Hanover Food Industries Advantage

Food Recall:
Risk Management Guide
Class I and II recalls have risen by 400% since 2008. Given that 50% of fresh fruit and 20% of vegetables are now imported, the food industry supply chain has never been more complex and global, leading to increased risks of recall. Additionally, increased attention on food safety due to highly public cases of food contamination has led to more regulatory oversight, most notably through the Food Modernization Act passed into law in 2011.

Under the Food Safety Modernization Act, the USDA now has authority to issue a mandatory recall, and will be conducting more targeted inspections to enhance food safety, domestically and from international suppliers.

Recalls threaten your profitability, and with recalls on the rise, it is important to enact good risk management practices to reduce recalls and the impact of recalls.

According to a 2011 study of recalls from 2000-2010, only 21% of recalls were detected by the business itself; 68% were detected during routine or spot testing by regulatory bodies. The two main causes of recall included:

- Operational errors, including mislabeling, presence of undeclared ingredient, or contamination during production, led to 56% of recalls
- Food fraud and corruption by suppliers further down the food chain

Estimating the cost of recall

According to a 2011 survey of members of the Grocery Manufacturers Association (GMA) that had experienced a recall in the past five years, the average financial impact of a recall for these global firms, including direct costs and lost sales, was more than $30 million. The four largest expenses were due to:

- Business interruption or lost profits
- Direct recall expenses
- Legal liability
- Damage to brand

Regardless of size, almost every food industry business has been affected by recall. Costs add up quickly and businesses of all sizes can expect the financial impact to be derived from the same categories as large global corporations. Understanding the potential costs of recall and mitigating risks is critical for business continuity. Several manufacturers have gone bankrupt following extensive recalls.
How do you accurately estimate the potential financial impact of a recall?

1. **Direct recall costs**
   - Value of lost product
   - Notification costs, including for the regulatory body, supply chain, consumers
   - Product transportation
   - Product destruction
   - Warehouse space to destroy product
   - Labor, which sometimes requires special staff due to nature of hazard.

2. **Indirect recall costs**
   - **Lost sales**—Consumer research found that 55% of consumers temporarily switch brands following a recall, while 15% of consumers said they would never purchase recalled product again, and 21% would avoid any product made by that manufacturer. The statistics show that recalls will temporarily affect your bottom line, and may even have a permanent impact. Therefore, lost sales should be included as an indirect cost of recall.
   - **Business interruption**—Additionally, business interruption due to recall should be factored into the potential costs.
   - **Liability**—Finally, should a recall include a contaminant or mislabeling issue, one must estimate the cost of liability from customers.

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**TOTAL RECALL COSTS**

1. **Direct Costs**
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2. **Indirect Costs**
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**AFTER A RECALL**

55% OF CONSUMERS TEMPORARILY SWITCH BRANDS
Recall risk management strategies

Clearly, the cost of a recall is high, short- and long-term. Best practices can help to avoid recall or minimize the financial impacts of recall. Actions to consider include:

- **Obtaining sufficient insurance coverage** for recall expenses, such as withdrawal, recall, inspections, repair, replacement, adjustment, removal or disposal of the product, and associated loss of profit. Ask your insurance agent to suggest limits based on your operations.

- **Investing in traceability of products**, which can limit recall losses. Studies have indicated that perfect traceability limited losses by 90–95% for products with a shelf life of 14–28 days.

- **Planning ahead**. Name a crisis team, develop a crisis plan, and conduct mock recalls of potential crisis scenarios to test emergency protocols, including recall procedures with distributors, communication response, and financial recovery plans.

- **Cultivating a food safety culture** throughout the organization.

- **Complying with Good Manufacturing Practices**, and monitoring each facility with spot checks to ensure Standard Operating Procedures are in effect.

- **Enacting routine maintenance procedures** for food processing facilities and equipment.

- **Documenting “reasonable care” standards** used to prevent contamination, which could provide a stronger defense in case of a lawsuit related to a recall.

- **Reviewing Hazard Analysis & Critical Control Points (HACCP)**. Poor HACCP analysis is a cause for many recalls. The HACCP should be reviewed and updated regularly to incorporate new scientific and technological methods and following any modifications to the facility.

- **Achieving Global Food Safety Initiative (GSFI) certification** as well as the prerequisite third-party certification through Safe Quality Food (SQF) Program, BRC (British Retail Consortium) Global Standards or FSSC (The Foundation for Food Safety Certification) 22000. Though certification and compliance are costly, they can help prevent the damaging long-term effects of recalls to your business.
• Managing contracts with recall in mind.
Effectively managing contracts with customers and suppliers is a key risk management strategy. Strategies and clauses for your legal counsel to consider include:

– **Indemnification**—Requires suppliers to bear the liability for their products in case of recall

– **Disclaimer of warranties**—Helps to minimize losses from negligence or liability claims, though not intentional conduct

– **Limit damages**—Limits liabilities to purchase price, not for lost profits or other damages. Additionally, contracts can be constructed to impose a dollar limit on damages

– **Additional insured**—Requires suppliers to add your business to their policies as an “additional insured.” This may be challenging in the case of international or small U.S.-based suppliers. Ensure that provisions meet your needs.

**Sources**


Queen’s University, Queen’s University puts over 2,400 food scares under the microscope, Belfast press release, March 22, 2011.


Filh, Moises de Andrade Resende and Brian L. Buhr. Economics of Traceability for Mitigation of Food Recall Costs. International Association of Agricultural Economists. December 27, 2010.

Why The Hanover?

The Hanover is a leading property and casualty insurance company dedicated to achieving world-class performance. Our commitment is to deliver the products, services, and technology offered by the best national companies with the responsiveness, market focus, and local decision making of the best regional companies. This powerful combination has been a proven success since our founding in 1852, and all insurance company subsidiaries are rated “A” (Excellent) by A. M. Best Company.