

RISK MANAGEMENT OF HUMAN ASSETS IN SMALL AND MEDIUM SIZE ENTERPRISES IN SINGAPORE

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An MBA Group Dissertation* related outcome- this paper is a summarized/abstracted version

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- In partial fulfillment of MBA-Financial Services of Vancouver University, Canada conducted by its Singapore Campus at Insurance and Financial Practitioners' Association of Singapore- IFPAS- based at 7, Hong Kong Street, Singapore, 059650- the address for communication . email: bcghosh@singnet.com.sg
 - Final revised paper

History has shown that more than 80% of all business failed within the first 5 years of establishment(Singapore government's own Statistics Department surveys during 1984 and 1994 confirm along this line too). There are many factors that lead to such a high failure rate but in this research; we will rather be looking at the failure of a business due to the death, disability or major medical crisis of the owners, partners, and shareholders, risks related to human assets management. We will also be looking, in particular, at how such risks can be managed by using established risk management tools which share risks, eg insurance plans. They are available widely in the West and also in Singapore and the nearby countries like Malaysia. They are established risk reduction tools, designed mainly for SMEs, though not exclusively so, and can be used to minimize risks in these situations.

Usually, when these unfortunate events occur, there are questions that the family members and the remaining business partners need to address:

1. Shall the business be dissolved or continued?
2. Will the business be sold or liquidated at a lower value?
3. Will the deceased's family members be interested and capable of running the business?

4. If the surviving partners would wish to buy over the shares of the deceased shareholder, where then the fund for such an acquisition be found?
5. similar related matters, where established risk management tools are available but often remain unused due to a lack of awareness, or more importantly, just a lack of planning for it.

The group investigated the relevant literature, only some were relevant at all, especially none available in Singapore/regional context, and it is to be noted this research is rather drawn in our regional context. It is here in this region, we felt, as financial planning professionals, that succession planning among SMEs is rather very poor, due to cultural and other reasons, including a level of awareness or rather the lack of it. We therefore planned to undertake a part randomly selected survey among business owners and also financial planning professionals, and partly conducting the same survey through a convenience based sampling. 80 business owners were administered a questionnaire and survey inputs were obtained through face-to-face interviews, and similarly with 55 financial planning professionals, but necessarily the questionnaires were different. These questionnaires were arrived at after due pre-testing and when agreed with our supervisor of the project.

The contents of those surveys and the abstracts analysis of the results are as follows:

BUSINESS OWNERS SURVEY

We had decided to use a unidirectional scaling method, Likert approach so to speak, for our purposes.

After several brain storming sessions, we created a set of potential scale items that can be rated on a 0-4 scale. These items consisted of the various insurance concepts applicable in business succession planning with special to risk management instruments available in the marketplace. We narrowed down to 10 items. The 10 items are as shown below(more explanations later, all human-assets related financial risk management tools in an SME context):

1. Executive Bonus Plan (Selective Employee Benefits plan)
2. Group Life Insurance
3. Key Employee Life Valuation protection
4. Disability Income for Key Employee
5. Split Dollar
6. Business Continuation (Buy/Sell Agreement)
7. Deferred Compensation
8. Medical Expense and/or Major Medical
9. Disability Buy out
10. Stock Redemption

The rating we assigned to each of the item is as follow:

Rating	Selection by Owner about the type of business insurance or other risk management protection
0	Never heard before
1	Heard Before But Not Sure
2	Have knowledge but no action taken
3	Action taken but uncertain if it is appropriate or adequate
4	Fully understood and action taken with periodical review

The final score for the respondent on the scale is the sum of their ratings for all of the items (this is why this is sometimes called a "summated" scale).

For each individual respondent, the minimum score is 0 and the maximum score is 40 (4 X10). Average mean score should be 20, per respondent. If it is less than that, then the conclusion would be the level awareness is less than optimal.

We define the awareness level as follow:

0 to 8	Very Low
9 to 16	Low
17 to 24	Medium
25 to 32	High
33 to 40	Very High

We define the level of awareness to be low if a respondent score a rating of 16 or below, as per our interpretation of the table above- this number is critical for our analysis purposes below:

Business Owners' Survey- Continued:
Sampling of Business Owners

A sampling size of 80 business owners is selected using the random sampling/convenience sampling method(in our case this was considered most suitable), out of which, 56 are limited companies, 12 partnerships and 12 sole-proprietorships. We did not think there was any bias in this sample, and they represented our situation well in regard to SMEs in Singapore and the region.

The samples(where applied) were selected at random without prejudices of their legal forms or industrial types as long as they fulfill the definition of Small and Medium Enterprises, by Productivity and Standards Board of Singapore(now renamed as Spring, Singapore).

Firstly, we state our main hypothesis as follow(we agreed on this basis, there was little in literature to suggest otherwise):

Null hypothesis, $H_0: \mu \leq 16$, The awareness level of business risk management insurance among business owners of SMEs in Singapore is below or equal to 16 on a scale of 40 points

(below 40% of 40 max per respondent-- see earlier discussion). Hence significantly lower than the number (mean >20) that would normally be expected from rational business owners.

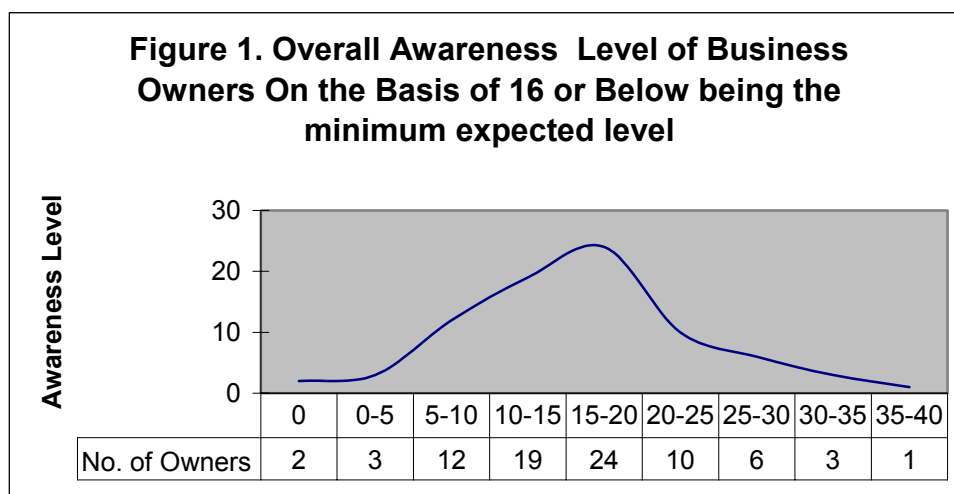
Alternate hypothesis, $H_1: \mu > 16$, "The awareness level of business risk management insurance among business owners of SMEs in Singapore is above 16 on a scale of 40 points (above 40%), indicating a generally acceptable level of awareness. This cut-off point admittedly, is a bit arbitrary, but based on conservative reasons that our market would probably show less than expected level of 50% awareness anyway, in respect of the awareness among our SMEs of these rather sophisticated financial risk management tools. No literature on this available according to our knowledge, but inside information within insurance companies locally supports this view.

We set the level of Significance to be 0.10

SYNOPSIS OF RESULTS

The number of business owners involved in this survey is 80.

With a total score of 40 points, the overall average score of all business owners involved in the survey is **16.65 (41.63%)**, much less than 20. The mode and median are **15** and **16.34** respectively.



Sample size = 80 Mode = 15.0 Mean = 16.65 Median = 16.34

Standard Deviation = 7.8%

Hypothesized value = 16 Significance level = 0.10

Critical value will be $16.00 + 1.2825(7.8/\sqrt{80}) = 17.78$. The sample mean value, 16.65 falls within this range, and therefore, we do not reject the null hypothesis

Alternatively, using test statistic = $(\text{Sample mean} - \text{hypothesized value}) / (\text{Sample standard deviation} / \sqrt{\text{sample size}}) = (16.65 - 16) / (7.8 / \sqrt{80}) = 0.74$. Critical value of distribution is 1.2825 (one-tailed 10%). Since the test statistic is less than the critical value, we do not reject the null hypothesis.

Next, we will calculate the p-value, which is the probability of observing a value of the test statistic at least as extreme as the value actually observed, assuming that the null hypothesis is true.

We have found that:

Test statistic = 0.74,

Significance level = 0.10,

Critical value = 1.2825,

p-value = $1 - 0.8864 = 0.1136$

Since the p-value obtained is greater than 0.1, H_0 is not rejected.

This result is consistent with our hypothesis that In general, business owners in our context(Singapore and the adjacent region) have an insufficient level of awareness with regards to the importance of managing the risk of losing the services of the owners and/or key employees due to their death, disabilities and retirement, and suffer from an insufficient awareness of due risk management tools available.

FINANCIAL PLANNING ADVISORS SURVEY

Unlike in the survey for business owners where we use a ratio measurement to determine their awareness level of business insurance using a scale from 0 to 40, the survey conducted for financial planning advisors are measured using Nominal and Ordinal measurements methods. First of all, we separate insurance advisors into two categories: those who had sold business insurance and those who had not. This is the Nominal measurement where we can find out the percentage of advisors who sold business insurance. Then for the group that sold business insurance before, we further separate the novices from the experts by categorizing them into four groups namely those who had sold to:

1. less than 6,
2. 6 to 10,
3. 11 to 15 or
4. more than 15

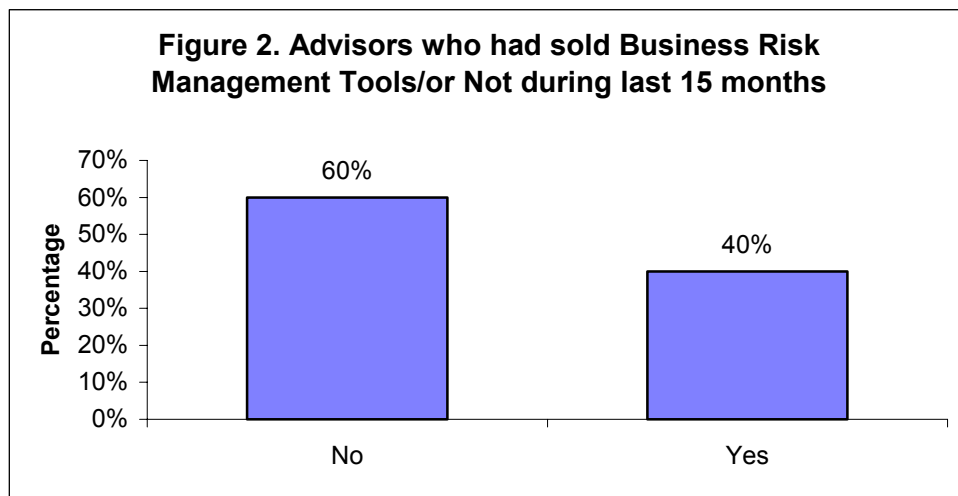
business owners and those who sold less than that, during last 15 months. After doing so, we ranked the four groups accordingly. This is the ordinal measurement method where we are interested in finding out which grouping can we find the highest number of advisor in it. From the result, we will be able to see the participation level of financial advisors in the business insurance /similar market with regard to use of available financial risk management tools.

We had also designed questions using ordinal measurement method to find out the reasons why insurance advisors are not selling to the business insurance market and the types of training they needed most if they were to enter this market.

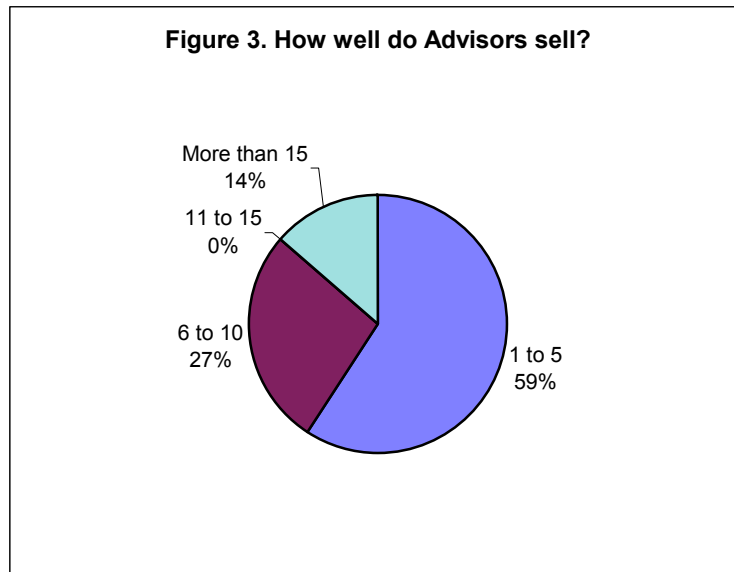
RESULTS OF THIS SURVEY

As earlier mentioned, we selected 55 face-to-face respondents from among insurance/financial planning/ bank employed planners, again part random, but mainly introduction through our personal contact. There was no other useful way, but we believe otherwise the sample was unbiased. Face to face interview also the only effective way, but obviously consumed a lot of time on both sides, hence the number of 55 was agreed as sufficient with our supervisor.

Firstly, we shall look at the percentage of advisors who had sold at least one business insurance before(or none!).



And the level of their achievement? The pictorial below is a better way of presenting the information, we would like to believe!



In other words, the advisors who are actively involved in promoting business risk management/insurance tools available are only a handful. In our sample, only 3 out of a sample size of 55 had sold business insurance to more than 15 businesses. This works out to be only 5.45%. The rest of the advisors who have sold business risk management tools seem to have done it by coincidence rather than through their deliberate effort, as our interviews revealed.

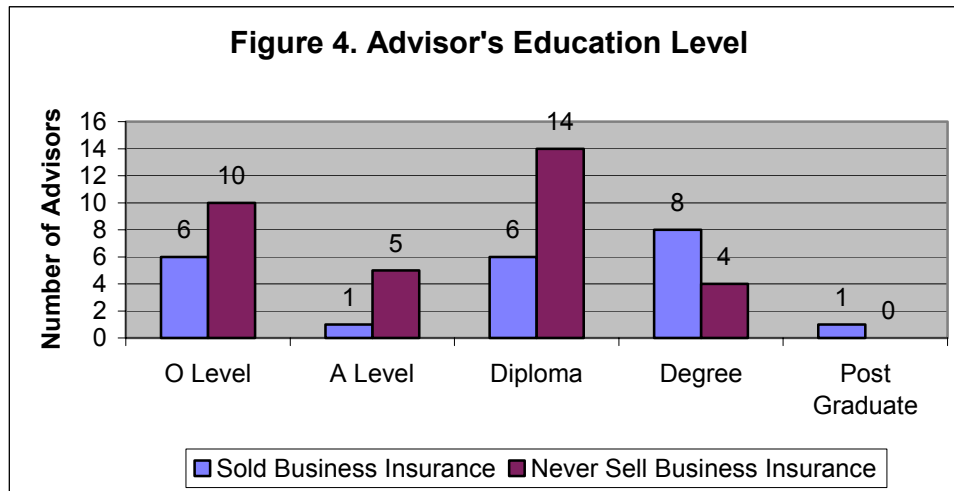
Other interesting findings from these interviewed revealed that:

The reasons quoted by insurance advisors in the order of importance are:

1. Prospecting the business risk/ insurance market is tough; owners seemed too cost conscious in the current very tough business situation. Present more than the future is the main thinking platform for SME business owners
2. Lack of mentorship and guidance from experienced advisors/corporations and
3. Inadequate and insufficient training by providers of these products eg insurance companies or banks.
4. Technical issues on tax and law not well understood by business owners.
5. Little incentive provided by providers of these products. Simpler to sell eg. personal insurance is simpler and pays the same.

What type of training these business planners generally received and how they lacked sufficient awareness training in these products:

1. On the job training with experienced advisors- mainly neglected in their opinion.
2. In-house training, some but quite insufficient
3. LUTC and other related vocational courses- some.
4. ChFC, CLU, CFP and other professional designations- some theoretical training included.
5. Others- very little mentioned.



SUMMARY

The data and our face to face interviews revealed the following picture(s):

1. The results from the survey of business owners confirm our hypothesis that the awareness level of business owners is generally low in regard to business succession/other risk management tools relating to human assets available widely in the market place.
2. Organizations with high profit have a higher awareness level than others.
3. Organizations with more than 8 owners have a higher awareness level than others.
4. The main reason why planning advisors do not promote business risk management/insurance tools(provided generally by banks or insurance companies) is because of the difficulties faced with “prospecting the business insurance market”.
5. The most needed training by advisors who are interested to participate in promoting business insurance is “On the job training with experienced advisors”.

CONCLUSIONS

Our findings support the following conclusions including recommendations:

SME owners and even among insurance professionals there is widespread absence of knowledge as how to use available financial techniques to control/manage financial risks inherent among key persons in whom the depends the fortunes of SMEs. Some of them cannot be eliminated, but yet can be minimized.

Related government bodies and trade associations should organize periodic workshops and seminars regarding business insurance to update and inform the business owners their knowledge about business risk management tools including relevant insurance products. Ignorance cannot be good for anyone, business owners or providers or financial planning professionals.

Insurance/banks and other companies should take the initiatives to organize their own pools of existing practitioners in the business insurance market to provide proper guidance to help those insurance advisors who are interested to participate in providing services to the business owners.

Financial planning advisors can upgrade their skills and knowledge by actively participating in related training so as to equip themselves with the proper tools to service the business insurance market competently.

Training providers, eg Insurance and Financial Practitioners' Association of Singapore, should take due note of these findings.

We daresay that this article is less related to the theory of SMEs, but based on facts gleaned from the operators of SMEs, about matters that concern them materially, yet they often seem unaware that those too could be managed. We also daresay that what we found to be true in Singapore could well be true in many other places, including today here in Jo'burg.

SOME READINGS CONSULTED

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Terms Explained- An Appendix Only (Well established Human Assets Related Financial Risk Management Tools available to SMEs in our market as in the West):

0/1/2/3/4	Plan	Objective	Key Benefits
	Executive Bonus Plan (Selective Employee Benefits plan)	Retention of key selected employee by providing life insurance and retirement benefits	<ol style="list-style-type: none"> 1. The employer pays deductible premiums for the employee. 2. The selected employee has an added incentive to stay with the company.
	Group Life Insurance	Provide life insurance death benefit for employee's family	<ol style="list-style-type: none"> 1. The employer provides low cost insurance coverage to employees with deductible premiums. 2. It improves overall employees' morale.
	Key Employee Life Insurance	Provide protection to offset financial losses to a business due to death of a valuable employee	<ol style="list-style-type: none"> 1. It stabilizes the business and assures creditors. 2. Instant cash available to line and train a new person. 3. The accumulating cash value will serve as extra funds for expansion, enhance the credit standing of the business, supplement the key person's retirement plan, etc.
	Disability Income for Key Employee	Provide salary continuation plan for selected employee during period of disability	<ol style="list-style-type: none"> 1. Improves the morale of the key person. 2. It continues paying salaries and retires pressing obligations.
	Split Dollar	Retention of key selected employee by helping him or her purchase life insurance at relatively low cost.	<ol style="list-style-type: none"> 1. It enables the insured employee to carry permanent life insurance at less than term cost 2. No cost or risk to the employer who contributes to the premium payment i.e. he gets his money back guaranteed. 3. The employer can single out promising young employees and tie them to the business by offering them low cost insurance coverage.

0/1/2/3/4	Plan	Objective	Key Benefits
	Business Continuation (Buy/Sell Agreement)	<p>Cross Purchase</p> <p>Disposal of business interest upon death of an owner, by transferring ownership to surviving co-owners who continue business</p> <p>Share Purchase Insurance Trust</p>	<ol style="list-style-type: none"> 1. No need to do business with the widow, children or executor of deceased shareholder. 2. Avoids the risk of unwelcome outsiders obtaining a control in the business. 3. It prevents a weakening of the business that would result from draining off cash or selling non-liquid assets. 4. It creates extra borrowing power for business emergencies or expansion.

		Disposal of business interest upon death of an owner, by setting up a Trust for purchase of deceased's interest	
	Deferred Compensation	Retention of key executive by deferring taxable income and providing salary continuation	<ol style="list-style-type: none"> 1. Help the employer to attract and retain a much-needed executive. 2. Enable the employer to offer a deferred salary increase PLUS a substantial death benefit. 3. Provides the employee with a sizeable retirement income
	Medical Expense and/or Major Medical	Provide basic and/or more extensive coverage for hospital, surgical, and other medical expenses incurred due to sickness or accident	<ol style="list-style-type: none"> 1. It takes care of a situation very often worst than death should a prolonged disability occur.
	Disability Buy out	To handle the disability business-continuation risk	<ol style="list-style-type: none"> 1. Lump sum benefit 2. continue salary payments to the owner 3. begin installment purchase payments to owner 4. provide an accumulated fund to enable the purchasers to provide a portion of the purchase price.
	Stock Redemption	Solve financial and estate planning for shareholders through redemptions of some or all of their stock.	<ol style="list-style-type: none"> 1. Shifting of control 2. Termination of Interest