

Business Over Breakfast

Product Recall Strategies for Your Company



BANKING
WEALTH
INSURANCE

Agenda

- **Welcome**
- **Speaker Introductions**
- **AmWINS Product Recall & Contamination Insurance**
- **SVA Tax & Accounting Strategies**
- **Q & A**



Featured Speakers



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Product Recalls

- Recalls are meant to protect consumers from products that may cause injury, illness or even death.
- Food and drugs are often recalled to remove them from the marketplace because there's reason to believe they may be defective, adulterated, contaminated, misbranded or mislabeled.





Product Recalls

- Manufacturer & Processor Company Proactive Approach to Food Safety
 - HACCP Plans
 - Mock Recalls
 - Traceability exercises
 - Evaluate and purchase Product Recall/Contamination Insurance
- Recalls are up 11% between 2013 and 2019, Frequency Peaked at 905 in 2016
- 733 Food Recalls in 2019, 530 Food Recalls in 2020





Product Recalls - Increased Frequency of Food Recalls

- **Contributing Factors:**
 - *Food Safety Modernization Act (FSMA) Gives the FDA more power*
 - *Improved Testing and Traceability - Whole Genome Sequencing and Blockchain*
 - *Supply Chain Complexities*
 - *Decreased FDA enforcement in 2020 due to COVID*





Product Recall and Contamination Insurance

- Protects you and your customers
- Triggered by contaminations, government orders and false media
- Requires potential bodily injury or property damage (or an allegation thereof)





What's Covered?

- Recall costs and replacement of your product
- Your loss of profit, business interruption and extra expenses
- Your brand rehabilitation and consultant costs
- Your customers' costs and loss of profit
 - *Direct and indirect customers*





Product Recall Insurance Market Conditions

- 14+ leading product contamination and recall insurers
- Large Losses
- Hardening overall Property & Casualty market conditions
- New entrants into the product recall market
- Overall pricing is flat to down 10% with a stable outlook





Case Study – Dairy King

- Hypothetical scenario based on real events
- Dairy base manufacturer – Listeria Monocytogenes
- Three weeks production = 360,000 lbs. of contaminated product
- Sold to three customers – ice cream manufacturing, smoothie manufacturing and gelato manufacturing





Case Study – Dairy King

- **General Liability & Product Liability Insurance Losses**
 - *Seven reported illnesses, two hospitalizations*
 - *Medical costs - \$96,500*
 - *Other damages - \$85,000*
 - *Property damage to customers' products - \$750,000*
 - *Total General Liability losses - \$931,500*





Case Study – Dairy King

- **Product Recall Insurance Losses for Dairy King**
 - *Withdrawal costs - \$175,000*
 - *Value of affected product – 360K lbs. @ 2.50/lb. - \$900,000*
 - *Loss of profit / business interruption - \$1.1 million*
 - *Other costs - \$100,000*
 - ***Total cost to Dairy King - \$2.1 million***





Case Study – Dairy King

- **Product Recall Losses to Dairy King's Customers**
 - *Recall costs, loss of profit, brand rehabilitation*
 - *Ice cream manufacturing - \$1.4M*
 - *Smoothie manufacturing - \$1.4M*
 - *Gelato manufacturing - \$1.2M*
 - *Total customer recall-related losses - \$4M*
 - ***Grand total product recall insurance losses - \$6.1M***



Preparation is Key for the Dreaded Recall



Presented by
Nicole Gralapp, Principal
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Preparation is Key

- Why the accounting role is so critical in responding to a recall to limit the impact
- Potential tax planning discussions that need to occur after the product recall



Accounting's Critical Role In Product Recall

- If not handled effectively, you will lose customer loyalty and experience brand damage from bad press
- Larger brands have more reserves to deal with claims and regain customer confidence



Preparation is Key



Preparation is Key

What percentage of consumers believe a company's ability to handle a recall indicates whether the company cares more about profits than customer safety?

93%

Preparation is Key

What percentage of consumers are more likely to purchase from companies that manage recalls “honestly and responsibly”?

87%

Preparation is Key



Preparation is Key



Why is the accounting role so critical?

- Accounting can drastically speed responses
- Quantify damages
- Mitigate financial risk
- Less lost customers
- Manage the financial and cash impact



What Costs Does Accounting Track?

- All the expenses involved in recalling products
 - *Destroyed products and/or materials*
 - *Equipment repair or replacement*
 - *Labor needed to facilitate the recall*
 - *Administrative burden of a recall*
- Lost profits
 - *You must be able to showcase financials before, during, and after the recall*
- Potential Lawsuits

Cash is King

- Cash flow planning is crucial during a product recall
 - *What will your insurance cover and when will it be covered?*
 - *Preparation needs to be made to fund replacements timely*



What are the costs associated with a product recall?

- Direct costs
- The costs of business interruption
- The costs associated with communication to key stakeholders, partners, regulatory agencies, and customers of the recall
- The costs associated with the required communication and logistics required to physically remove the affected product from the supply chain
- The cost of investigating the source of the recall and future prevention

What are the costs associated with a product recall?

- Fines and Penalties
- Consumer and Supplier Suits
- Lost Sales
- Insurance Costs
- Brand Reputation Damage



The Aftermath: Tax Planning

- Does the recall span over multiple years?
- Does the recall generate a net operating loss?
- Multi-state reporting and allocation



Thank You

Questions?

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