

Insurance-based strategies for startups

Businesses face evolving financial needs and priorities as they advance through the life cycle. As your clients' trusted partner, you can help them navigate these changing needs. And while many financial professionals focus on businesses that are well-established, there's great opportunity in the often-overlooked startup market.

Working with startups

When you help newer businesses meet financial needs while struggling with limited resources, it can be rewarding. And your relationship will often grow as their business matures. We can help make it easier for you to get started in the business market. From our experience as a leader in this market, we know some of the most common needs for startups include protecting their business from the loss of key employees, providing debt coverage, and helping ensure smooth ownership transitions when the unexpected occurs.

In 2019, over 1 million businesses were startups (less than one year old).¹

What to consider for key person insurance and retention strategies

Help protect against the loss of intellectual capital. A startup's future can depend on the originating business idea coming to fruition. What would happen if a founder passed away or became too sick or hurt to work before the idea was fully developed? Could the business survive? Key person life and disability insurance on the owner(s) would allow the business to receive the funds necessary to help it continue.

Find an appropriate amount of key person life insurance.

A good rule-of-thumb for coverage is 3-10 times the employee's compensation. But it's not uncommon for young companies to have limited cash flow and pay top employees less than fair market value with a promise of a future equity stake. Then, you need more information about the employee to determine an appropriate amount, including:

- ☐ What makes them key to the organization?
- ☐ Do they currently have an ownership interest, or will they in the future?
- ☐ What's their total income (including bonus and/or K1 (if ownership))?
- ☐ What was their previous compensation? Was it higher at a previous employer, for example?
- ☐ Is there a concern they could be lured away by a competitor?

Help keep top talent with the organization. Key employees are difference-makers for their firm and are often coveted by competitors. And in a tight labor market, competition for talent is even more fierce. For less-established firms, loss of a top performer can be a big set-back because the talent pool is typically not as deep. Key employee retention strategies can be used to protect startup businesses from the departure of key employees—plus provide a death benefit to the business should the key employee die.

What to consider with the buy-sell agreement

Have a current, properly funded agreement.

When a business has multiple partners and one dies prematurely, the consequences can be serious for the remaining partners/owners, who may be obligated to buy the deceased owner's shares. If there's no buy-sell agreement, or the one that exists isn't properly funded, the needed guidance and liquidity may not be available.

Keep the business valuation current. The amount of buy-sell funding needed is based on the value of the business. In startups, the value can increase rapidly based on the industry and/or nature of the business. If the value isn't current, the price per share may not be accurate when the time comes. Additionally, if an entity purchase buy-sell structure is used, one strategy to

consider is to layer key person coverage on top of the buy-sell funding amount to help minimize the need for evidence of insurability for future insurance increases.

- Consider multiple factors to determine the amount of coverage.
- What is the total invested amount—both from the founders and outside investors? Roughly 50% of the investment can generally be covered.
- Are there purchase agreements? Outstanding loans? Total of any venture capital investment? Financials?
- What's the track record for the founders and private equity firm, i.e., past work/investment results?
- What other debt does the business have?

➔ **All successful businesses have a starting point. Help clients start their journey off right and provide guidance to take them from startup to a thriving organization positioned for long-term success.**



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¹ Frequently Asked Questions, U.S. Small Business Administration, Office of Advocacy, December 2021.



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