

THE TEAM WITH THE BEST PLAYERS

WINS..... Jack Welch

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Product and Service Are the Drivers Each Time a New Business Is Started

By William York, VP of Marketing



In all new business startups, it is about the profit that can be generated when selling new products and services. This is the driving force behind starting a new business.

Creating a Captive Insurance Company is the same!

The only difference is the fact that an insurance company also represents a **social issue**. The governmental bodies understand that insurance companies serve a social purpose and as such the governmental bodies provide unique benefits to insurance companies. After all, insurance companies protect business from losses and secure employment. They affect the economic engine of the country. However, when forming a new insurance company, the first driving force is always profit. AIG, HARTFORD, AON etc., were all created to ultimately produce revenue for the people who took the risk, invested capital and understood the needs of the people buying their product.

Supporting the needs of the sponsoring companies should be the driving force behind the formation of a Captive Insurance Company. Professionals working in the Captive area understand that a Captive will help control risk which in turn will enhance profits and ultimately create reserves in order for a business to flourish more effectively.

They understand that Captives serve multiple purposes standing beside the sponsoring businesses.

They understand that a Captive Insurance Company is a separate business and must operate separately and must be driven to produce revenue.

An experienced professional will be able to analyze not only the risk management needs of the sponsoring business but the unique business needs that can be derived by creating and operating a Captive Insurance Company. This fact, however, is often overshadowed by the short-term view that Captives are a tax planning strategy. Our experience has shown that the needs of the business will in time overshadow this short-term focus.

During the creation of a new Captive Insurance Company consideration must be given to the ownership design. While Congress has demanded that the ownership of each 831(b) Captive mimic the ownership of the sponsoring business, there are situations when the sponsoring business has multiple owners. So, how should the ownership issue be handled? Should the Captive be owned by an LLC which has the same ownership as the sponsoring company, or should the Captive be owned directly by the various partners?

By setting up the ownership of the Captive utilizing an LLC, we can create an operating agreement between the partners which in time will more effectively serve the needs of the various partners.

Without an effective operating agreement, this new business.....your Captive Insurance Company, will be severely limited.

Vertical integration is when a company controls more than one stage of the supply chain. It is a competitive strategy and it is a more effective methodology to bring a product or service to the end user. It makes sense because it allows a company to reduce costs across various parts of production, ensure tighter quality control, and ensures a better flow and control of information across the supply train.

Usually each member of the supply chain is engaged in a different stage of the development process of product or service, and the multiple components of the supply train integrate to satisfy a common need. As many businesses grow and mature, they look for more effective and efficient means to grow revenue and boost profits. This method is effective because the supplier or service provider is already making a profit serving the core business. It's, therefore, logical since the core business is knowledgeable about the service providers.

From our experience, an additional benefit is that the core business also gains better control of their risks, including the risk of a key supplier folding or choosing to sell to a competitor. However, a proper advisory board to evaluate the potential risk of these transactions is essential. While the various state insurance departments will permit these transactions, we know this is a true business issue not an insurance issue and due diligence is essential. Without an independent advisory board this risk should not be taken.

In line with this thinking a mature captive is in its own right a large investment management company that controls millions of dollars of investable assets. Unfortunately, we find the task of managing these assets often falls in the hands of an investment advisor who is not connected to the needs of the sponsoring company that created the captive and needs the captive to enhance its growth.

Losses are not useable within a captive!

Therefore, certain strategies should be avoided.

Dividends are preferential in a captive!

Therefore, they should be preferred.

Because of its social requirements an insurance company operates under different guidelines than a regular corporation. The investment advisor managing the firm's 401(k) should not be the same person managing the assets of the Captive Insurance Company. This role should fall under the control of your advisory board. 831(b) captives are designed for middle market companies to enable them to compete more effectively with larger companies. Unfortunately, middle market companies do not have the same level of professional staff as the Fortune 500 companies. To eliminate emotional decision making a level of control needs to be created.... This is achieved by an advisory board.

In the end it comes down to who advises the sponsoring firm during the creation and the operation of the captive insurance company.

Should you be guided by an accounting firm, a law firm, an investment manager, an insurance person or a business consultant ...

The answer is very clear.

No Captive should be formed without the assistance of an independent business consulting group.

- ✓ This is a business arrangement not a tax manipulation strategy.
- ✓ This is a method of growing your bottom line.
- ✓ This is a separate and new business that requires selective knowledge and experience.

Call Independent Captive Associates, LLC to learn how to get started.

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