StrategicRISK

SPECIAL REPORT:

PRODUCT RECALL

Recalling a product is a potentially crippling step – and the digital revolution has made it even riskier than ever

In association with

Swiss Re Corporate Solutions

Back where it all began

The risk of a product recall is certainly nothing new, but with the relentless rise of technology, the risk landscape has changed out of all recognition

Product recalls have always loomed large as a risk that can be deeply damaging, even terminal, to some corporations. Perhaps most famously in recent times was Volkswagen's worldwide repair of 11 million diesel vehicles so that their emissions systems would comply with pollution regulations.

The cost of this recall? Somewhere in the region of $34bn, according to reports.

The damaging effects of such drastic actions are not just short-term and financial either, nor does the product recall need to be for particularly petrifying reasons (like last year's recall of children's crayons from China for containing asbestos).

Take the mineral water giant, Perrier. In the early 1990s, Perrier was the leading water brand in a growing market.

Then, in 1992, it was discovered that some bottles had miniscule quantities of benzene, with no impact on human health. Perrier recalled 160 million bottles from 120 countries at a cost of more than $250m.

Despite not a single illness from the scare, by 1995, sales of Perrier water had fallen to half of their 1989 peak.

A lot has changed since then.

The Perrier recall was before the widespread use of the internet and well before the advent of social media, while the delivery of products and information has been changed forever by the maturity of new technologies.

CLAWING BACK COSTS

So, what are some of the new, and sometimes hidden, issues in the supply chain that have been caused by the rise in electronics and other technological advances?

"There is an increasing trend for producers of products to look to suppliers to recoup recall costs," says Angela Kelly, head casualty Asia-Pacific, Swiss Re Corporate Solutions.

"TECHNOLOGY ALLOWS PRODUCERS TO MORE ACCURATELY IDENTIFY WHERE RAW MATERIALS COME FROM AND THIS HELPS THEM TO RECOUP COSTS"

Swiss re Corporate Solutions head casualty, Asia-Pacific
Angela Kelly

"Advances in technology allow producers of products to more accurately identify where raw materials come from and this helps them to recoup costs from companies down the supply chain."

Kelly says raw material producers tended to hold the view that they were protected from recall costs recouping because it is too difficult for them to be identified accurately. Not any more, however.

"In the context of technology in the automotive industry, there is an increasing trend towards platform standardisation, and sharing this can result in higher recall costs – because if there is an issue with one platform, it can impact a higher number of vehicles across numerous brands," notes Kelly.

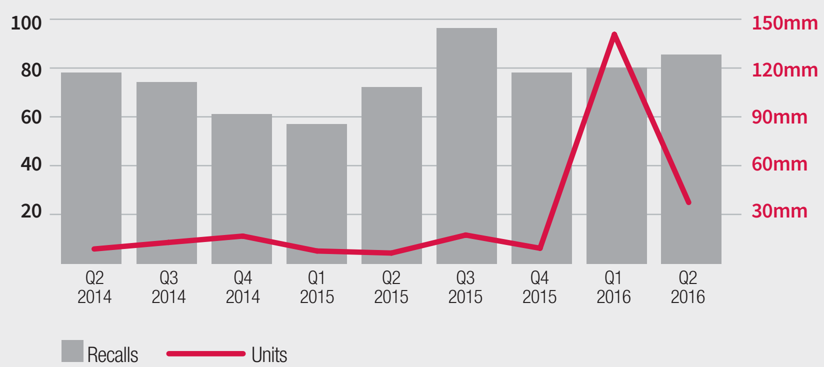
She says the key issues for food and beverage and auto companies – today and moving forward – include the impact of globalisation, increased traceability for recalls, reputation issues (particularly around social media), cost management, crisis management and regulatory developments.

Peter Jackson, director, Asia region, multinational clients, Lockton Insurance Brokers, adds that some of the new recall risks are around "dependencies", such as suppliers being dependent on IT systems, third-party IT cloud suppliers and third-party logistics systems.

"Risk has been delegated, but it is not necessarily understood either what those risks are, or who is responsible for managing them," he says.

When American firm Stericycle Expert Solutions studied recalls in the US, this is what it found

Consumer recalls and units



Source: Stericycle Expert Solutions Recall Index Q2 2016

THE INTERNET OF THINGS' IMPACT

With the proliferation of the Internet of Things (IoT) – the network connectivity of physical devices, vehicles, buildings – product recall risks take on other forms.

"Take vehicles, for example," Swiss Re's Angela Kelly says of IoT. "It is now possible for vehicle manufacturers to remotely fix a problem within a vehicle operating system without the need to replace parts or inconvenience consumers with having to physically return the vehicle.

"However, IoT may also lead to a shift of losses from product liability to recall. Due to early detection of issues, there is a lesser chance for BI/PD to occur and companies will increasingly initiate a recall where they may not have before, or will do so earlier."

Lockton's Peter Jackson says IoT potentially disperses production and service across multiple organisations and geographies: "This brings complexity to how you assess ultimate responsibility for a product failure, who is responsible singly or shared, and where are they domiciled? At the very least, it makes subrogation more difficult."

Jackson says businesses could be using new technologies, such as 3D printing, drones and driverless vehicles, and are facing new risks from those technologies that are not yet fully apparent.

"Then there are new payment methods, such as Apple Pay, AliPay, WeChat Pay, TrueMoney, Bitcoin, which are helping consumers, but they are still largely untried and untested, particularly from the perspective of cyber risks."

RISK MANAGER CHALLENGES

"It is not uncommon for risk managers to have a view that since they are at the very beginning of the supply chain, a recall claim will not happen to them," Kelly says.

"There is also a general lack of awareness on how claims happen and evolve and a divergence of opinions on the impact of the changing landscape when it comes to recall exposures."

Jackson says that the attitude of risk managers depends on whether or not they have experienced a major recall event. If not, there is a danger of complacency.

"This is consistent with other risks. Companies tend to be less concerned about risks they haven't experienced, which doesn't make sense when you think about it," he explains.

Kelly says risk managers should mitigate the new risks around the supply chain and product recall by identifying current and future risks, evaluating against risk appetite and transferring the risk. She adds: "Mitigation can happen through improving manufacturing processes and standards, contractual agreements, financial instruments such as self-funding or risk-transfer mechanisms to protect against earnings volatility, plus having a comprehensive up to-date and regularly tested recall plan."

"ONE CHALLENGE TODAY IS CHANGES IN DISTRIBUTION BUSINESS MODELS, ESPECIALLY WITH ECOMMERCE"

Head, group risk and internal audit, Lazada Group
Gordon Song

Gordon Song, head, group risk and internal audit, Lazada Group, says the firm recently invested some time in coming up with a product recall plan.

"One challenge today is changes in distribution business models, especially with ecommerce.

"The question of who is liable for the product is fuzzier and the laws for ecommerce and consumer protection are not geared for this," he says.

RIGOROUS OVERSIGHT

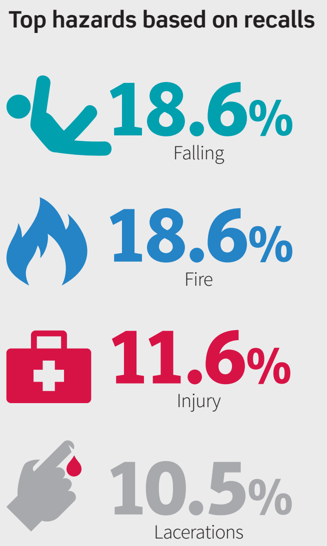
Another challenge for product recalls in Asia over the next 10 years is the increased focus by authorities.

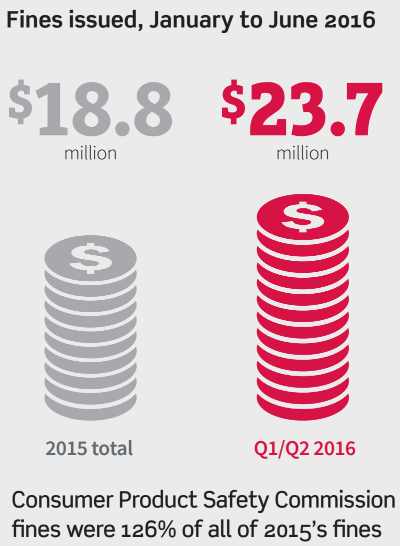
RQA Group managing director Vince Shiers says food safety authorities in this part of the world are following their US and European counterparts in increasing regulatory oversight.

"For example, 2015 saw the new Food Safety Law from the People's Republic of China, which emphasises food safety requirements and includes requirements for online retailers," he says.

Notification of recalls to the public is also now commonplace in some Asian countries. For example, the Singapore Agri-Food and Veterinary Authority (AVA) has an excellent real-time listing of food product recalls.

As Shiers concludes: "There is no doubt that this regulatory focus and transparency will develop further in the coming years and it will result in more recall alerts nationally and internationally."





The remarkable evolution of product recall insurance

At one time, policies dealt solely with the risk of the buyer suffering bodily harm or property damage – but a rapidly changing world made insurers raise their game

Product recall insurance is an essential risk mitigation measure, but as the recall space has evolved, so has its insurance coverage.

"Historically, product recall covers were triggered only by an actual or imminent threat of bodily injury or property damage," says Angela Kelly, head casualty Asia-Pacific, Swiss Re Corporate Solutions.

"Triggers have evolved to recognise the changing contractual obligations of the manufacturer-buyer relationship to allow for cover where the product fails to perform its intended function."

Kelly points out that cover is also more freely available as the number of companies offering such policies has increased.

Eddie Ong, senior vice-president, corporate risk services, Marsh, says that over the years, product recall insurance has evolved to indemnify losses arising from events other than accidental contamination, such as adverse publicity, government recall, intentional impaired ingredients, malicious product tamper and product extortion.

"Solutions that are more bespoke may also be possible for some food and beverage sectors," he explains.

"The types of losses that are recoverable from these events have also expanded from first and third-party recall expenses to business interruption to consultancy costs, and others."

Kelly at Swiss Re notes that a non-standard policy, or a parametric solution, for product recall insurance would include customising retention levels, attachment points, profit commission and additional premium features such that the value of the insurance is optimised.

One possible example of a non-standard policy using a parametric solution, Ong suggests, could be one where the insured receives a payout when pre-agreed events occur within a defined period, leading to a predetermined fall/fluctuation of a financial key performance indicator.

As for captives, Kelly says they can play an integral role in helping firms to achieve an efficient and self-directed risk transfer mechanism. For his part, Ong feels that rather than self-insuring the exposure, the captive can be used as a vehicle to create an efficient funding option.

Speaking about the kind of developments that will take place in the product recall insurance space moving forward, Kelly expects further innovation and says that non-standard solutions will play a more prominent role.

At Marsh, Ong agrees that the product recall insurance space will continue to innovate.

"However, we suspect it is likely to be incremental changes as we have seen over the years, rather than 'leapfrogging' innovations.

"Any improvement or change will largely be dependent on the evolving needs of clients and the business and regulatory risk landscape that they face," he adds.

THE WAY TO MANAGE A CRISIS

Vince Shiers, managing director of consultancy RQA Group, on the role of risk managers in a crisis

When it comes to building resilience pre-crisis, Shiers says there needs to be a focus on prevention, including an effective plan and well-trained staff.

"The crisis team should receive annual crisis training in managing a range of crises considering various scenarios," he explains.

"There should be annual simulations considering varied scenarios relevant to the company, varying the complexity to reflect team knowledge and capability, as well as business complexity."

Shiers says risk managers often work in a complex management structure where they have risk management objectives, but do not always have teams of personnel reporting to them that can implement the risk management strategies.

"Risk managers therefore have to work with other senior management to ensure risks priorities are represented.

"They will ensure the risks are mitigated where possible and insurance cover is purchased where the risks dictate."

He adds: "During an actual incident, the risk manager will often be the person who has contact with external resources linked to the insurance, such as brokers and specialist consultants."

A good reputation cushions the blow

Research shows that by a very large margin, 'excellent' companies with a good name among consumers are more likely to bounce back from a crisis

The relationship between a company's reputation and its resilience to a product recall crisis has been highlighted in study by the Reputation Institute.

The research body found consumers are more likely to give the benefit of the doubt to better-reputed companies when it comes to a product recall crisis that relates to product quality issues, supply chain disruptions, workplace, and ethical or regulatory issues.

When a crisis strikes, 79% would trust companies with an 'excellent' reputation to do the right thing. Only 27% would trust firms with an 'average' reputation and 8% those with a 'poor' one.

RL Expert managing partner Leesa Soulodre says speed of communication is key: "Effective reputation risk management requires a company to communicate accurately, timely and transparently about these facts and to take responsibility/accountability for the issue and any clean-up.

"The faster the company is to apologise, to show empathy to its victims and to be seen to be addressing the issues so that it can never happen again, the more likely it is to preserve its reputational equity."

The choice of spokesperson is also key, she says.

"Reputation risk management is about effectively developing advocacy and trust over time for continuous market access and licence to operate. This means significant investment in risk communications and stakeholder engagement prior to any incident. This requires multi-stakeholder engagement from across the organisation."

Recall expert Vince Shiers, managing director of RQA Group, argues the use of social media in product recalls also has major implications. "It will become more common for consumers to post their experiences on social media rather than contacting the consumer care departments of producers or retailers," he says. "On social media anyone can say anything – it doesn't have to be true, so sorting true complaints from falsehoods will seriously challenge the crisis teams of companies when they are trying to evaluate the scale of a food safety incident and what action may be required."

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Managing partner, RL Expert
Leesa Soulodre

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THE RECALL REALITY

BY KEVIN LEUNG,
Interim head of casualty, Asia-Pacific, Swiss Re Corporate Solutions

Most global corporations have tried-and-tested scenario plans for natural catastrophes, acts of terrorism and supply chain disruption events. But when it comes to product recall crises, many companies across the entire supply chain are still finding out the hard way what the true reputational and financial impacts to their organisation will be. In many cases, the results can be crippling and aren't limited to just the large manufacturing companies, as recalls can now be traced to the beginning of the supply chain. Despite this, there is still a tendency among some organisations to believe that it won't happen to them. In many cases this may be because they are far removed from the end product that is being manufactured.

The reality, however, is that the frequency and severity of global recall events are on the rise.

Firstly, consumer safety standards are rapidly increasing, and consumer awareness of those standards is rising too. Second, regulatory activism is more evident, particularly in the automotive sector and the food and beverage industries. Corporations are also placing a much greater focus on product quality as a point of difference against the competition. That's causing corporates to recall products as a precautionary measure in some instances in their efforts to be socially accountable.

Higher consumer expectations and more stringent regulations are influencing the frequency and nature of product recalls. In turn, this indicates a stronger correlation to increasing costs of recall, which are often under-estimated, especially when one considers the reputational impact.

Together this is driving a steady increase in the demand for product recall insurance, but there's some way to go to close the protection gap. The decision not to buy insurance is generally driven by a lack of understanding of what a company's real exposure is and how that's changing. But one only needs to look at a number of recent news articles to see how damaging and widespread a recall event can be.

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