Don't Overlook Statistics With Business Continuation Plans

Insurance companies live inside the world of probability and statistics. Insurance is about managing risk and the law of large numbers. The insurance risks posed by any one individual don't usually have a significant impact to an insurance company's business due to the mitigation of risk through the law of large numbers. However, the same cannot generally be said about most other types of businesses. Since most small businesses depend routinely on a select few people (owners and/or key people), the impact of the loss of just one of them can be quite significant.

Two significant risks are the death or disability of an owner. These risks are generally easy to address with insurance. When there are other owners – or family – who wish to continue the business after the death or disability of another owner, a few things need to be considered. One of the primary considerations they need to address is the buyout of the departed owner.

So if a death or disability were to occur to an owner, then how do the surviving / remaining owners buy out the departed owner? It's probably fair to say that the remaining owners would like to be able to quickly address: (a) how to replace an owner who is no longer able to contribute to the company, and (b) if any of their business agreements call for it, how to buy out that owner's business interest. Trying to accomplish both of these goals without causing cash constraints is a primary challenge for many businesses. The most direct way to address this challenge is to secure life insurance and disability buy-out insurance policies on the lives of the owners. Too often, though, that does not occur, as coverage is either non-existent or inadequate. Reasons for not implementing or keeping coverage vary, but what doesn't vary are the statistics and the probabilities associated with these risks.

Let's look at this with an example of a five owner business. In this case, all five owners are men, with respective ages of 52, 47, 44, 43, and 40. Assuming that each of these individuals is rated as a standard non-smoker, actuaries expect each of these individuals to have a life expectancy approximately between 84 and 85.3 years.

What does "life expectancy" really mean? It means that for a random sample of people alive at a given age today, only half of that sample will be alive at the respective future age. So, for example, for a group of one thousand (1,000) 52 year-old males alive today, mortality probability says that 500 (half) of them will be alive at 85.3 years of age. So if half are alive at 85.3 years of age, what about the other half?

The other half – statistically speaking – will have passed away at some earlier age. That's all it says. It does not tell us when any of those 500 who passed away prior to age 85.3 actually passed away. That's all well and good, but that may not be enough to get you to look at things much differently. So let's look at one more probability result:

The probability that **at least one** of these five individuals will pass away prior to reaching age 65 is 26%.

Explained this way, probability now takes on a new meaning. It tells the same story in a different way. So if the probability is 26% that at least one of these five will pass away prior to age 65, then which one of the five is it likely to be? Nobody knows.

Let's not stop there. Let's look at disability. Assuming there is no interdependency of disability between/among owners, the actuarial probabilities are:

Age	Probability of Disability before Age 65	Probability of No Disability Before Age 65
52	14.50%	85.50%
47	16.57%	83.43%
44	17.41%	82.59%
43	17.64%	82.36%
40	18.23%	81.77%

Based on these percentages, there is about a 40% chance that no one in this group will become disabled prior to age 65. If there is a 40% chance that no one in the group will become disabled prior to age 65, then that, in turn, implies that there is a 60% chance that at least one of these five **will** become disabled prior to age 65.

If we assume the 52 year-old became disabled today, actuaries calculate that there is a 21% chance that he'll still be disabled at age 60, and a 17% chance that he'll still be disabled at age 65.

In looking at our example business, nobody can say who of the five owners – if any – will become disabled prior to age 65. This is the essence of risk. But looking at the probabilities with our sample five owner business may change the way you look at these risks. A 60% probability that one of these five owners will become disabled prior to age 65 is not insignificant.

Sometimes the story that statistics tell isn't the most compelling, but the statistics shouldn't be ignored, and the risks shouldn't go unaddressed.

Source for Statistics: Life and Disability Actuaries, The Guardian Life Insurance Company of America.

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