

# RISK FOCUS

FOOD & AGRI BULLETIN MAY 2015

## Business Interruption

Business interruption (BI) is arguably one of the most complicated insurance covers that food and agri companies buy and yet many do not give it the specialist attention it deserves. This can leave firms with a policy that doesn't fit the underlying risk profile of the business and insurance that responds inadequately following a loss.



Estimates vary, but some sources point to as many as eight out of ten businesses failing within two years following a significant inadequately insured business interruption loss.

Whatever the rate of failure, there is no doubt that having the correct cover will give food and agri firms essential funds that will help them protect their balance sheets and allowing them to rebuild their business.

The trouble is that many of the businesses in the food and agri sector

do not have the in-house expertise required to avoid common pitfalls or to ensure their business interruption policy is set up to see them effectively through a loss.

### COMMON PROBLEMS

Sums insured and the length of the indemnity period are the two biggest and most commonly made errors when it comes to business interruption cover.

The sum insured comprises the insurable gross profit. This should not be confused

with the gross profit figure used for accountancy purposes. The two can be very different. The insurable gross profit consists of annual turnover less truly variable costs multiplied by the chosen indemnity period. It therefore provides cover for regular payroll and other ongoing fixed costs. If these are not fully included then the sum insured will fall short of what is required.

The other main issue is around indemnity periods and many businesses underestimate the time needed to

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complete the necessary reinstatement works and to return the business to its intended level of activity, putting the insured back on their feet both financially and operationally. In the wake of a property loss, like a fire within a factory, it might take longer than expected to get planning permission or there could be delays in the construction phase. Lengthy lead times for specialist equipment can also cause longer outages. Further, customer approval processes post reinstatement (such as those by the major UK retailers) can extend the recovery period.

Then there is the time it takes a business to recover to planned levels of sales to restore its market share. “Some businesses fall into the trap of looking at the indemnity period in terms of the time it will take to reinstate their assets,” says Adrian Brennan, Partner from Echelon Claims Consultants.

“If your customer base is with the supermarkets, for example, and you are delisted, then the ability to recover that market will probably extend way beyond

the reinstatement of the physical assets. Other businesses will have taken over your shelf space. So you may have to find new customers and markets in order to restore the business to anticipated level of turn over. You need to give yourself enough headroom in the indemnity period to recover your market share” Says Tim Cracknell, Head of Consulting Risk Practice at JLT Specialty.

For growing businesses there is a further consideration as a BI policy is there to put your business back in the position it would have been “but for the loss” and not “before the loss” as with most other insurance policies. Whilst this may seem like a point of semantics, it is far from it. For example, if a food business has invested in new plant, machinery, employees or a new site with a view to growth, they will want to protect this future return on investment. However, a loss that occurs today, which may put them out of action for 12-18 months may only be covered up to historic gross profit levels unless the business has used accurate forecasting to arrive at the appropriate level.






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## LOSS MITIGATION EXPENSES (ADDITIONAL COSTS)

A key question that arises concerns whether additional costs incurred to mitigate the loss of gross profit, as insured, and to regain the planned financial position is covered by the business interruption policy. The good news is that a standard BI policy includes cover for ‘increased cost of working’ so long as it adds up on an economic basis. This is often the first part of any BI claim as the immediate consideration is whether the BI loss can be mitigated. The economic point is often an area of confusion and is best dealt with by way of an example. So, if spending GBP 1,000 on promotional offers will decrease the gross profit loss by GBP 1,000 then insurers will meet such costs under the standard cover. However, beyond that point insurers will only pay out the uneconomic element of any extra costs incurred under an extension to the BI policy that has to be purchased separately termed ‘additional increased cost of working’.

## EXTENSIONS TO STANDARD COVER

Leading on from the comments above on additional costs, given the need to occasionally incur uneconomic costs to accelerate reinstatement, regain sales and market share, Cracknell adds: “Additional increased cost of working is an important extension to cover that we recommend all JLT clients take out, even if for only a modest amount.”

There are also other extensions to BI policies that food and agri firms should consider carefully. Some such businesses, for example, do not purchase cover to deal with BI losses arising from damage to suppliers or customers

operations, whereas this cover can be very useful. These risks can be greater than the loss of the insured’s own site, especially if suppliers are overseas and there is only a wholesale element or low level production in the UK.

Brennan says: “Customer and supplier losses are triggered by the insured peril that is insured under your policy – if the policy is limited to fire, lightning and explosion then if your supplier suffers damage from one of those perils then that would trigger cover. If you have ‘all risks’ cover then most scenarios would be provided for interruption events at your suppliers’ and customers’ premises.”

But in most cases the level of cover offered by supplier and customer extensions is not the same as that offered under the primary policy. Generally, inner limits will apply. It is important, therefore, to quantify your exposure and negotiate higher than standard inner limits where needed. This will avoid any unexpected surprises from a loss arising from interruption events suffered by customers and suppliers that have knock on effects to your business.

There are two options of providing cover for customers and suppliers. Firstly, a generic lower level of cover is available for all customers and suppliers, without having to provide any names or addresses. Secondly, you can name specific third parties and addresses to which the higher limits you need can be purchased. Deciding which trading partners are covered and the amount of cover that is put in place will depend upon the impact that the loss of that partner, say, for an extended period of time of 9 – 12 months, will have on the ongoing performance of the your business.

JLT Specialty Limited provides insurance broking, risk management and claims consulting services to large and international companies. Our success comes from focusing on sectors where we know we can make the greatest difference – using insight, intelligence and imagination to provide expert advice and robust –often unique - solutions. We build partner teams to work side-by-side with you, our network and the market to deliver responses which are carefully considered from all angles.

JLT's Food and Agri practice incorporates insurance broking professionals, risk management, supply chain and environmental consultants, plus technical claims management specialists, who have provided industry specific insurance and risk management solutions to the food and agri industry for over 20 years.

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## GETTING SPECIALIST ADVICE

Specialist business interruption advice is available at JLT to help clients with all their BI issues, to map their supply chain exposures and develop business continuity plans to mitigate them. They can also test those plans and create an accurate understanding of exactly how a business would fare in the face of different potential losses.

This makes it possible to very carefully tailor the particular core cover and extensions needed. A thorough understanding of a company's finances will enable it to accurately calculate the appropriate sum insured, inner limits and extension limits. A clear view of the recovery profile following potential disaster will enable the indemnity period needed to be appropriately set.

Too often business interruption insurance gets consolidated in with another dozen or so lines of cover when food and agri firms discuss their annual insurance programme. As BI is a complicated cover requiring a detailed understanding of the underlying business, JLT recommend specific advice be sought otherwise ill thought through BI Cover can and regularly does backfire.

## ESSENTIAL BI CONSIDERATIONS

### CASE STUDY

We recently worked with a business where one half of the firm was operating as a food manufacturer and the other half as a food wholesaler. Across both elements of the business there was a 24-month indemnity period in place on the business interruption cover.

A business continuity planning exercise found that due to the short lead times on wholesale products coming into the business, this level of cover was excessive. In turn this led to a 35% premium reduction on the Business Interruption policy and allowed us to help the firm redesign its insurance programme to provide more appropriate levels of cover, focused on their supply chain.

- Insurable gross profit is different from the figure used for accounting purposes and provides cover for direct costs such as wages and factory overheads
- Indemnity periods should not just reflect how long it will take to reinstate physical assets but also take account of how long it will take to recover sales to restore market share
- Consider Additional Increased Cost of working and third party extensions such as key customers and suppliers to make sure the insurance will respond as needed.

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