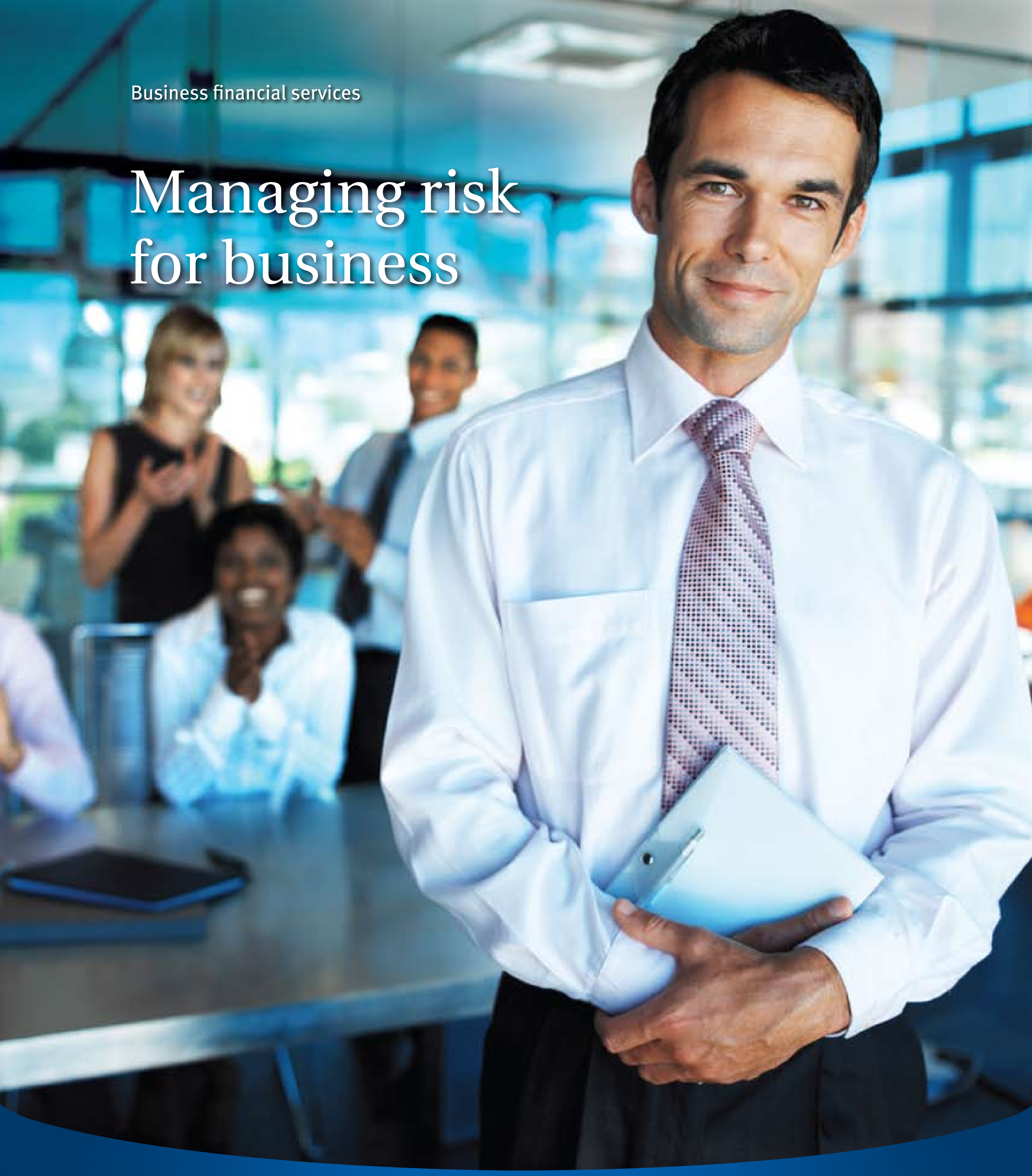
Business financial services

Managing risk for business



RBC Royal Bank®

Contents

Introduction

Risk awareness and management — supporting the success of your business

As a business owner, there are a variety of risks and challenges that you must deal with every day, from maintaining demand for your product or service, to managing resources, to making strategic business decisions such as changing or expanding your operations. But what about the less obvious risks — the ones that you don't necessarily deal with on a daily basis but are just as critical to your business success?

Some business risks (such as retaining employees) are within your control; others (such as economic change) are not. But there are ways of managing both types. Your awareness of the risks that could negatively affect your business is the first step in the risk management process.

That's where this guidebook can help. It highlights nine key risks that are common to many business owners, and it's a great place to begin the risk assessment process for any sized enterprise.

Once you've identified the risks that could affect your business, you'll be in an excellent position to assess the steps you may want to take to manage these risks — and stay on track for business success.

We can help you assess your business risks

RBC Royal Bank® business account managers can help you assess the risks that could affect your business. If you have any questions about the information in this guidebook, or other business risks you may be concerned about, please visit us at any RBC® branch.

Employee and Owner Risks

Attracting and retaining employees

Employees represent the greatest asset of almost every business, and attracting and retaining the right people is a cornerstone of business success for most enterprises. While the ability to hire and keep the right people can be based on many diverse factors, there are a few proactive steps you can take to ensure you are an employer of choice in a competitive labour market.

Here are some strategies that can help you turn human resources risks into a business advantage.

Ensure compensation is competitive. The marketplace for talent can change quickly, so it's important to evaluate the competitiveness of your employee compensation package at regular intervals. Your evaluation should go beyond base pay to other key benefits that employees value — such as vacation, wellness and lifestyle programs, profit sharing, and retirement savings.

Your business may also be able to tailor individual compensation packages to meet specific employee needs — for example, the option for employees to purchase more vacation time.

Add a group benefits program. Group insurance is a coveted employee benefit and can provide you with a competitive advantage in attracting and retaining staff. Group insurance can provide reimbursement for an employee's common health-related expenses and financial protection in the event of illness, disability and death. Often, group insurance programs are enhanced with employee assistance and lifestyle programs that can help maximize employee health and productivity, which in turn can contribute to the success of your business.

Group benefits are typically very flexible. Programs can be customized to meet the needs of large companies as well as those with only a handful of employees — with costs covered fully by the employer or shared with employees. And because some benefits are not taxable to an employee, it can be a tax-effective way to deliver compensation.*

In addition, you may want to offer your employees the opportunity to purchase individual coverage, which can be done through a simplified guaranteed standard issue process. Individual insurance can provide enhanced life and health coverage to defined employee groups and has the advantage of being portable.

Consider value-added perks and programs. There are a number of value-added employee benefits that you can offer to employees at little or no cost to your organization. These range from programs that deliver a significant benefit — such as discounted group home and auto insurance — to smaller perks such as preferred cell phone plans, travel clubs, health club discounts, kitchen coffee bars, or monthly staff lunches.

Ownership conflict or change

Partners or co-owners can bring essential strength, expertise and support to a business, but a conflict between them — or the unexpected loss of one of them — can create problems that are often not anticipated.

Where there is an ownership conflict, business progress could hit a stalemate unless a mechanism is in place to resolve the conflict. In the event an owner or partner is no longer able to participate in the business due to death or disability, his or her business interest could pass to a spouse, estate or other beneficiary who is not well suited to running a business.

Multi-ownership risks can be managed in a couple of ways:

Ensure that your shareholder or partnership agreement has a buy-sell clause. A buy-sell clause specifies the conditions under which owners or partners have the right to buy the business interest of other owners or partners. Typically, a buy-sell clause includes certain triggers (such as death, non-contribution to the business, disability, divorce or retirement at a specified age) that will activate that right and also specify how to transfer the business interest.

Use insurance to fund a buyout. If your co-owner or business partner dies, or suffers a disability or critical illness, a shareholder or partnership agreement will typically require that the absent party's interest be bought out. But for the agreement to be effective, it needs to be funded in a way that won't cause financial hardship to either the company or to the partner being bought out.

One of the most effective solutions is buying life, disability and critical illness insurance to insure each owner or partner. When an owner or partner dies or becomes disabled or ill, the company (or the surviving parties, depending on how the insurance arrangement is structured) can use the insurance proceeds to buy out the owner or partner's business interest.

QUICK ASSESSMENT

STAFFING RISK

- ❑ Do you need employees with specific education or skills?
- ❑ Is there a competitive market for the type of employee you need?
- ❑ Is your company's benefits plan less generous than the plans of others in your industry?
- ❑ Do you plan to expand your business — and your staff — beyond its current size?
- ❑ Do you have a staff turnover rate that's higher than your competitors'?

Good employees are the lifeblood of any business. If you answered yes to any of the questions on the left, you may be at risk of losing those employees. Your RBC Royal Bank business account manager can help you implement programs and procedures aimed at attracting and keeping top talent.

QUESTIONS?
Talk to an RBC Royal Bank business account manager about your general insurance needs:
Go to your nearest RBC branch.

QUICK ASSESSMENT

OWNERSHIP RISK

- ❑ Do you have a co-owner or business partner?
- ❑ Do you and/or your partner have a spouse or former spouse or other dependants who might have a claim to your business assets?
- ❑ Would the business benefit from additional funds to buy out a business interest in the event of that owner or partner's death, disability or illness?
- ❑ Are you or your partner active in other businesses?

Owning a business with another individual or taking on a partner can make your company stronger, but it also represents a potential risk. A shareholder or partner agreement that includes a buy-sell clause is essential in these situations to protect you, your partner(s) and your business. A licensed insurance advisor can help you determine the best solutions for your business.

Both sides benefit from the arrangement. The departing party (or the estate) receives the buyout proceeds immediately, and the business can carry on operations without the additional financial burden of securing funds from loans or cash reserves to make the purchase.

Loss of a key person

For business owners, the consequences of the loss of a vital member, known as a "key person," in the company through death, disability or critical illness could be significant. The business would lose the input of a valuable member, creditors could withdraw financing, tax liabilities could be created and customers might go elsewhere. In addition, there could be significant out-of-pocket costs in terms of recruiting and training a suitable replacement.

For many businesses, the definition of a key person extends beyond the business owner to key sales people, product developers or senior executives. For your business, you can define a key person as anyone connected to the business whose temporary or permanent absence might cause a significant disruption to your normal business operations.

Here are a few ways that you can manage the risk of losing a key person in your business.

Insure your most valuable people. Key person life, disability and critical illness insurance can provide the funds necessary to keep your business operating should a key person suffer an unexpected illness, accident or death. The business is the beneficiary of the policy, and the funds can be used for any number of business purposes, such as recruiting or training a replacement, providing supplementary cash flow to replace a decline in business income, or paying suppliers.

Consider creditor insurance. The death or disability of you or another key person in your business could affect profits and the ability of the company to repay business debts. Creditor insurance helps ensure that financial responsibilities, such as business loans and mortgages, are met in the event of death or disability of a key person or owner. Creditor insurance is offered by financial institutions such as RBC Royal Bank on eligible business loans and mortgages. It differs from key person insurance in that the proceeds of the insurance are paid directly to the financial institution (not to your business) and are used specifically to cover your debt obligations.

Cross-train employee skills. Where possible, you should ensure that employees are cross-trained so that one or more people can take over if a key employee dies or has to be off work for an extended period.

QUESTIONS?
Talk to an RBC Royal Bank business account manager about your general insurance needs:
Go to your nearest RBC branch.

QUICK ASSESSMENT

KEY PERSON RISK

- ❏ Do you have one or more employees who are key to driving the success of your business?
- ❏ Do any of your employees have a specialized skill that someone else in your business could be trained to do?
- ❏ Would the permanent or temporary loss of a key employee cause financial hardship to your business?
- ❏ Are you the sole signatory for your business's cheques and requisitions?

While it's impossible to replace a key employee, there are steps you can take to protect your business interests if you or anyone else essential to the firm dies or is sidelined by illness or injury for an extended time. Ask your RBC Royal Bank business account manager what you can do to protect your business from the loss of a key employee.

Economic Risks

Currency and interest rate fluctuations

If your business pays suppliers or receives payments from customers who are outside of Canada, you're likely aware of the impact that fluctuations in exchange rates can have on your cash flow. While currency movements can work in your favour — for example, when the Canadian dollar declines in value and you have foreign currency receivables — an unfavourable exchange-rate swing can quickly turn profit into loss.

Interest rate changes can also negatively affect your cash flow. For example, the Canadian prime rate increased by 67% between 2004 and 2007, from 3.75% to 6.25% [source: Bank of Canada]. This type of increase can have a devastating impact on a business with a high debt load and a variable rate loan arrangement.

Here are some strategies that can help you manage your currency and interest rate risks.

Hedge currency movements. One method of eliminating currency uncertainty relating to major transactions is through a currency forward contract you can arrange with a financial institution.

A currency forward contract is a binding agreement between two parties to buy or sell currency at an agreed-upon future date for an agreed-upon price. It neutralizes the impact of any currency exchange movements that may occur between the date your contract or transaction is entered into and the date your currency transaction takes place.

For example, if you know you must pay a supplier US$50,000 six months from now, you can enter into a currency forward

contract today that ensures you have access to US$50,000 in six months at today's exchange rates. While you no longer benefit from any potential currency gains during the period of the contract, you are fully protected from currency losses.

Move to a fixed interest rate. While variable-rate loans are ideal when rates are falling, sharp increases in interest rates can have a dramatic impact on cash flow. If rates look like they have more upside than downside, you may want to consider a move from a variable-rate to a fixed-rate loan structure to provide greater cost certainty.

You may also be able to lower your monthly payments by extending the amortization period of your loan. While this increases your interest costs over the long term, it can be an important strategy for keeping payments affordable over the short term.

Use a cash reserve. One of the simplest ways to manage currency exchange and interest rate risk is to build a cash reserve that can cover the higher costs or lower income that can result from currency or interest rate changes. This is an excellent strategy for businesses that have only a modest or infrequent exposure to currency or interest rate risks.

QUICK ASSESSMENT

CURRENCY AND INTEREST RATE RISK

- ❏ Are you planning to expand your Canadian business into a foreign market within the next 12 months?
- ❏ Are you carrying a high debt load at a variable interest rate?
- ❏ Do you have major suppliers outside of Canada that you pay in a foreign currency?
- ❏ Do you have a significant amount of foreign currency receivables from customers outside Canada?
- ❏ If your interest costs increased significantly, would you have trouble meeting your current debt obligations?

> Changes in currency exchange rates and interest rates are elements that are, unfortunately, beyond your control. But you can be proactive in seeing that they don't harm your business. Your RBC Royal Bank account manager can provide you with advice on how to protect your business from the impact of exchange rate fluctuations.

Reduction in consumer and business spending

Ask any business owner who survived the economic slowdowns of 1990, 2001 and 2008: nothing goes up forever. The economy is cyclical and few businesses are immune to the threat of lower sales when consumers and businesses reduce their spending.

Here are some strategies that can prepare you for a possible reduction in sales when the economy hits a lull.

Trim now, not later. Regardless of current economic conditions, re-evaluate your expenses on a regular basis to avoid the "cost creep" that can occur over time. Streamlining your operating costs can put you in an excellent position to offset lower revenues during tough economic times.

Spend strategically. Review the key drivers of your business and focus on what you should be spending your money on. For example, while advertising costs may be substantial, a reduction in this expense may be a poor strategy if it's a key source of sales. There may be other expenses — entertainment, payroll, even your occupancy costs — that may be more suitable for reduction.

Identify "needs" versus "nice to haves." While economic slowdowns may be a fine time to plan for growth, it may not be a good time to execute the strategy. Whether you're expanding locations, launching a new product or adding staff, if it's not a "need to have" change, it may be prudent to delay any addition or expansion until an economic recovery begins.

QUESTIONS?
Talk to an RBC Royal Bank business account manager about your general insurance needs: Go to your nearest RBC branch.

QUICK ASSESSMENT

RISK OF REDUCTION IN SALES

- ❑ Can individuals or businesses survive without your product or service?
- ❑ Do you have lower-cost competitors that your customers might turn to in times of economic hardship?
- ❑ If your business has been operating for several years, did it experience a decline in sales the last time the economy faltered?
- ❑ Are you planning to expand your business, based on positive results over the past few years?
- ❑ Are you carrying significant debt that you plan to pay down based on projected sales revenue?

› If you answered yes to any of these questions, your business could face real hardship in recessionary times.

Supply chain cost fluctuations and disruptions

If your business relies on one or more key supplies, volatility in the price of these supplies can have a significant impact on your costs, pricing and profitability. In addition, an interruption in service from a key supplier can slow down or even stop your production.

If you have exposure to one of these supply chain risks, here are some strategies that could help you manage them.

Hedge supply price. If your key supply is a common commodity such as grain, fuel or a base metal, for example, you can gain greater cost certainty through forward contracts or other hedging strategies, much the same as for the currency risks discussed earlier. Your financial institution can explain the options to you and help determine if a hedging strategy is appropriate for your business.

Consider contingent business interruption insurance. If you have specific suppliers who you know are essential to your business, you can purchase insurance that covers the risk of a supplier failing to deliver due to a catastrophic event such as fire or flood at its work site. This coverage is known as contingent business interruption insurance and can be added as part of your business's property coverage.

Source other suppliers. If there is potential for supply interruptions that are not insurable (such as those due to labour unrest, volatile political situations or supplier bankruptcy) then sourcing other potential suppliers is the best way to mitigate this risk.

QUICK ASSESSMENT

SUPPLY AND SUPPLIER RISK

- ❑ Do you rely on one or more key suppliers in the running of your business?
- ❑ Would an interruption in supplies from a key supplier cause financial hardship to your business?
- ❑ Would your profit margins be reduced or eliminated if the price of your key supplies increased significantly?
- ❑ Is the price of your goods or services largely "inelastic"? In other words, if the cost of your raw materials were to rise, would you have difficulty passing along the increase to consumers without seeing a decline in sales?
- ❑ Do you use different suppliers than most of your competitors?

› If you answered yes to any of these questions, you may want to ask your RBC Royal Bank business account manager about steps you can take to protect your profit margins in case of an interruption in supply.

QUESTIONS?
Talk to an RBC Royal Bank business account manager about your general insurance needs:
Go to your nearest RBC branch.

Protect your intellectual property

It's a competitive world, and if your business has a unique product or service offering — or is turning the corner from business to brand — it's important to assess your intellectual property protection options.

Getting legal advice on the patent, copyright or trademark protection that may be available to you is an important step in the risk management process. An intellectual property lawyer can also advise you on the steps you can take to enforce your rights once your protection is in place.

Credit Risks

Non-payment of accounts receivable

Most businesses must offer credit to remain competitive, and accounts receivable can represent a substantial portion of a business's value at any given time.

If you have one or more large customer accounts, the failure to collect a significant receivable could represent a major financial setback. Even if you have a wide customer base, you can still be exposed to substantial defaults on receivables during periods of economic downturn.

Here are two ways you may be able to protect against a default in your accounts receivable.

Consider accounts receivable insurance. If you sell business-to-business, accounts receivable insurance can protect your business from losses due to unpaid account receivables stemming from your customers' inability to pay, or the late payment of legitimate receivables. And if your clients are outside of Canada, it will even help protect you from defined political risks, such as currency inconvertibility or problems with currency transfers.

Check out the credit history. If the credit you plan on extending to a client is for a significant amount in relation to your business, a credit bureau check on a potential customer before you deliver the product or service can be an important safeguard. This one extra step can make the difference between a strong, profitable relationship and one of loss and aggravation.

This coverage is available to businesses operating both domestically and internationally and can offer valuable protection if your business has large, concentrated receivables from a small number of customers or if you are planning to expand into unfamiliar markets. With accounts receivable insurance, you can focus more on business development and less on the collection of receivables.

QUICK ASSESSMENT

ACCOUNTS RECEIVABLE RISK

- ❏ Is it your company policy to routinely accept credit from anyone who requests it?
- ❏ Is a large portion of your accounts receivable from other businesses?
- ❏ Do you have a small, concentrated customer base?
- ❏ Is the amount of credit you extend to any one customer or industry enough to cause your business financial hardship if it went unpaid?
- ❏ Is your ability to meet your own debt repayments dependent on receiving payments from customers?

Not many businesses can operate without credit. The key is to track it closely, so you can extend credit where it benefits you and your business without unduly interrupting your cash flow. Your RBC Royal Bank business account manager can help you develop an effective credit-management strategy.

Operational Risks

Lawsuits and legal liability

The legal liability of your business for an injury, product defect or monetary loss involving an employee or third party can take many forms. That's why it's essential for you to assess the type of liabilities and legal actions to which you may be exposed — and tailor a liability insurance package to cover the key risks.

For example, if a customer or other third party suffers an injury at your work site, you could face potential liability for the injury. And don't overlook the fact that legal fees are payable even if you are successful in defending the lawsuit.

Here are some ways you can protect your business from liability claims.

Insist on essential coverage. Liability insurance is essential coverage that most businesses need to protect themselves from the cost of legal actions and any damages that may be awarded. Every business is unique in its potential exposure, and a key part of the risk management process is determining an appropriate level of coverage for your operations. You may also want proof that another business you deal with — such as a business that rents space from you — has liability insurance coverage so that your business remains protected in the event something happens on that property.

Consider your need for specialized coverage. There are many types of specialized insurance coverage that are either mandatory or highly recommended for different types of businesses.

For example, errors and omissions insurance can protect your business from claims relating to errors in professional judgement that others will use in making their business decisions. This type of coverage is mandatory for some professions — such as engineers, lawyers and accountants — and is often delivered through their professional associations. However, additional coverage is often purchased to provide coverage above the minimum limits required, as some awards and settlements are exorbitant.

Other specialized types of coverage include industry-related coverage that can protect against specialized risks that are often excluded from general liability coverage.

QUICK ASSESSMENT

LIABILITY RISK

- ❏ Are your business premises open to clients or members of the public?
- ❏ Do you sell a product?
- ❏ Do your customers rely on your professional judgement — and could an oversight cause them financial harm?
- ❏ Do you operate in a sector that is subject to human error, such as engineering, accounting or law?
- ❏ Do you rent space to other businesses or regularly outsource key tasks to third parties?

> A protracted lawsuit could seriously damage your company's finances. A licensed insurance advisor can help you determine the best solutions for your business.

QUESTIONS?
Talk to an RBC Royal Bank business account manager about your general insurance needs: Go to your nearest RBC branch.

Catastrophic risk

Catastrophic events, such as fire, flood and major thefts, are rare, but it only takes one event to close down a business permanently if the proper coverage is not in place.

Fortunately, property insurance, which provides protection in the event of such catastrophes, can go beyond providing coverage for the four walls of your business premises to protect the sustainability of your business operations as well.

Here are some strategies to consider when assessing catastrophic risk protection for your business.

Review property insurance terms. Not all property insurance is created equal. Be sure to obtain coverage that's tailored to the potential risks your business faces, whether it's the breakdown of heavy equipment or machinery or a higher risk of crime and vandalism. Some events may be excluded from coverage, or have low coverage limits, unless specialized protection is put in place.

Protect your business operations. A major loss may force your business to close for an extended period of time due to the loss of supplies, equipment or your actual business premises. Business interruption insurance may replace the lost earnings of your business and offers a number of different coverage options. For example, depending on the type of protection you choose, your business interruption insurance coverage may cover your payroll expenses to retain the skilled workers you'll need when your normal business operations resume.

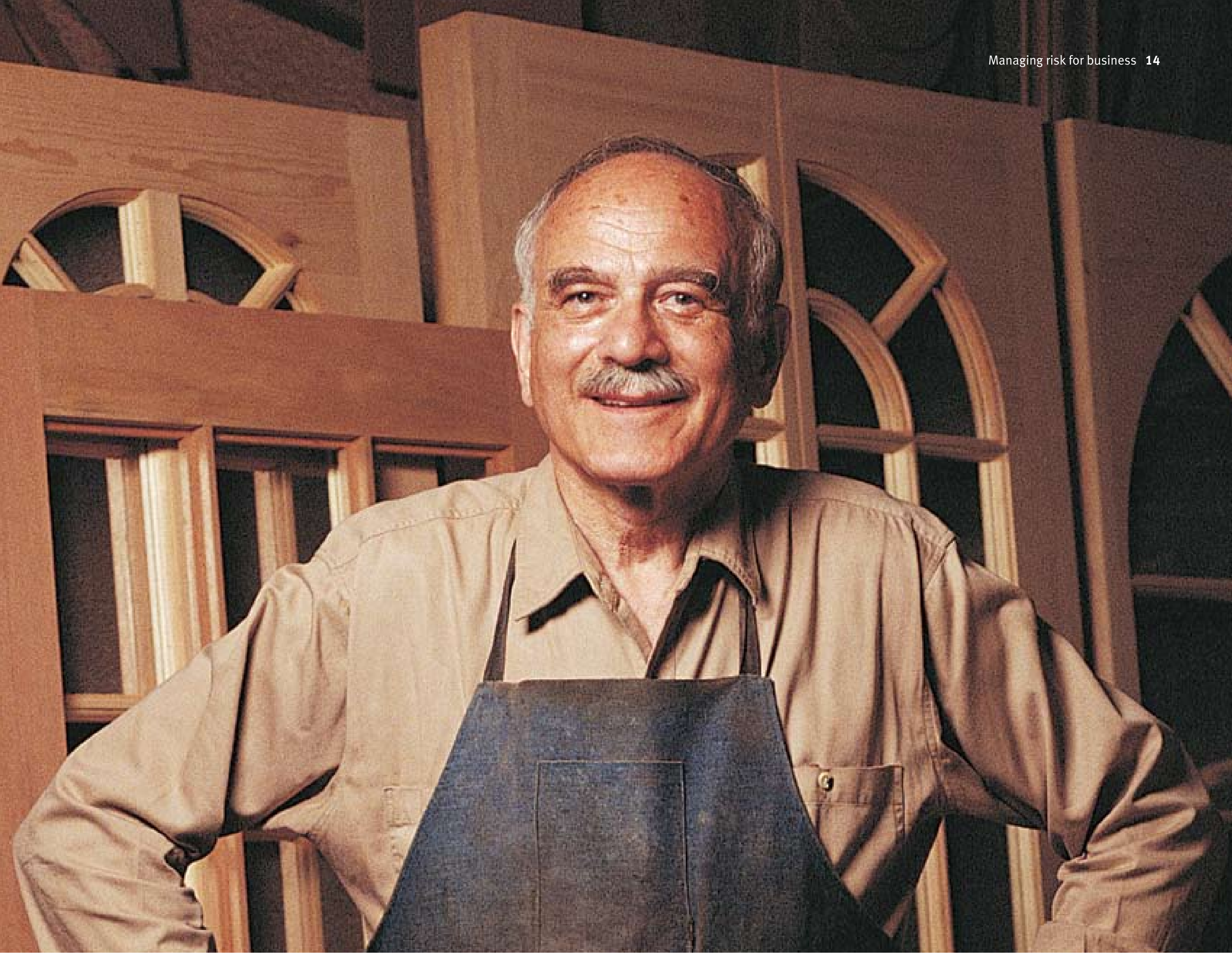
Have a contingency plan. Aside from any insurance coverage you put in place, ask the "what if" questions and make certain that your business has a contingency plan should an unexpected event occur. Are there alternate premises where your business can operate? Are back-up files easily accessible? How will you and your staff communicate? While it's difficult to predict how or when a catastrophic event may occur, business owners can and should be prepared.

QUICK ASSESSMENT

CATASTROPHIC RISK

- ❑ Are your facilities concentrated in one area?
- ❑ Would the viability of your business be at risk if you had to shut down operations for a period of weeks or months?
- ❑ Would you be able to continue paying employees if your business temporarily closed?
- ❑ Does your business make use of specialized equipment or machinery that is central to your business operations?
- ❑ Would your business be in jeopardy if a key supplier or customer were shut down, even temporarily, by a catastrophe?

Fortunately, natural disasters like floods and ice storms happen infrequently. But when they do, the effects can be devastating. While property insurance will help to replace damaged physical items, you also need to protect your business operations. A licensed insurance advisor can help you protect both the tangible and intangible items essential to your business.



Reassess risks at regular intervals

A risk management plan is an excellent way to protect your business from the risks it currently faces. But your business will change over time — and this can require the addition or removal of risk management strategies. For this reason, make a regular risk assessment part of your longer-term business planning. A single meeting with an RBC Royal Bank business account manager can help you identify the risks your business may be exposed to and provide access to the insurance solutions you need.

QUESTIONS?
Talk to an RBC Royal Bank business account manager about your general insurance needs:
Go to your nearest RBC branch.

We can help you evaluate and manage your business risks. Talk to us today!

While this guidebook describes several of the key risks that your business may face, there may be other risks specific to your business that you may need to address. We can help you with this evaluation process. An RBC Royal Bank business account manager can be a key partner in helping your business grow and prosper — with access to the risk management advice and solutions you need.

› Visit your nearest RBC branch

Quick Business Risk Assessment

1. If a fire or flood forced you to shut down for a few days, would you have difficulty covering your regular expenses?

☐ Yes ☐ No

2. Do you have specialized equipment or machinery that your business relies on to maintain operations?

☐ Yes ☐ No

3. Would the permanent or temporary loss of a key employee cause financial hardship to your business?

☐ Yes ☐ No

4. Is the amount of credit you extend to any one customer or industry enough to cause your business financial hardship if it went unpaid?

☐ Yes ☐ No

5. Do you own a vehicle for your business or sometimes use your own vehicle for business purposes?

☐ Yes ☐ No

6. Has it been two years or longer since you've reviewed your current insurance coverage or its limits?

☐ Yes ☐ No

If you answered yes to any of these questions, you many want to ask your RBC Royal Bank business account manager for general insurance advice to help protect your business.

RBC Royal Bank®

Before making any final insurance decisions it is always best to consult with a licenced insurance advisor.

* This information is being provided for general information purposes only and the contents should not be relied upon as containing specific financial, investment, tax or related advice. Clients should seek their own independent advice.

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