on those things that you've bought, as well.

Dennis Zink: Well, he paid it off right away.

Allison Boswell: Yeah, if you're not paying your bills, then you're really in trouble.

Dennis Zink: Does discounting merchandise hurt cash flow?

Allison Boswell: Not really. It depends. You have to start with a healthy markup to begin with, but markdowns or discounting is a normal part of business and sometimes it can actually improve your cash flow. When people are holding onto merchandise that really isn't saleable anymore, it's been sitting there for 6 months and you're just hoping somebody's going to come in and want it, chances are, they're not, but if you mark it down you can get the cash out of it. Then use that money to buy merchandise that will maybe be more appealing to your client and turn faster.

Dennis Zink: What do you think about businesses that offer buy one, get one free? How do they do that?

Allison Boswell: Well, that's a promotion, and it's one that it's usually done on things that are moving slowly. It's not something you would do on a hot item, but if you're overstocked and you're trying to reduce your inventory and get out of the problem, it's a good way. You could mark things down at half off, but often a buy one, get one free, which is basically the same thing, you're getting rid of more units, so it can be a good strategy.

Dennis Zink: What's the most important thing a business can do to improve their cash flow?

Allison Boswell: For most businesses, it's controlling their inventory and controlling their buying. When I ask new clients how they decide what to buy, many say, "Well, I just bought what I bought last year," but how do you know if you bought correctly last year? What if you want to grow your sales? You can't do the same thing and expect a different result. I encourage you to look at your business again by classification, not by SKU, vendor, or department but really drill down. If you're a clothing store, what's your top business? What's your pant business? What's your jacket business? What's your dress business? Vendors and SKUs change dramatically from season to season, so there's not that much you can learn from that.

Your customer buys by classification based on need, so you're buying -- it should reflect that need. Those things will stay fairly consistent year over year when you look at the classes and vendors and styles will change. You might have the appropriate amount of inventory in your store, but if it's not allocated correctly, it's still going to be a problem, and carrying too much inventory is probably the number one reason why stores have poor cash flow.

Dennis Zink: There's a show you may have seen on CNBC called The Profit, and it's a fellow, Marcus Lemonis goes into various businesses and he wants to invest in the businesses if they're successful. About. it seems like 50 percent of the time he goes into their back room and he finds tons and tons of stuff back there that has never sold, never will sell, and it seems like that's his first occupation in there is to get rid of that stuff. It seems like inventory control is a real serious problem in the retail industry. Can you elaborate a little bit about how that happens and what the best strategies are to deal with it?

Allison Boswell: Yes. First of all, we love Marcus and it is a big problem. Mainly, people don't really know that your POS system is supposed to be telling you where you are with your numbers, but there's a lot of POS systems out there, and quite frankly a lot of them aren't very good. I say that's usually because they're designed by IT people instead of retailers.

Dennis Zink: POS being point of sale, right?

Allison Boswell: Point of sale systems, which connects your cash register to your inventory. Having a good POS system is really important and also being properly trained on your POS system, which is a step a lot of people don't bother to go through, but if you have that data, then you have the tools to understand where you are. What we do at Management One is take that information from your POS system and create a plan for the future. We do that by looking at your history but also by looking at your current trend and where we see opportunity to grow business and also where we see maybe some liabilities. If you have a good plan for your inventory then you won't be overstocked like that.

Dennis Zink: Maybe I'm dating myself here, like old inventory, but my first job was an inventory control manager for Sperry Remington Office Machine Division in New York. We used a Cardex system it was called, where you had these cards. Then each card had a piece of the inventory number of the serial number and what it was, and we'd move these cards around all day as inventory moved out to dealers and stuff, but boy how things change. Just a point of information. What are some other ways businesses can save money to improve their cash flow?

Allison Boswell: Well, many businesses overpay for their credit card processing. Often it's because they think it's easier because it's linked to their POS system or they have a relationship with the bank, but you shouldn't have to pay more than about 2 percent for processing. It can be challenging to vet that, because a lot of companies have teaser rates, but there are some good ones out there that really do provide a good value. Not having your own UPS or FedEx account. Many vendors overcharge for shipping, because they don't actually weight the packages. If you ask them to use your account, you'll be charged directly by the shipper and we've seen stores save a significant amount of money by using their own accounts.

Another way you can improve your cash flow is really be wary of ordering merchandise you don't really need just to qualify for price breaks. Again, the max I think any business that has an inventory business should ever order is six month supply. Any more than that's really going to hurt your cash flow, but for most businesses, you don't even want that amount. Another thing that hurts cash flow is ordering merchandise you don't really need, because you're getting dating. If you're taking in merchandise that is not appropriate for your season, dating isn't going to help you. If you feel like it's -- what you should be getting is a discount, not dating.

Fred Dunayer: Can you explain that? I don't know your use of that word, dating.

Dennis Zink: Dating is like, "Would you like to go out on a Friday night to a movie with me?"

Allison Boswell: You swipe right or left. I don't know.

Ordering merchandise you don't really need because you're getting a dating or extra time to pay the bill. There's no reason to order merchandise you don't need just because they're giving you three or six months to pay it. If you're negotiating with vendors on something, negotiate on a discount instead. The other thing that most businesses don't look at very carefully is their pricing structure. There's some old fashioned formulas for what a margin should be, but those things have changed, because the market has changed dramatically. It's so much more promotional now than it ever used to be. It means you need to get a couple extra points on the front end.

Another thing that hurts cash flow is not having a separate account for your sales tax. Some business owners end up dipping into their sales tax money and then get short when it comes time to pay it. It's not your money. Don't use it. If it's in a separate account, it moves the temptation as well as the stress of scrambling to pay that bill.

Dennis Zink: You talked about dating. We called it terms, getting favorable terms. Taking discounts, are you suggesting, for example, that 2 percent 10 net 30?, So you take 2 percent off if you pay the bill within 10 days. Is that what you're referring to?

Allison Boswell: Yeah. That kind of thing. It's less commonly offered than it used to be, so you have to ask.

Dennis Zink: Why do you think that's so?

Allison Boswell: Vendors want to keep that 2 percent.

Dennis Zink: All right. You know, pricing is interesting, and you mentioned there are formulas. Are you talking about a keystone markup where you?

Allison Boswell: Yeah. A keystone markup in at least in the apparel industry. They did that when they had a cash register that had a bell on it. That's not how we mark things anymore. A retail store should be a minimum of 55 percent, but we like to see stores closer to 60.

Fred Dunayer: Allison, is there anything that we have talked about that you would like to stress so that our listeners walk away with a particular point in their mind?

Allison Boswell: I think the main point is that planning is really important and you should never be surprised by your cash flow. You might miss your goals, but you should always know what you're expecting to ... Separating your monthly expenses, which are probably a little bit more consistent, then from your inventory looking at those separately, looking at your sales goals, and tracking it, projecting it out for at least six months so you can see where you're going to be and you'll know if you're going to have a time when you're going to be a little bit more squeezed than other times and know that you're going to come out of it and be able to pay the bills.

Fred Dunayer: I would suggest, as I'm thinking about it myself, that you also need to make a real effort to separate your variable costs from your fixed costs.

Allison Boswell: Absolutely.

Fred Dunayer: Knowing the difference will incredibly help your planning, and not knowing the difference will cause your plans to probably not work.

Allison Boswell: Right.

Fred Dunayer: What about you, Jami, is there anything that you'd like to share with us that we haven't talked about?

Jami Schwartz: Yeah, absolutely. Here at Kabbage, about a third of our customers are actually in the retail space, so I completely agree with Allison's point that a line of credit is usually the best option. That way you can access those funds when you need it and understanding that the structure of any borrowing you do is extremely important, so whether there it's an origination fee or early payment fees and things like that is also very important, so not just what the money you need is but also what any fees associated with any borrowing you do, and here at Kabbage we really pride ourself on no fees other than what you take out and transparency about those fees.

Fred Dunayer: Is there anything else that, as you listen to the conversation, was there anything that struck you as an important point that our listeners should remember?

Jami Schwartz: I think planning is the number one key that we also tell our customers. If you really understand when you're going to experience those highs and lows of your business, then you're ready to take out funds.

Dennis Zink: Well, thank you both for enlightening our listeners on cash flow and inventory management. It's been a pleasure having you on Been There, Done That.

Jami Schwartz: Thank you so much for having us.

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Dennis Zink: Episode #40, Types of Insurance and Filing Claims. Fred Dunayer joins me today in our studio as co-host, SCORE mentor, and our audio engineer. Good morning, Fred.

Fred Dunayer: Good morning, Dennis.

Dennis Zink: Fred, we have Peter Hedberg returning today as our guest. Peter, welcome to Been There, Done That! again.

Peter Hedberg: Thanks for having me.

Dennis Zink: Peter Hedberg started his insurance career in 2003 at Hayes Company in the Midwest. Peter handled management liability lines and professional and privacy insurance. In 2013 he moved to New York and joined the underwriting side of Hiscox, a global specialty insurance company based in London. He currently manages professional and privacy liability insurance for the Northeast region of Hiscox. Peter, what are the different types of commercial insurance?

Peter Hedberg: Well, there's a very long list. I think we're going to spend a lot of this podcast talking about how the insured identifies which ones they need, but if it's okay with you, I'd just like to start at the top of the list. One of the oldest forms of commercial insurance, in its present form, it's been around about 40 years, but it has its roots going back about 100 years, is called general liability.

It's a type of coverage that was designed so that businesses can continue to exist after, frankly, bad things happen, whether it was their fault or not. General liability today covers bodily injury and property damage that you cause to third parties, whether it's your products or something you did, and it also covers you for advertising injury. If somebody's alleging that you're infringing upon their trademark or something like that. It also covers personal injury as well. If for whatever reason you have defamed somebody unintentionally, it'll pick up.

One of the most important things about general liability, again, we mentioned this in the previous podcast to, is it provides defense coverage. When you get sued by a plaintiff attorney alleging that you did something wrong, one of the most important things the policy does is it's going to start to pay you to secure a defense attorney. Those costs are oftentimes outside of the limit, which means to say if you bought $1 million, the defense costs don't actually take away from that million yet. The million is still set aside for the settlement.

The next type of insurance that's meant to compliment general liability in a way is called professional liability. It's oftentimes referred to as errors and omissions, or E and O. This type of insurance is really meant for when you cause financial harm to a third party. Again, it's not if you cause bodily injury or property damage necessarily. It's when you've caused a financial harm. A great example of people that carry this type of insurance are accountants and lawyers and doctors and so on and so forth. Accountants are a great example because when an accountant files your taxes incorrectly, it's going to cost money when you have to try to fix it with the government of course. That's a financial loss you incurred because a professional rendered a service to you. That type of insurance will then protect the accountant when you bring a claim against them.

The business owner's policy is oftentimes a single policy that people can purchase and it includes multiple lines of insurance. I affectionately refer to it as the Happy Meal policy because you get several different types in one and there's a discount involved there.

The next type of insurance is business interruption coverage. Typically business interruption is triggered when you have a weather-related event that removes or it takes away your ability to make money as a company. A great example of this would be say a hurricane in the New York area that prevented you from producing whatever you manufacture in your facility. The business interruption coverage is going to pay for the extra expense to either find a location to continue making your product, it's going to pay you the income that you lost for that product, and then it's also going to set up any additional facilities that you might need or repairs to the facility that you have to continue operating.

The next type of insurance is cyber insurance. It's a very new type of coverage. It's been around for about 20 years, but it's only until very recently that people have become very aware of it and are starting to purchase it in general. It's a type of insurance that protects you.

It has third party and first party components. The third party component pays for defense attorneys to defend you when somebody alleges that you have wrongfully disclosed their personally identifiable or private or corporate confidential information. The first party component is going to pay you to notify the necessary people if you're responsible for doing that. It's going to pay for forensics to help identify the extend of the loss within your network. It's also going to pay for data restoration or business interruption if it was indeed a cyber event that caused those things.

Again, very popular type of insurance. A lot of people are purchasing it now, and its pricing is now more affordable than it ever has been.

Fred Dunayer: Peter, if I can ask you a quick question about that insurance, how do you ensure that your client is taking adequate precautions in the first place, because obviously if they don't do everything they're supposed to do in terms of system updates and everything else, you guys end up on the hook?

Peter Hedberg: Like most insurance policies in general, there's an application process where there's several questions. For very basic types of insurance, the questions have really been boiled down over the years. If you're applying for a property policy they typically ask you, "What's everything worth? How much square footage do you have? What kind of office space are you in?" Something like that.

When it comes to applying for cyber insurance, there is still an application. The application does have a lot of questions. A lot of times what I find is that the CFO or the insurance buyer of an organization looks at the application and literally just hands it to their IT director, because some of the questions are pretty in-depth about those different controls that they have in place within the IT department.

Fred Dunayer: I would imagine that just seeing that questionnaire wakes up a few IT departments.

Peter Hedberg: It's funny. You know that you probably need the insurance when the actual application is giving you new ideas on what you should be doing with your organization to protect it. Trust me, I've seen that happen.

Dennis Zink: Peter, I have got a question for you. You mentioned business interruption insurance and you said that's often or mostly weather related. What about a fire? Would that be under that too?

Peter Hedberg: Yeah, absolutely. I'm glad you brought that up. One of the business interruption claims that I dealt with when I was an insurance agent back in Minnesota was a fire had taken out a turkey processing facility. While it's hysterical to joke about cooking turkeys, it actually removed their ability to process the animals. Not only were they not able to get business income because they weren't able to receive the animals, they needed to find extra expense because they needed to do something with the actual damage from the fire because it was a hazardous material because it was turkeys. Then they also had shipments coming in of new turkeys that they were getting ready to process in the facility, and they didn't know where to put those. They didn't have anywhere to keep those. There were no coolers or anything to place them in a safe place.

In other words, all of these consequences were completely unforeseen for this business interruption claim. It was all started because of a fire, and it was a mechanical fire that took out one part of the processing facility. Glad you brought that up. That's exactly right.

Dennis Zink: My follow-up question is was there an early Thanksgiving with cranberry sauce and all? If the turkeys were on fire there, it must have smelled pretty good.

Peter Hedberg: I bet it did. I bet it didn't take long for the fire department to find that one.

Another type of insurance is key person insurance. It's one that you don't hear about a whole lot because I don't know how often it's purchased anymore. I'd imagine that if you're taking out a loan for your business, the bank might want to see you cover this. It's essentially life insurance on a key person within your organization.

If you have a sales person that, let's say you have 60% of your revenue tied up with and something happens to that sales person and they can't actually produce that revenue for you anymore, this type of insurance might pay and it might pay to a) satisfy any bank loans that you have because you can't make that sort of revenue anymore, or just pay to indemnify your business to somehow continue in some way.

The next one is commercial property. It doesn't need a ton of explanation. It's very basic in that commercial property will pay you for the loss of use of the property. It will pay you for the contents within your property. For small business owners, one thing that's really important to know about this is business personal property. All of the equipment you bring around, everything that's in your office, whether it be computers and printers and so on and so forth. If you are a tradesman of any sort, let's say you're a small architect. You have drafting boards and you have special types of software. It will pay for all of that. Then if you own the building, it's obviously going to protect you if you lose the building, whether it be to a fire or a wind storm or something like that.

Fred Dunayer: Peter, a lot of businesses are now allowing their employees to take equipment home or they might even have a bring your own equipment policy, not in the insurance sense, but a business policy. Does commercial property insurance cover items that are either brought by an employee or given to an employee to take off premises?

Peter Hedberg: Great question. Most of the time it does, but you do have to check because not every insurance policy in this regard is written the same way. What is considered business personal property may be different from policy to policy. If your company allows you to take your personal laptop to work with you and you lose the personal laptop, it may or may not be covered based on the fact that it is your personal laptop. It's something you definitely want to ask your agent and/or your direct insurance company about if that is one of the ways you've arranged how to run your business.

Dennis Zink: Okay, it's kind of confusing sometimes with the word personal. When "business personal property," they really don't mean the employee bringing in his computer, do they?

Peter Hedberg: That's exactly right. One of the difficulties we have in the insurance agency is we use words intentionally, and unfortunately I don't think we use the right ones all the time. Then people start to use acronyms all the time as well, and it becomes very confusing. Great question. I'll answer it definitely by saying that most of the time, yep, absolutely your business personal property includes your personal property that you bring with you, but you do have to check. There are limitations and restrictions on that.

The next type of insurance is business auto, and we're all familiar with automobile liability insurance. We all have to buy it, unless you live in the great metropolis of New York and you might not have a car. One thing that's very important to note about business auto coverage is typically when you buy it, it sits excess of your own personal policy that you purchase, which means to say that your own personal policy, whether you buy a $100,000 limit or $250,000 limit, that has to be triggered and exhausted first. That has to be used first before the business auto kicks in.

One thing that's really important about business auto though, is oftentimes it has what's called the hired and non-owned component, which means when you rent a car for the business, that business auto policy then becomes the main auto policy for your rented car. Very important to know, especially if you're going to be renting cars for your business.

Dennis Zink: What about in a no-fault state, does that change any of the variables?

Peter Hedberg: No, it doesn't. No fault really has to do with how the claim is then going to be dealt with by the state and how it's going to be adjusted. The insurance is going to apply the same.

We're getting near the end here. One of the last types of insurance is theft insurance. It's oftentimes referred to as an employee dishonesty bond or just employee dishonesty or crime insurance, theft insurance. Typically when this product was invented it was really meant to protect the employer from an employee stealing from them. It's been greatly expanded in recent years and so it also includes theft by third parties from the business, whether it be computer fraud or literally someone burglarizing and taking money out of safe or something like that. It's one of the only types of insurance that actually is legally allowed for you to be made whole from a crime.

Some of the last types of insurance we have, there's obviously personnel insurance. We typically, here at Hiscox we're a property and casualty underwriter so we don't typically talk about life and health. We did want to mention that when you have employees, it's really important to know that there are several types of accident, death, disability, medical, those types of insurance that are often offered as benefits.

The big one obviously is medical insurance. We hear about health insurance a lot. In most states you obviously have to give that to your employees, depending on how many you have of course. The other type of insurance is you can offer life insurance to your employees as well, and accident, death, and disability insurance, whether it be long-term, short-term, and that sort of thing.

Finally, last but not least, there's workers compensation insurance. We did touch on this in the earlier podcast. Workers compensation is a very important insurance coverage. I think a lot of small businesses in America are not aware of it or are not purchasing it and statutorily, they probably should be. There are many states that will allow you to not have to purchase it if you are your own business and you have to file and get a waiver. Most of the time people purchase it anyway. It's very important because obviously it protects you as the employer if your employee gets hurt and finds you liable, or simply your employee gets hurt and they need their medical costs reimbursed.

Dennis Zink: How does an employer know if they need professional liability, general liability, or BOP, business-owners policy? Maybe they only need one. How do they know?

Peter Hedberg: This is where it's great to have an independent insurance agent, because that's their job. They are a professional that their whole job is to design an insurance package that's tailored for you and your needs. You can also get this by calling Hiscox and dealing with our customer service representatives. They do the exact same thing with our products here at Hiscox.

More important too, you're going to find that as you're a small business, especially when it comes to professional liability, your contracts are also going to drive a lot of the type of insurance you buy because the contracts that you sign oftentimes require a laundry list of different types of insurance. Being a contract, they are negotiable as well, so sometimes you'll get a contract with, say, a large national bank and they'll say I want you to purchase $10 million of professional liability. That might not be reasonable if you're a $250,000 a year small business. You might say I'll purchase a million and negotiate that. Again, your contracts can oftentimes inform what types of insurance you should be carrying.

Dennis Zink: I would imagine that has a lot to do with the amount of the contracts or the anticipated amount. If you're only doing a million dollars with them in business or less, you're not going to need 10 million.

Peter Hedberg: Yeah, absolutely. That's correct too. A lot of times the contracts themselves are limited to the value of the contract. The insurance is considered a backstop anyway.

Dennis Zink: How much does small business insurance cost?

Peter Hedberg: Small business insurance is now more affordable than it ever has been. It's not necessarily going to cost thousands of dollars. In some cases it's really down to hundreds of dollars. The premiums are typically annual. The renewal will be annual as well. One of the nice things is that the renewals often times are now automatic, assuming that your underwriting exposure hasn't changed. That's very helpful as well. When I say automatic, I mean to say you just pay the bill and it keeps going. You don't have to provide any further information.

Dennis Zink: When should someone decide to report a claim or not?

Peter Hedberg: I always advise people to report a claim whether they think they should or they shouldn't. The reason I say that is because insurance policies have provisions within them that allow the insured to deny a claim if the insured did what was called a late report, which means to say that the insured handled the claim themself, settled it, and then they just went back to the insurance company and said, this happened during the policy term. I need a check for this. The reason the insurance company doesn't like that is because the insurance company actually wants to be involved in any claim process you have, whether it be property or liability.

One of the big reasons for that too is the insurance company has relationships with vendors already that can help you. They get preferred rates from those vendors as well. I always say err on the side of caution and turn the claim in. I know that there's a fear a lot of the times from turning a claim in because of various other reasons, but you will never be doing the wrong thing by alerting an insurance company that you think you have a claim.

Dennis Zink: What happens after a claim is reported?

Peter Hedberg: That's a great question. There's some misconceptions that go along with that as well. The biggest misconception is that I report a claim, nothing happens, and they're still going to increase my rates. That really doesn't happen. The reason why is because there's actually several state laws that make it very hard for insurance companies to just arbitrarily raise insurance rates. They can raise insurance rates if your exposure profile has changed. In other words, say you move your business from the middle of Denver where the fire risk is low to, say, a hillside in Aspen where you have regular wildfires or something. That would increase your premium.

More often than not, a claim that you report in that nothing ever happens on, is not going to increase your rate. On top of that, if you do report a claim and it's usually a small loss, the increase in premium is usually incremental as well.

The other thing to consider too, is everybody thinks if I report a claim my insurance company is just going to cancel me or they're going to non-renew me. I think one thing that's important to know is that insurance companies don't necessarily just want to pay one claim and then just get rid of it. That's not a sustainable business practice for them because then they would just continue to decrease the size of their insurance or their insureds.

When they cancel or non-renew you, it's really because they see a pattern of behavior with the insured that's not improving, which is to say they expected to continue to pay more losses and they want to avoid that if possible. It's very hard to get canceled or non-renewed necessarily.

If you work in a type of business that for a strategic reason, the insurance company has decided to not do anymore, that's a different story. If you have an insurance company that likes to write, let's say a great example is title agents. For many years Hiscox wrote a lot of title agents. Unfortunately for about three or four years in a row, we paid a lot of claims. We were basically losing more money than we were making. It was very upside down. There was just really no sign that that was going to get better. The result of that is we had several title agents that said why are you non-renewing my coverage? What did I do wrong? We said you specifically didn't necessarily do anything wrong, but from a business standpoint, for us to be continuing to write this line of business, we were just losing way, way, way too much money.

That's an example where you might see a non-renewal, but again, the misconception being that you report a claim and then you just get non-renewed. That's not the reality.

Dennis Zink: Assuming that you have a claim, who should be called first?

Peter Hedberg: You can do one of two things. You can call your agent, and your agent should be prepared to file that claim for you with the insurance company. It's also important to keep your policy information available somewhere, whether it just be in a three-ring binder under your desk somewhere or in a file that you know where it is, because the policy will always have what's called a jacket. The jacket's going to contain information on how you can actually contact the insurance company. Most of the time it's an 800 number. You can fax in claims sometimes. You can email claims, but the telephone is nice because at least you're going to get somebody on the line who's going to start to take down information and open a file right away.

Dennis Zink: Peter, what are some common contractual requests that might happen that deal with insurance coverage?

Peter Hedberg: There are three big ones. I think there's a lot of confusion about what they mean. We do get a lot of calls about these still from different insurance agents who say, "My insured needs this. They're trying to sign a contract. If they don't get this from the insurance company, their contract's going to be void and they can't continue with business." I think it's really important to understand there's really three big ones.

A lot of contracts will ask for waiver of subrogation. Subrogation is a very fancy word that insurance companies use for recovering, which means to say if the insurance company pays a claim and they find out that it's actually somebody else's fault and they are legally allowed to go recover from that person that was at fault, so the insurance company can be made whole, that's what subrogation is. What a lot of contracts say is I don't want the insurance company to be able to do that. I want them to pay the claim and then not be able to go after anybody else. They say I want the insurance company to waive their subrogation against us. When I say us, I mean the party that you're signing a contract with.

Dennis Zink: Why would they care if they went after a different third party?

Peter Hedberg: Typically it has to do with workers compensation. That's how most of the time it applied. Workers compensation is primary, but workers compensation policies are notorious, I shouldn't say notorious, they rightfully do this, for subrogating. Workers compensation policy, let's say they pay for somebody that was injured on a construction site, and they find out that when the person was injured, it was actually the fault of another contractor that was on-site who, say, dropped a brick on this other guy, or something like that.

The workers compensation carrier is going to want to go after the insurance of the guy who dropped the brick because they want to be made whole because it wasn't necessarily their insured's fault. The other contractor whose fault it was, they don't want to have to pay for that. They don't want that to be on their loss record at all. They say, no, you waived your subrogation against me. You can't come after me for that.

Dennis Zink: Good explanation. Thank you. What is an additional insured mean?

Peter Hedberg: This is probably the most common out of the three I'm talking about. When you sign a contract, a lot of the people who are signing a contract say I want to be an additional insured on your policy. What they're saying when they ask that is they want to have access to your insurance coverage if they get brought into something that involves you as well. The reason they do that is they don't want to have to use their own insurance. They want to use your insurance. Most companies are happy to grant this if the relationship is clear. Some of the times, insurance companies don't necessarily want to grant this or grant a full additional insured status because basically you have a very large company that just doesn't want to ever use its own insurance and so they try to continue to push onto all their small contractors. They try to push all the liability by doing this. It's a very common grant that we do now.

The third and the last one is primary non-contributory. This clause basically says that if there's multiple insurance policies that might apply for a particular claim, and this usually happens in big catastrophes or big accidents, that I want yours to apply first because I don't want to have to use mine. I don't want to have to contribute. Does that make sense? What they're saying is, in the order of who has to pay, they're going to try to make yours pay first.

Dennis Zink: One of the things I've noticed is I always had these ACORD statements on the wall. What does that mean?

Peter Hedberg: ACORD is actually an acronym. It stands for the Association for Cooperative Operations Research and Development. It's a nonprofit that is founded by the insured's industry. It was meant to really standardize a lot of things. An ACORD certificate, namely an ACORD 25, 25 is the actual number for the particular form that most people are asked for, is a certificate that just says you buy insurance.

Typically when you're signing a contract, the contract will say you must evidence your insurance with certificates. They must be ACORD 25 or they'll make other stipulations like that. The certificate itself is broken out into a grid, and it's got your name at the top. Then at the bottom it has a certificate holder, which is usually the person that you're signing a contract with. Then in between it's got the information, the type of insurance, the policy number, the term of the insurance, the dates, and how much limit you carry. It's a very simple document. If you'll notice in the upper right of the document, it always says "This insurance confers no rights or responsibilities to anybody." It's just used for information purposes. It's just used for evidence.

I think what happens a lot of times is that people are really asked to heavily amend and change these certificates of insurance because I think the people think that they're some sort of safety, and saying on the certificate something like "you're additional insured," "we waive subrogation," or something like that. I really, really, really want to stress that the certificate is really just meant to be an evidence document. It's not a contract. it's not a declarations page from a policy itself. It's not meant to be coverage on it's own. It's just meant to demonstrate it. That's all.

If you're a small business, you'll be asked for these. The fastest way to get them is to obviously contact your insurance agent, or if you're writing your insurance direct like through Hiscox, you can contact us directly and we'll produce one.

Fred Dunayer: Thank you, Peter. That was very good information and it went surprisingly quickly for a discussion on insurance. Is there anything you wanted our listeners to go away from this session with at the top of their mind?

Peter Hedberg: Yeah, absolutely. Really use an insurance agent or call us directly if you have any questions on what you should or should not be covering. Please don't be afraid to report a claim if you think you have one. Insurance is really designed to keep the economy functioning, more importantly keep your business functioning. Unfortunately we live in a society where bringing a lawsuit or bringing an action against somebody is just all too easy. We have a lot of attorneys that are really happy to do that as well. Our business would grind to a halt if there was no way for us to transfer liability to somebody else. That's what insurance companies do. Again, if you think you have a claim, please send it in.

Then, other than that, when it comes to contractual requests, don't be afraid to negotiate. Don't necessarily think that you have to go out and find $10 million in limit for insurance. You obviously can go back and say I'm not that large of an organization. It's not that large of a contract and try to argue that down.

Dennis Zink: Peter, thank you for enlightening our listeners today about the different types of insurance and filing claims.

Fred Dunayer: Thank you, Peter.

Peter Hedberg: My pleasure, guys. My pleasure.

Fred Dunayer: You've been listening to the SCORE Small Business podcast, Been There Done That! The opinions of the hosts and guests are theirs and do not necessary reflect those of SCORE. If you would like to hear more podcasts, get a free mentor, view a transcript of this podcast, or would like more information about the services we provide, you can call SCORE at 800-634-0245 or visit our website at www.score.org. Again, that's 800-634-0245 or visit the website at www.score.org.