

SUPPLY CHAINS

Pruning supply risks

With supply chains entwined through businesses like ivy, disruption risks are climbing. Under-utilised policy wordings and little-known specialist covers haven't weeded them out

By Edward Murray

Supply chain risk is a boardroom concern rather than a priority, according to the spring 2018 *Risk and Confidence Survey* by CNA Hardy.

The research found that in the last six months there have been some significant shifts in the risk landscape and the exposures that most concern senior executives.

Cyber and regulatory risks have pushed political and economic exposures off the risk radar, but corporate and supply chain risk continue to struggle for priority status with most c-suite executives.

According to the survey, only 8% of firms rank supply chain risk as a major concern. It has floated around this level for the last year.

"In our view, they are still not giving corporate and supply chain risk the attention they deserve," says Dave Brosnan, CEO at CNA Hardy.

"It is difficult to think of a time when corporate and supply chain risks have been higher. In our view, companies risk failing down the line if they do not address these risks in a prompt manner." Dave Brosnan

He adds: "It is difficult to think of a time when corporate and supply chain risks have been higher. In our view, companies risk failing down the line if they do not address these risks in a prompt manner."

Julia Graham, deputy CEO of the Association of Insurance and Risk Managers, comments: "If you ask c-suite executives what their top-of-mind issue is, I would be surprised if many of them said supply chain is at the top of the list. That is, unless they worked in a business that was almost totally dependent on suppliers or they had had an experience that had affected them."

She adds: "Large supply chain events do not happen every day of the week and it is one of those things where people say: 'Well, don't procurement deal with that?'"

This outdated view of the commercial landscape is potentially dangerous for companies that do not appreciate how reliant they are on others. Graham says:

"Supply chain risks are evolving into much more of an ecosystem. For me, they are a lot more amoeba-like than they used to be, and connected risks need connected answers. Supply chains are ever-more connected. They are entwined through businesses like an ivy."

In addition to the more business-critical nature of supply chains, they have also become more fragile and this is a potentially dangerous combination.

Mark Wing, partner at Clyde & Co, explains: "There are a number of different factors that make supply chains more fragile today than they have been in the past. Companies have streamlined their supply chains in the sense of contracting with fewer suppliers and so there is an increased exposure to individual suppliers. But at the same time, supply chains have become longer as suppliers have increased their own dependence on others.

This means that any disruption, at any point, has the potential to escalate and become very serious."

As businesses become more reliant on their supply chains, and those chains become more complicated and fragile, companies must decide how they mitigate their exposure and explore whether insurance offers an effective risk transfer option.

Supply chain risk insurance

Specialist supply chain risk insurance policies have been around for several years, but they have not gained significant traction in the market.

Zurich is one insurer that has invested time and effort in this area, although it has taken time to grow policy numbers and raise awareness.

Nick Wildgoose, global supply chain product leader at the insurer, says: "We bound our first cover in 2010 and



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yet you could ask 80% of your readership and they may not know the product exists."

Initially tailored to larger corporates,

Zurich is looking at how it can make the insurance more attractive to the mid-market. The all-risks cover is written

around a named supplier and supply, although Zurich is looking at other options. "It might make sense," says

Wildgoose, “to have some named perils packaged up, rather than coming at this from an all-risks direction.”

The business interruption cover is not restricted to losses that flow from property damage and the trigger is a reduction in supply that leads to a loss of output and/or gross profit.

While some insurers have decided to create standalone, specialist supply chain risk policies, others provide it as an add-on to existing policies.

Brosnan says: “We do not offer a pure supply chain policy. We offer coverage in various forms through various products in different industry sectors.”

“The thinking behind this philosophy is that CNA Hardy wants to focus on the nine industry segments that it targets and offer products and advice that relate specifically to their needs. It does not want to “create a generic supply chain insurance policy”, says Brosnan.

Scope of existing policies

In addition to specialist policies and cover offered via policy extensions, there is also insurance cover available through existing policy wordings, although it is often under-utilised.

Gavin Dollings, director of commercial underwriting at Covéa, says: “What insureds often do not fully appreciate is the scope that exists under existing policy wordings to cover some of the major risks within the supply web, which is an issue we are addressing in a new presentation as part of our Broker Training Academy.”

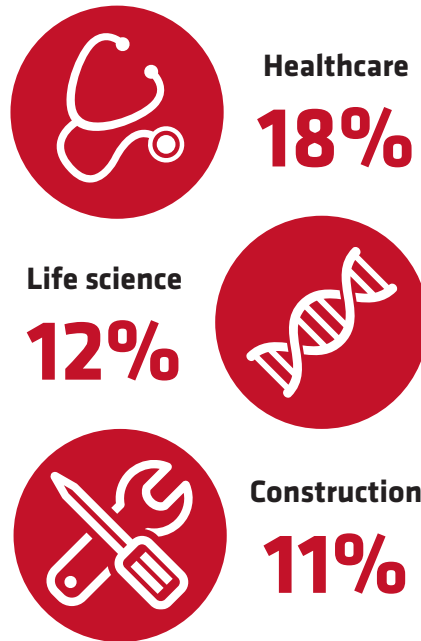
Highlighting some areas to consider, he adds: “In addition to the usual suppliers and customers extensions, there are utilities extensions (energy companies are often overlooked as critical suppliers), extensions to cover stock held at third-party fulfilment or logistic hubs, extensions to cover disruption at contract sites, and transit policies to cover materials and finished goods as they are transported around the supply and distribution web.”

There are then cyber insurance policies to create protection for policyholders in the event of IT outages. Such a patchwork of covers does not cover all eventualities and it is complicated to arrange. But Dollings believes it offers companies a good level of

Supply chain risk

Top three sectors for supply chain risk

Percentage of firms ranking supply chain risk as a key concern in spring 2018



cover in relation to their supply, distribution and procurement dependencies, and at an affordable premium.

Room for improvement

While there are various insurance options, not everyone is convinced they are good enough. “Generally, insurance products for supply chain risks have failed to keep pace with supply chain evolution,” says Tina Jolliffe, head of client management corporate, at broker HW Wood.

In the main, she says the cover being arranged by clients is BI cover for specified suppliers or on an unspecified supplier basis. The cover given is for standard perils, which are often restricted for overseas

unspecified suppliers or where the supplier resides in a natural catastrophe area.

The cover fails to reflect that suppliers themselves have complex supply chains, and are exposed to wider risks such as insolvency, industrial action, infrastructure failure or political unrest.

Jolliffe says: “There are non-damage BI/supply chain solutions available that do consider these more ubiquitous risks as opposed to site-specific. Nevertheless, they are few, and often seen as expensive. I would like to see greater competition in the market from insurers vying for more holistic supply chain risk cover while allowing the client to tailor the protection to meet their global supply chain risks.”

Comfort in contracts

Others also believe the insurance solutions available do not meet the needs of companies as well as they could.

Matt Grimwade, head of automotive at JLT, says there is a “mismatch between the insurance industry and the business industry.”

He adds: “The most clear and obvious mismatch is when it comes to indirect or unspecified suppliers.”

Where suppliers are named and detailed, insurers can provide very specific and definitive cover. But today’s interconnected nature of business ecosystems means significant losses can come from unexpected quarters. Clearly insurers cannot provide limitless cover for all eventualities, but Grimwade believes there must be a better way to extend the coverage available and to generate more certainty for policyholders.

“The golden egg for us is to find a way to look at the unknown and unspecified supply chain exposure and be able to create a mechanism to give insurance carriers enough comfort and knowledge of what the accumulated global exposure looks like so they can give the breadth of cover required.”

Insurance is not the only avenue of recourse for companies that suffer supply chain disruption.

Source: Spring 2018 Risk and Confidence Survey by CNA Hardy

“Supply chains are ever-more connected. They are entwined through businesses like an ivy.” Julia Graham

Contracts govern the respective responsibilities and obligations of customers and suppliers. Where these are not met, many contracts contain detailed dispute resolution procedures. Where resolution fails, there is the option to litigate and to seek compensation for breach of contract.

Disgruntled parties

One factor that can drive disgruntled parties towards litigation is that many disputes arise over supply chain disruptions that are not typically covered by insurance, such as labour disputes, insolvency, denial of access, quality issues, IT outages and war/terrorism.

Jolliffe comments: "When disruptions occur, the natural route is to put pressure on suppliers to provide financial compensation. Suppliers will generally be looking to protect their revenue stream first and foremost and be prepared to give consideration to their customers, whether in the form of compensation or recognition in future contracts.

"Tighter contract terms and Service Level Agreements support this action as a primary route for clients, although contract provisions, such as force majeure clauses, might influence the level of success in pursuing any action."

The problem is that litigation can be expensive, disruptive and acrimonious. Thrashing out a dispute is one thing, but going through full-blown litigation is quite another and it is likely to take its toll on both parties.

Litigation may result in one party securing the compensation or satisfaction it is after, but there are other detrimental aspects to consider.

Wildgoose comments: "If you are suing a supplier, it is likely they are a significant supplier. You probably have a collaboration that goes back over a number of years, encompassing innovation, shared ideas and so on. Litigation will do a lot of damage and the trust is gone."

He adds: "If that supplier then comes up with a brilliant innovation – and a lot of innovation comes out of the supply chain – would they come to you, or the company that has not sued them?"

"I would like to see greater competition in the market from insurers vying for more holistic supply chain risk cover while allowing the client to tailor the protection to meet their global supply chain risks." Tina Jolliffe

It may be understandable why companies turn to their legal teams to resolve disputes over supply chain disruptions, but there are few who think it should be the first option on the table. As Brosnan says: "Litigation has a place, but my personal view is that most outcomes are better than litigation."

Risk management and mitigation

Prevention is better than cure and by avoiding issues in the first place, companies will not have to decide on how best to resolve them.

As insurers seek to develop supply chain risk products that better meet the needs of commercial companies, there is also a lot of work going on to improve the understanding of those risks and how they can be effectively managed and mitigated.

Graham says supply chain mapping has become significantly more advanced in recent years: "Some of the analytics companies are doing fantastic work and they can map supply chains down to the last washer or digit. They can produce a very comprehensive map of where everything in an organisation is."

The value created by good supply chain risk management means it is a service that brokers can provide, but only if they have invested in developing their own expertise in this complex area.

Jolliffe says: "Given increasing supply chain complexity, it is a risk management discipline on its own merit and should not be confused with transactional placement of insurance. Where brokers have invested in this area, I believe that clients are able to secure value from the engagement.

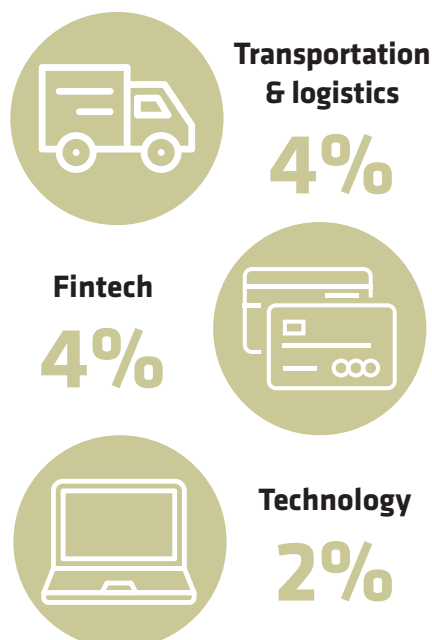
"Certainly, this can provide the broker with an additional revenue stream. However, in my eyes, client value is the key focus, this value being derived by way of reducing the client risks, or vulnerability to those risks, along with identifying the most appropriate insurance solution."

As insurers and brokers develop their supply chain risk offerings, they must also educate c-suite executives about the exposures they face and the solutions available. Until clients are convinced that supply chain risks are a primary concern, protecting them effectively will remain a secondary consideration. ■

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