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Product Contamination: Managing and Mitigating the Fallout From a Food-Borne Illness

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$10 million

The average cost of a food recall.

(Source: Grocery Manufacturers Association)

When it comes to food-borne illnesses, the issue for food and beverage companies shouldn't be: "Can this happen to us?" It should be: "When it happens to us, how will we respond?" The Centers for Disease Control and Prevention (CDC) estimates that each year roughly one in six Americans (48 million people) get sick, 128,000 are hospitalized, and 3,000 die of foodborne diseases.[1]

According to a 2010 study by a group of industry experts, the average cost of a recall to participating food and consumer product companies is $10 million, in addition to brand damage and lost sales.[2]

When faced with a product contamination event, an organization's primary focus must always be the individuals most affected. Customers are typically the victims of food-borne illness resulting from a product contamination and can face a myriad of issues ranging from minor, short-term illnesses to long-term, life-altering health repercussions. Adequate actions must be taken to ensure the customers' best interests are considered and addressed.

In certain cases, the C-suite and senior level management may even face personal accountability for any damages arising out of a product contamination event that occurs under their leadership. The Department of Justice (DOJ) has indicted and imprisoned several senior executives and staff members for poor governance on food safety. During a product contamination event, senior leaders should perform an evaluation and assessment of what enabled the incident to occur and do their utmost to avoid a reoccurrence.

1 Centers for Disease Control and Prevention. "Estimates of Foodborne Illness in the United States." http://www.cdc.gov/foodborneburden/.

2 Grocery Manufacturers Association. "Recall Execution Effectiveness: Collaborative Approaches to Improving Consumer Safety and Confidence." http://www.gmaonline.org/downloads/research-and-reports/WP_RecallExecution.pdf.

The following are steps that food and beverage companies should take immediately following a product contamination event to effectively manage the situation and minimize the fallout and long-term damage:

ACTIVATE THE CRISIS TEAM

When the worst case scenario becomes a reality, the organization's crisis team should be engaged immediately. The crisis management team should consist of C-suite or senior level management empowered to make decisions and commit significant resources to resolving the issue. The team could include representatives from functional areas such as human resources, operations, communications, IT, and legal, but the members should be organizational leaders who are decision makers.

IMPLEMENT THE CRISIS MANAGEMENT PLAN

The crisis management team should have a pre-established, integrated, and aligned plan that provides an overall response structure detailing how the team will work together. Such plans should have been validated and rehearsed through table top exercises to ensure that each member of the team has a clear understanding of their individual roles and how the overall plan will be executed during an actual incident.

The role of the crisis management team is not only to manage the immediate and obvious, but to consider potential long-term impacts. The first questions the crisis management team should consider are:

- ► What do we know about why this may have happened?
- ► What don't we know?
- ► How do we want to respond?
- ► What could potentially result from this incident several years from now?

During the initial response, the team will likely not know where the fault lies for the contamination (for example, is it an internal issue, a vendor, or something else) or even what caused the problem. Additionally, the team will be expected to make decisions quickly — often with little information or data. Answering these questions can help the company gather enough information to address the problem before it escalates into a bigger crisis.

It is essential that the team helps the company transition from what could be a chaotic situation to a proactive and controlled response by staying in front of the problem, gathering information, and clarifying what the actual situation is.

As tempting as it may be to speculate about the cause of the issue, it is best to stick to facts and how the company is responding. The team should not offer facts or conclusions unless they have been confirmed.

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IDENTIFY THE ROOT CAUSE

When facing an incident of product contamination, there are two possible approaches: treat the symptoms or cure the condition. While the initial instinct may be to rush to address issues as quickly as possible, companies should take the time to closely investigate and identify the root cause of the contamination to ensure that the issues don't reoccur.

Additionally, the crisis management team should consider whether the company has the necessary in-house expertise to manage the issue or if they need outside support.

Insurance could play a role here. Depending on policy specifics, insurance may cover the cost of outside support during the contamination event. This could include help in areas including crisis management, problem identification, insurance, public relations and crisis communication, and legal. The crisis management consultant can help the company to effectively manage relations with retailers, customers, government authorities, and the media.

The organization should engage professionals to help understand the key contributors to the contamination event, including:

- **Regulatory oversight:** What regulatory guidelines were compromised?
- **Food handling/production:** Was there a lapse in protocol?
- **Supply chain:** Did the contamination come from a third-party?

Once the root cause is identified, it is imperative that management confirms the issue(s) have been resolved by ensuring the supply side and internal operations are functioning optimally and conducting a root cause analysis.

PARTNER WITH THE REGULATORS

Companies and regulators have the same goal — to resolve the product contamination and ensure it doesn't reoccur. Companies therefore need to partner with federal, state, and county/local regulatory agencies.

As the event is unfolding, the crisis management team should be in close communication with the regulatory agencies that are involved. This should be done through a spokesperson who is a senior technical leader who can articulately address what went wrong, what the team did, and what the plan is to further control or resolve the issue.

MANAGE MEDIA RELATIONS

The company's messaging around how it is addressing the contamination may be different for media, employees, and investors, but the core message must be consistent. It is important that the company appears prepared, organized, and empathetic.

The 24-hour news cycle and the prevalence of social media do not allow for delaying comments. As more facts become available, the crisis management team should ensure they are shared immediately through both social and traditional media. This will help paint a clearer picture of the issue, demonstrate the company's efforts to resolve it, and address any misinformation that has been circulated. If the

crisis team withholds information, the media will determine their own angle on the story.

MITIGATE REPUTATIONAL RISK

Whether an organization survives a crisis with its financial condition, operations, and reputation intact is determined less by the severity of the event than by the timeliness and effectiveness of the response.[3] The negative impact of any event is much shorter and less severe if a company has prepared with a predetermined and rehearsed action plan.

To minimize reputational damage, it is important that companies detect problems early and quickly alert the right levels of the organization. One effective way of doing this may be to:

- Develop a reporting system in which employees are empowered to flag issues as they arise, without fear of repercussion.
- Have the crisis management team get in front of the situation in order to minimize the effect of the contamination. Should they close stores? Pull product off the shelves?

It is crucial that the team not underestimate the contamination and its possible impacts. A crisis isn't business as usual. The team should think realistically about potential outcomes. Could it become worse, and are we prepared to handle it if it does?

TRANSFER THE RISK WITH INSURANCE

Class-action lawsuits from victims are not uncommon, but costs may be covered under an organization's general liability (GL) insurance. Regarding product contamination, preparation is an organization's best defense. This is why companies spend thousands of dollars developing crisis plans, conducting drills with their employees, and ensuring they have the insurance coverage they need to withstand the possible customer fallout from an event. There are two types of insurance that are essential for a company to have when faced with a product contamination: general liability and product recall.

Depending on policy wording, GL policies typically cover:

- Bodily injury, pain and suffering, and third-party property damage claims.
- Third-party recall if the insured's product is a component of the third party's product and cannot be remedied by removal of the insured's product.

Again depending on specific wording, product recall insurance typically covers the resulting economic loss, such as:

- Business interruption.
- Brand and sales rehabilitation costs.
- Recall and replacement costs.
- Specialty consulting costs.

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3 Helio Fred Garcia, (2006) "Effective leadership response to crisis", Strategy & Leadership, Vol. 34 Iss: 1, pp.4 - 10

However, the overwhelming financial risk of a contamination incident is not from the number of injured people and the lawsuits looking for compensation. It's from the risk of losing customers and potentially never getting them back. Companies should consider:

- ► How will we get our customers back?
- ► How long will it take?
- ► How much will it cost?
- ► Do we have the cash to afford this?
- ► How will we finance this process?

These expenses will not be covered under a GL policy, but rather by the product recall coverage. Of the major product contamination events in the last five years, the product recall loss was generally significantly higher than the GL loss. The business interruption and cost of reestablishing the brand and market share can be the biggest financial burden.

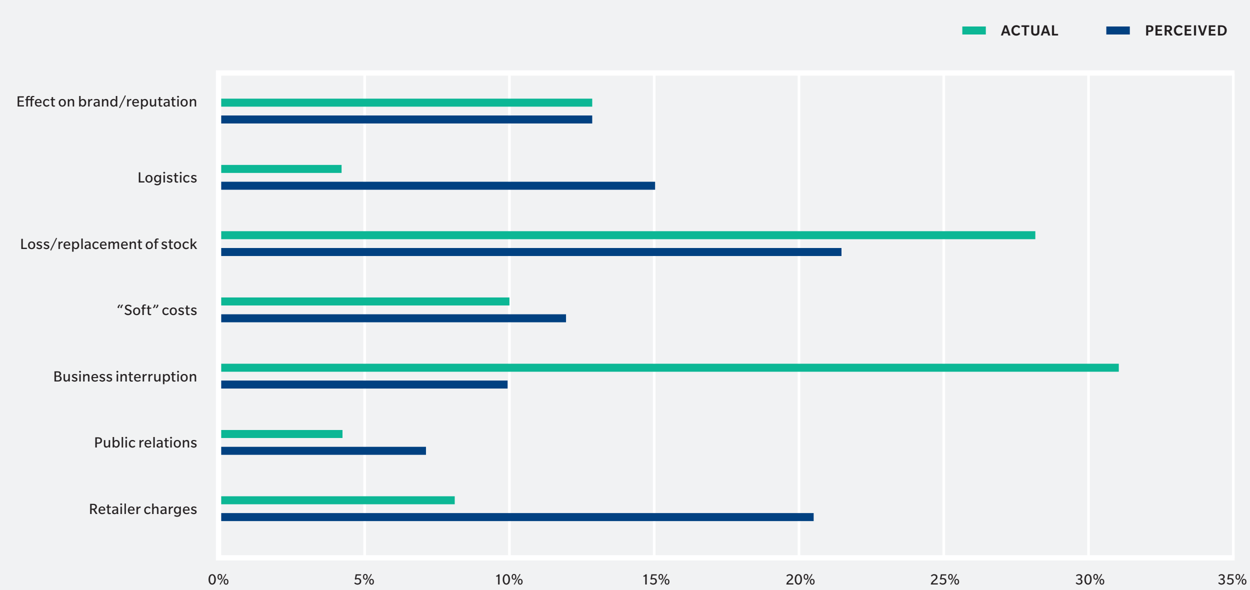
For example, one company that experienced a product contamination — which unfortunately killed three people — experienced product recall-related losses that were five-times higher than their GL losses. The failure to secure product recall insurance nearly put the company out of business.

Consider what would happen if a company's bestselling product saw a 20% decrease in sales for six months. That describes the exposure on the balance sheet that is uninsured in this example if the company doesn't have product recall coverage.

RECALL COSTS: PERCEPTION VS REALITY

Historically, one of the main misconceptions regarding product recall costs has involved business interruption (See Figure 1).

FIGURE 1 **Recall Costs: Perception vs Reality**
Source: Marsh UK April 2010



The above shows the difference between where the actual costs of a product recall event arise compared to where companies believe the costs arise.

Although BI typically accounts for more than 30% of the cost, many companies believe it comprises only about 10%. Companies also tend to overestimate the cost of retailer charges and logistics. Approximately 75% to 80% of the biggest food companies in the US buy product recall insurance. However, only 40% to 50% of smaller or medium size companies have product recall coverage, despite lacking the financial and brand protection afforded by multiple product lines.

A company's product recall policy usually will cover:

- Recall costs including testing, destruction, cleaning of plant/ machinery, destruction cost, and value of product.
- Business interruption costs if a company can't sell their product or make margin on the product.
- Rehabilitation of brand, including increased advertising, coupons, and discounts.
- Consulting costs.
- Third-party risks.

THIRD PARTY RISKS

Beyond the direct costs to their own operations, companies could face expenses from third parties and retailers. For example, when a company recalls products from a retailer, the retailer will charge a slotting fee. After the contamination issue is resolved, the retailer will charge another fee to restock the shelves with the product. This fee is charged per store and per stock keeping units (SKUs). Beyond such fees, a company may lose its prime shelf space to a competitor, increasing the business interruption loss impact.

CONCLUSION

Product contamination and the resulting expenses and impacts to a company are an unfortunate reality for food and beverage companies — from manufacturers and producers to distributors, grocery stores, and restaurants. While much can be done to prevent a contamination event, the threat cannot be eliminated. It is important for companies to have crisis management plans in place in order to mitigate damage to customers, finances, and reputation and to ensure they can quickly return to normal business operations.

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About Marsh's Food and Beverage Practice

Marsh's Food and Beverage Practice is comprised of more than 500 colleagues dedicated to serving the risk management needs of our food and beverage clients. We work with our clients to build effective and efficient risk management solutions, incorporating appropriate risk transfer, mitigation, and retention strategies to manage their unique risks and suit their individual risk appetites. Marsh places more than $500 million in insurance premium annually for more than 375 food and beverage clients in North America, including:

- 50% of the top 100 food and beverage companies in the US and Canada, as ranked by foodprocessing.com.
- 45% of the top 75 supermarkets, as ranked by *Supermarket News*.
- 6 of the top 10 food service chains, as ranked by *Nation's Restaurant News*.

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