Pre-Loss Planning Creates Happy Ending

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The story you are about to read is fictitious and intended to illustrate scenarios that we see in reality every day. The setting could be any city, state or region where medium-sized clothing, specialty food or mercantile retailers operate.

Broad Peak Sportswear, Inc. is operating normally even though the past couple of years have been tough. The business has been able to stay above water and is now poised for an excellent year. In August, anticipating a turnaround in the economy by year's end, Board Peak buyers spent last winter and spring ordering large quantities of stock for their 30 specialty stores. The updates from wholesalers and suppliers in Asia were positive; all expected their shipments to be made, clear customs, and delivered on time at the beginning in October.

In September the company received reports that indicated winter temperatures would be cooler than last year. It was shaping up to be an excellent year for "winter wear." The retail managers began ramping up for a big holiday season and committed to moving a large increase in stock this year.

The distribution manager advised that 50% of the stock that arrives at the distribution centers would be forwarded to outlets during the first week of November, arriving at least two weeks before Thanksgiving. The balance of the stock would be distributed as needed from the closest warehouse after Black Friday. There were predictions of snow before Thanksgiving in the northern part of the country. Broad Peak contacted their insurance broker to make sure their coverage was sufficient for the increased warehouse exposures and stock values.

At the beginning of October, the distribution manager advised that freight was beginning to arrive at both of our warehouses and was being sorted and reassembled in lots to be delivered to the retail stores as outlined in their logistics plan. All seasonal freight was expected to arrive by the 3rd week of October to the western warehouse located in Washington and the following week for the central warehouse in Ohio. Policy amendments for our insurance policies are still pending. Broad Peak decided to check with their broker.

And then, as stories like this go, disaster struck. A fire leveled the western warehouse destroying 75% of the seasonal merchandise for Broad Peak's western distribution network.

How will the story end?

A fire is a tragedy in itself, but a major loss can easily be amplified by actions companies take before and after the loss event. Here are a few examples that can turn this story into a catastrophe:

1. In the chaos following the fire, nobody kept trick of expenditures and the credit facility (revolver) providing working capital exceeded it limit thereby creating an accounting nightmare and delaying payments to creditors. The delays in payments lowered the credit rating of the company and financing became more expensive or not available during this tight credit market. In the end, there was no money to pay suppliers, manufacturers, transportation, and other expenses of the business.
2. An insurance adjuster hired a forensic accounting firm to promote a lower cost amount (attributable to the loss event) to the insurance company. Broad Peak had no claims advocacy to refute this process and outcome. In the end, the insurance recovery was not enough to keep Broad Peak from failing. Having a strong claims advocate could have prevented this outcome.
3. Broad Peak failed to line up contingencies for manufacturing, shipping and distribution forcing them to pay the market value. This caused their ultimate sales cost to soar to 20% higher than their competitors resulting in a significant financial loss for the Holiday season.

4. Because they hadn’t fully planned for a catastrophe, they didn’t have the needed insurance in place while they were trying to recover from the catastrophe. It took longer than expected and their insurance didn’t have the coverage needed to protect them for the extended period of indemnity needed to get sales back to where they were before the fire.

And Now the Moral of the Story

An essential part of a successful recovery process, is to follow a pre-loss plan that identifies who and how the firm will deal with the monumental task of syncing together the business needs with the reality of the insurance response and the peculiarities of the process. Planning first starts by forming a recovery team. The Risk Manager, CFO, COO, the facility Manager, corporate counsel and any other essential personnel make up the recovery team.

An event of this magnitude will test all of the pre-loss planning a recovery team has put in place. To conclude our story, let’s assume that Broad Peak had formulated a plan long before this catastrophe occurred and have been able to fine tune it over time. A well crafted pre-loss plan can literally save a company in a scenario similar to our Broad Peak illustration.

A pre-loss planning team begins its analysis by 1) determining the objectives of their organization, 2) identifying exposures to loss, 3) measuring those same exposures, 4) selecting alternatives, 5) implementing a solution, and 6) monitoring the results. This process results in the organization having the ability to mitigate most of its exposures to loss by being proactive in controlling the table stakes in most any situation. What risk the organization couldn’t assume or sufficiently mitigate is transferred to another party or eliminated. While having a plan for these exposures doesn’t guarantee that losses will have minimal impact on the business, it does better position the organization for the uncertainties that are experienced along the way.

In the Broad Peak example, their plan’s initial response was to stabilize the situation and resume operations. Documentation was vital from the beginning. A cost code was set up in Broad Peaks accounting system so that all expenditures associated with the loss or recovery was recorded. This recording of this information was the cornerstone of the claim that they submitted to the insurance company.

Broad Peak stabilized and resumed operations by utilizing the stock in the eastern warehouse and distributing to all stores while a temporary warehouse was established in the west. The remaining stock in transit for both distribution territories was delivered normally to the temporary western and eastern warehouses and distributed to stores as needed. Inter-warehouse shipments were utilized as needed. In the end, all stores received enough holiday stock to carry them through Black Friday.

Contingent expedited manufacturing commitments were negotiated originally with suppliers in Asia (albeit at higher costs which later became part of the insurance claim). They also used other suppliers where they could. This allowed Broad Peak to keep the stock flowing to the stores after Black Friday. For this season, the company adopted a just in time distribution mentality, particularly after Black Friday. Wherever possible, shipments were consolidated upstream and sent directly to stores to save time. They had excellent relationships with not only suppliers, but also their insurance company and the brokers claims personnel which they called upon. In reality, all parties had a vested interest in keeping Broad Peak in business.

In our real world experience we have worked with “Broad Peaks” of all shapes and sizes. Some have engaged in pre-loss planning and have recovery plans in place for major losses. Others have devoted only cursory time to pre-loss planning. The point of this article is that spending time planning for recovery in the event of a catastrophe may be the difference in creating a happy ending for your business.