Industry Cluster Briefings Series

RISK MANAGEMENT

MUST-DOS FOR SMALL TO MEDIUM-SIZED BUSINESSES

INSIDE

Overview

Following the landfall of Hurricane Sandy in 2012, many New Jersey businesses experienced a wide variety of business disruptions. These disruptions ranged from the temporary loss of power to rationing of gasoline; from transportation and supply chain challenges to physical damage of inventory and structures. In addition to the need to recover from the disaster, many businesses expressed a desire to learn from the events of the days, weeks, and months that followed Sandy and apply those lessons to recover more efficiently from the next incident. In response, a series of federal, state, local government and private sector roundtable meetings were convened to identify actions that could help NJ businesses be better prepared. This toolkit was developed in response to those discussions, and summarizes the many risk management information resources available from the Federal Emergency Management Agency, Small Business Administration, Insurance Information Institute, Institute for Home and Business Safety, and many other professional organizations. Included are materials that focus on three major elements of risk management: business continuity, insurance, and hazard mitigation. Additionally, the tool kit includes industry-specific guides, training resources, sample plans, and useful implementation checklists.

Risk Management Checklist:

1. Business Continuity
2. Insurance
3. Hazard Mitigation

1. Business Continuity

Business Continuity includes the plans businesses create and the activities they undertake so that, in the event of a disruption, they are able to resume operations as soon as possible. While failure to plan for a major disaster frequently results in many business failures, the chances of surviving a disaster double with a good Business Continuity Plan (BCP).[1] About 40 percent of small businesses fail because they have no plans for rapid recovery and insufficient funds to cover the expense of extended downtime.[2] ; however, BCPs may lower that number as much as 20 percent.

The main objective of a BCP is to quickly recover from business disruption. The recovery plan must ensure continuity of important business operations by documenting the most cost effective recovery procedures for the most likely scenarios. A value-driven recovery requires a focus on minimizing downtime and lost productivity and maximizing revenue while maintaining customer satisfaction and avoiding disruption to existing supply and distribution channels. A comprehensive BCP can speed recovery to profitability by minimizing tangible and direct losses such as lost sales, lost production, and missed deliveries. Depending on the business model, the return on investment for business continuity implementation practices may vary, but it often helps to think about the value of BCP investment. This investment can be measured in terms of the number of days a business saves by regaining the ability to produce and/or sell its' products and services.

Resources

It is critical to identify key processes, personnel, suppliers, distributors, and other links needed to either regain or maintain an acceptable level of production and/or sales. Establishing plans to guide staff through the unexpected can become invaluable resources during challenging situations.

Losses can be minimized and reputations can be protected by well thought out and rehearsed contingency plans. More information on Business Continuity may be found in the following links:

- FEMA Preparedness for Businesses
- SBA Disaster Planning
- Institute for Business and Home Safety
- FEMA: Ready.gov
- Red Cross Ready Rating

Fundamentally, the BCP asks three questions:

1. What threats face us?
2. What risks do those threats impose on us?
3. What can we do to minimize (or eliminate) those risks?

A well-designed BCP attempts to answer those questions. It will include, at a minimum, four components:

1. People (Who backs up whom? How will you reach them?)
2. Places (Where can they work if we lose our facility?)
3. Process (How can they operate if the primary process is unavailable?)
4. Protect (How will you protect your key data and records? How will you ensure cash flow during the disruption? How will you protect physical assets?)

[1] http://www.arcweb.com/pages/default.aspx, http://www.slideshare.net/AChatha/business-continuity-and-recovery-planning-for-manufacturing
[2] IBHS: http://www.disastersafety.org/

2. Insurance

When purchasing business insurance it is important to obtain the right amount, and the right product for the unique risks faced by each business. Ensuring that a company is neither over insured nor underinsured is critical. Coverage should be chosen with input from management, legal counsel, and the insurance provider.[3]

Business Interruption Insurance

Business interruption insurance compensates for the business income lost following a disruption. This form of insurance is also commonly overlooked by businesses. This oversight is the result of a combination of factors, but most often is because business owners expect their property insurance will cover ALL losses, when almost all only cover physical damage losses. Even if the business does purchase business interruption coverage, it is important to ensure coverage for a sufficient post-incident cash flow and a "rainy day" fund. Business interruption insurance coverage typically does not activate for a specified time period after an event occurs. The time period will be listed in the policy and is generally not retroactive to the first day of disruption. [4]

Commercial Property Insurance

Commercial property insurance will provide coverage for any building owned or leased, including improvements and permanent fixtures and equipment, business property on premises and personal property of others in the 'care, custody or control' of the company. Companies may also need to add coverage for goods in transit and buildings under construction. Finally, an insurance policy review should be conducted at least annually to determine if any changes or updates are needed due to changing circumstances such as new facilities or equipment.

Insurance Package Policies

New Jersey businesses can purchase bundled coverage, like the Business Owner Policy (BOP), or the Commercial Package Policy (CPP). Both the BOP and CPP combine Liability, Property, and Business Interruption Insurance. Some contain additional coverage designed specifically for individual companies. The BOP usually targets small and medium-sized businesses. The CPP has more flexibility to tailor insurance coverage to the specific needs of a mid-sized to large business or a business that may encounter greater hazards. *(cont. on page 3)*

[3] Insurance Information Institute, www.iii.org
[4] http://www.insureuonline.org/smallbusiness/topic_bus_prop_liability.htm#tips_prop

2. Insurance continued

Insurance Package Policies, cont.

It should also be noted that business interruption will generally not be covered by perils that are not covered under the general business policy. For example if wind is not a covered peril, any business interruption caused by wind will not be covered. Check with the insurance provider for ways to get specific perils covered by insurance. Additionally, most often the situations when coverage is triggered are limited to physical damage that ceases operations, physical damage to other property which blocks access, and government action to restrict access to the business.

Key Questions to Ask an Insurance Provider

At the annual review of the business' policy the following questions should be asked of the insurance provider:

- Which perils are or are not covered under the current policy?
- What insurance changes may be coming in the next year?
- What should be considered for increases in coverage?
- How can the company become more attractive to insurers in an effort to receive better coverage at a better price?
- What is the provider's biggest concern with current insurance coverage?
- Are there any additional options?
- Are there any incentives/benefits available to businesses that have undertaken mitigation or continuity activities?

National Flood Insurance Program

The National Flood Insurance Program (NFIP)[5] was created by Congress in response to increasing costs of floods, primarily due to disasters. At the time NFIP was enacted, flood insurance was not readily available or affordable through the private insurance market. NFIP was recently changed. On July 6, 2012, President Obama signed the Biggert-Waters Flood Insurance Reform Act of 2012[6] extending the National Flood Insurance Program through September 30, 2017. The act instituted many changes, and a thorough review is recommended for any business considering flood insurance. The program and changes can be found via this link: National Flood Insurance Program and Reforms

[5] http://www.fema.gov/national-flood-insurance-program
[6] http://www.fema.gov/flood-insurance-reform-act-2012

2. Insurance continued

Examples of the changes in the new Act include:

- Subsidies on properties with repeated losses, which many properties suffer, will be phased out
- It will be easier to apply for the FEMA buyout program
- The legislation caps annual premium increases at 20 percent, a 10-percent raise over the previous cap
- Coverage is now available for multifamily properties, which were excluded under the old program[7]

Two additional links to information on NFIP are:

- National Flood Insurance Program
- Building Higher

3. Hazard Mitigation

Hazard mitigation is any sustained action taken to reduce or eliminate long-term risk to life and property from a hazard event.[8] For example, hazard mitigation refers to structural investments such as storm shutters, placement of generators to higher elevations, relocation, or raised elevations, structural retrofits in severe event-prone areas, controlled burning, among others. Mitigation is taking action *now, before* the next disaster, to reduce human and financial consequences later.[9] Mitigation also presents a significant cost savings; each $1 invested in mitigation saves at least $4 in long term disaster repairs and recovery[10].

Links to simple Hazard Mitigation strategies

- Installing a Generator for Emergency Power
- Protecting Business Records and Inventory
- Rebuilding with Flood Damage Resistant Materials
- Installing Sewer Backflow Valves
- Raising Electrical System Components

Additional Information on Implementing Hazard Mitigation

- Additional Mitigation Programs and Activities for the Home
- Additional Mitigation Programs and Activities for Businesses
- FEMA Region II Coastal Analysis and Mapping

[7] http://www.insurancejournal.com/news/national/2012/07/31/257675.htm
[8] http://www.fema.gov/what-mitigation/federal-insurance-mitigation-administration
[9] http://tulane.edu/cpreg/hazmit.cfm
[10] http://www.gpo.gov/fdsys/pkg/PLAW-111publ351/html/PLAW-111publ351.htm