

7 ways to minimize small-business risks

By *G.M. Filisko - Bankrate.com*

If you're a small-business owner, you're by definition a risk-taker. The danger, however, of being comfortable with taking leaps of faith is that you can sometimes overlook smart and simple ways to minimize the damage if your leap ends in a fall.

Here are seven ways to do just that.

1. Be cash-conscious

"The number-one risk for most small businesses is improper cash-flow management," says Scott Lovingood, CEO of The Wealth Squad Inc., a small-business consultancy in Riceville, Tenn. "Calculate every month how much money you have on hand and how long it will last if your income dries up. Also evaluate monthly your total accounts payable and the number of days accounts are outstanding because a slowdown in accounts payable will lead to cash-flow crunches."

Avoid those crunches by creating a contingency plan and setting aside three to six months of operating costs in reserves. "In the contingency plan, ask where your business would be three to six months from now if you lost your biggest client," explains Lovingood. "Which expenses could you cut? Which would you have to keep paying? That number of three to six months is variable because you could have cash-flow problems for various reasons. Losing a key customer could take away 50 percent of your revenue, but it might also take away 50 percent of your expenses."

2. Insure against your specific risks

It's not enough to purchase standard insurance policies. You must know the specific risks your business faces and insure against them. "There are a lot of key risks that business owners don't realize they're not covered for," explains Andrew Cohn, president of ALC Risk Solutions Inc., an insurance agency in Boca Raton, Fla. "Today I met with the owner of an air-conditioning company. He didn't have coverage for his equipment if his tools or air-conditioning units were stolen during an installation. He also didn't have coverage for customers' property in his workers' care and control. If his workers moved an armoire, and it was damaged or injured someone, he wasn't covered."

If your business includes an online component, determine how effectively your policies cover that aspect of your business. "Assume you have a shoe store," explains Jonathan Ezor, a law professor at Touro Law Center in Central Islip, N.Y. and special counsel to The Lustigman Firm, a New York City law firm. "You probably have coverage for inventory, along with business-interruption insurance. But does the business-interruption insurance cover you if your Web hosting company goes out of business and your online business is down for two months? Probably not. You may also host an online forum where customers can talk about shoes. If someone posts child pornography or a computer virus there, is that covered by liability insurance meant for slips and falls on the sales floor? Probably not."

3. If your business changes, your insurance should, too

Meet annually with a trusted insurance broker to determine whether your business has changed in significant ways that require modifying or adding coverage. "Go through a checklist of coverages and have a discussion," advises David Kirkup, a partner at Atlanta-based B2B CFO, which provides part-time chief financial officers to small- and mid-sized firms. "What new things have you done in the last year? Have you acquired a company, introduced a new product, begun to do business in a new state or country, hired different people -- all those things might trigger a new risk."

4. Insure key people

If key staffers leave or can't perform their duties, your entire business could fail. "You've got to have key-person insurance on anyone who's mission-critical to your business," says Lovingood. "If you already have key-person insurance, review your policy quarterly because it may be outdated if your business has grown dramatically."

5. Use contractual indemnification clauses

Seek indemnification for potential damages caused by other businesses and people your business relies on regularly. "Let's say you distribute a piece of software to your customers," explains Ezor. "It turns out the provider didn't have the rights to the software, and you get sued. That's where indemnification comes in. But it's only as good as the finances of the other party. If you're worried the finances on the other side of the contract aren't sufficient for the possible risk, you can contractually require the other company to maintain insurance."

6. Give yourself an out

If you launch a new venture or enter into a new contract, you need to be able to cut your losses if it goes bust. "Your contract should cover how you can end the relationship," says Ezor, "and what happens when you do."

7. Create separate entities

Any time you take on a new risk, consider creating a new legal entity. "If a new risk involves the same market but a different set of customers, you probably don't need a new entity," says Lovingood. "But if it adds additional risks from a monetary, lawsuit or partnership standpoint, you need a separate entity. Any time you cross state lines, add partners, or add legal risks your current business doesn't already deal with and that you're not insured for, look at separate legal structures."

Also use separate entities to prevent the loss of your assets. "Whenever significant long-term assets exist, consider a separate holding entity," explains Kirkup. "Real estate is the prime example. Put property into a separate entity, and rent it back to the business. Another example could be patents for your products."

Don't shy away from creating new entities because of the cost. "In most states, setting up a corporation or limited liability company costs \$400 to \$600, and your accountant may charge you to do an extra tax return," says Lovingood. "You may pay only \$1,000 a year for additional risk and asset protection."

The key to minimizing risks is foreseeing and preparing for them. "Small-business owners can get off track by falling into the prediction trap," explains Randy Park, a Toronto-based author and speaker on small-businesses. "You assume that what happened yesterday is going to happen tomorrow. But you need to be really clear on the risks affecting your business model."