Indirect losses

How dependent property coverage protects business owners **Interviewed by Amy Borghese**

Many businesses require the services or goods of another company to make their product or to run their business. As a business owner, your company may never experience a tragic loss or damage, but what would happen to your business if one of your suppliers experienced such a loss? Do you have the proper insurance to cover your loss if your sole supplier can no longer provide goods or service?

Business income provides for the business what it cannot provide for itself. Dependent property takes this coverage to the next level to protect the business even if the loss happens to a third-party on which it relies, says William V. Reedy CIC, AU, The Learning Group, Westfield Insurance. Business owners who understand the protection offered with dependent property coverage and recognize their need are considered savvy insurance consumers and risk managers, he adds.

Smart Business spoke with Reedy about the need for dependent property coverage, how it can help protect your business and how to evaluate your company's risk to determine if such coverage is needed.

William V. Reedy, CIC, AU
The Learning Group
Westfield Insurance

What is dependent property coverage?

Most businesses depend on other businesses to supply them with the raw materials or finished products they will sell. Conversely, supplier businesses rely on having other businesses that will buy their product. In both cases, the business is dependent on another entity to conduct its business. When a business cannot get the materials or product to sell, it will experience indirect financial loss.

The fact that it is indirect does not lessen the loss. Conventional business income insurance reimburses a business for income and expense after its own loss. Dependent property coverage is used to protect a business when the loss takes place at a business on which it relies.

Why is this type of coverage so important?

Dependent property coverage is extremely important because the actual physical loss (fire, wind, etc.) may happen to the business you depend on and not your business. The fact that this coverage responds on your behalf relieves you of the financial loss you would have had. These losses can be debilitating to a company.

Most business owners and insurance agents readily identify buildings and business personal property when they consider property exposures. Business income is sometimes overlooked in this process. Business income coverage without the dependent property endorsement will not respond to the dependent property exposure. It requires both business income along with the dependent property endorsement to make sure all dependent exposures are addressed.

Who requires such coverage?

Any business that relies on another business is a candidate for dependent property coverage. This coverage is especially important and most often provided when there is a single or short list of key contributing or recipient dependent property businesses.

For example, perhaps the insured business makes wooden rocking chairs that are known for their craftsmanship and quality. It may only use one particular supplier of hickory that provides the best wood. Since the chair company bases its reputation on quality, it is dependent on this particular wood supplier. If the chair company added the hickory supplier as a dependent property and a fire occurs at the hickory supplier's location (rendering it unable to supply the insured company with top-quality wood), it is considered a covered peril, since fire is a covered peril under the policy.

The business income policy endorsed with dependent property would pay the insured company the amount it would have earned until the wood supplier is back in business. With dependent property coverage, the company is indemnified for the business it normally would have done, and it does not have to resort to using inferior wood and potentially damaging its reputation for quality.

Are there different types of dependent properties?

There are four main categories of businesses that may require this coverage.

- Recipients: businesses that rely on others for product
- Contributors: businesses that rely on others to whom they sell their product
- Manufacturing locations: businesses that sell a product on behalf of a manufacturer
- Leader locations: businesses that rely on other businesses to draw traffic to their location. An example would be a card shop located near a large retail chain store. The card store benefits from the traffic and would experience a downturn in revenue if the chain store were to close.

How can one determine risk of exposure?

If a business has a number of potential suppliers or available markets in which to sell its product, then the need for dependent property coverage is not as great as if it depends on a more limited and thus more important few. The questions any business owner should ask are: On what other businesses do I depend? What would happen if they were forced to shut down for a month, six months or a year? Would I lose income as a result? If the answer to these questions results in identifiable companies that would cause financial loss if they were out of business, then one may conclude that dependent property coverage is necessary. <<

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