# **Business Over Breakfast**

Product Recall Strategies for Your Company



#### 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
  - HAACP 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 <u>and</u> 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
- Diary 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 CPA, CExP™





- 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











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

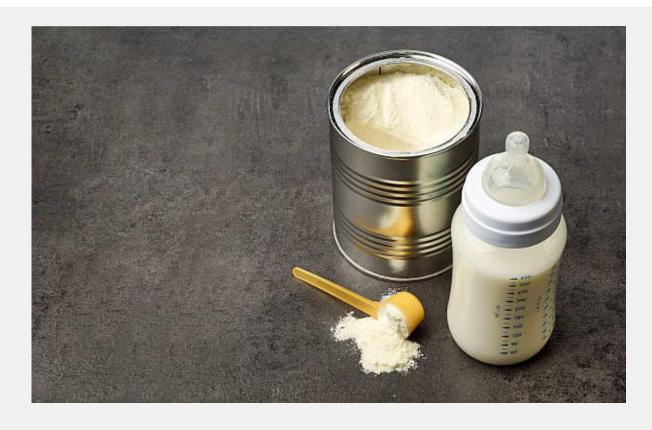
93%



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

87%

















### 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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