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Does a Frumpy Economy Lead to Insureds Singing the Blues?

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Last spring, a middle-aged, frumpy-ish, unemployed, single church volunteer walked out onto the stage of one of the U.K.'s most popular TV shows – *Britain's Got Talent.* The audience and judges chuckled under their breath as the woman prepared for her musical audition. They expected she'd be a flop. It was obvious that the woman didn't belong in the competition…another in a long line of music hopefuls with unrealistic expectations.

However, after silencing the crowd of critics by hitting a home run with her rendition of *"I Dream a Dream,"* Susan Boyle became an overnight phenomenon – with 12 million views over the next 5 days on YouTube alone. Unrealistic expectations? Maybe not.

Our current "frumpy" economy may be the root for some of the same types of questions about unrealistic expectations…at least when it comes to business interruption claims. Let me explain.

In a slower economy like we've had for the past 18-plus months, sales at most companies tend to trend lower. Often, this leaves insured companies and their insurers at odds when it comes to claims for loss of business income. The typical argument goes something like this:

Insured: "Last year, we had first quarter sales of X. Before the fire, we expected similar sales this first quarter.

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CASEWORK EXPERIENCE

FASNA member casework includes, but is not limited to, cases involving:

- Inventory/property loss
- Employee dishonesty
- Business income loss
- Personal injury or wrongful death claims
- Truth in lending/truth in leasing
- Post judgement matters/ calculations
- Loss of income/earnings
- Divorce and fidelity claims
- Business valuation
- Expert testimony
- Fraud

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- Construction, contracting, and engineering
- Financial/money management, trust, and estate
- Healthcare
- State and Indian tribal government
- Insurance claims
- Manufacturing
- Real estate
- Restaurant and hotel industries
- Retailing/wholesale

Based on last year's sales figures, our loss of business income claim is XX."

Insurer: "The whole economy is struggling. We don't see how you could have expected sales to be similar to last year's. We think your loss of business income claim should be XX minus 30% due to the likelihood of 30% lower sales."

On the surface, it does seem that the insurer may have a point. Unless the insured can demonstrate a reason that their product or service is more resistant to an economic downturn, it stands to reason that lower sales should lead to a lower loss of business income claim. Is this a case of unrealistic expectations from the insured?

Maybe...maybe not!

It's important to consider both the sales and expense side of the ledger when determining business income loss claims, especially during slower economic times.

See, loss of business income claims are based on a company's activity – not just sales. Besides sales, there are a number of factors that go into determining a company's profitability – especially if you look on the other side of the accounting ledger, costs.

Typically, companies respond to a tougher business climate by shedding expenses. It's almost predictable.

Often, what appears to be higher expectations of an insured turns out to be reasonable given other factors that are often overlooked.

Sales start to decline. For a short time, companies may try to weather the storm by tapping corporate savings. However, once it becomes evident that sales are likely to drag along lower for a while, companies start cutting expenses – or shifting them - to maintain an acceptable level of profitability and cash flow. In a well-managed company, that may mean profitability remains level or only down a little. And in those cases, something that may look like an unrealistic expectation of an insured in a business income loss claim may not look so unrealistic after all. Here are some examples of factors we look for in claims like this:

Repairs and maintenance. Postponing repair and maintenance costs for vehicles and equipment can be a significant short term savings to the bottom line. If these expenses were pushed into the time of the business interruption, it could affect the claim.

Lost customers. Often, a poor economy causes a company's clients to close down or consolidate their outside purchases. It makes sense to see if there were significant client losses just prior to the claim event that may affect the insured's bottom line.

Consolidation. Likewise, a client business will often consolidate purchases or eliminate branch locations to balance income and expenses. In this case, an insured's claim may be higher if more of the business was being handled out of a damaged location because other locations had been closed.

Subscriptions and upgrades. Companies will often delay upgrades to software, publications and subscription based services to eliminate expenses. By shifting or eliminating these costs, insureds can improve their bottom lines without necessarily hurting their business. In this area, we may ask for operating budgets that document this approach.

People. Unfortunately, people are often a casualty of a struggling economy. Employers who terminate employees usually reduce their expenses. However, it is sometimes worthwhile to investigate the results of these layoffs. Sometimes they come with additional expenses like training costs for employees taking on new responsibilities or temporary help to help when employees take vacations. On the other hand, expenses like health insurance and other employee benefits should also be considered.

Bottom line? A down economy often causes anticipated lower business income losses because of lower activity. It's important not to mistake proactive actions taken by a business to compensate for the economic downturn, as a sign of a struggling business. As with Susan Boyle, first impressions can be misleading.

As forensic accountants, our job is to help insurers determine actual economic loss by factoring a number of factors – which can often be impacted by the economic environment.

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