In case of disaster, dissent or default

INSURANCE A breakdown in the supply chain can be costly so it makes good business sense to insure against loss and contingency costs, writes Peter Archer

The temptation may be to cut costs, but insuring against calamity can pay off when money is tight.

Despite the downturn, business is buoyant for insurers who can help improve a company's chances of securing finance from a potential lender.

"If a company can show it is insured against losses, a bank is more likely to lend it money," says Paul Culham, head of the marine and special risks division at Kiln, underwriters in the Lloyd's insurance market.

Nevertheless, few companies seem to be aware of the full scope of cover when insuring the supply chain.

According to Nick Wildgoose, supply chain proposition manager at insurance giant Zurich, increased outsourcing of production has lengthened supply chains and shifted the needs of corporate insurance.

"So few people own the means of production these days," he says. "Outsourcing to far-flung places brings with it a set of new risks compared to the days when the factory was just a few miles down the road."

Trade disruption insurance (TDI), which tends to look at specific risks has been on offer for a number of years but market penetration is relatively low. Supply chain insurance, often with all-risks cover including loss of profits, was launched in 2009 by Zurich in response to customer demand.

Alan Day, managing director at supply chain consultants State of Flux, says: "The disruption caused to air freight by Iceland's volcanic ash cloud has raised the profile for the need of this kind of insurance. Events like this make supply chain insurance more important.

"The alternatives are living with the risk or changing to a supply chain with fewer risks," he says.

There are types of cover which insure against the impact of physical disasters, like the Gulf of Mexico oil spill. If oil pollution forced the closure of the Mississippi, movement of grain down river, for example, would be disrupted and result in alternative freight or warehousing costs which could be covered by insurance.

The impact on the supply chain of a natural disaster, like the recent earthquake in Chile, can also be insured against.

And there is insurance to cover the consequences of political events, such as unrest in China, which could interrupt manufacture and delivery of goods to the West. Trade embargoes, port blockages, strikes, IT failures, as well as war, terrorism and piracy, could all be covered.

Then there is insurance to cover economic problems; for example, if a company in the supply chain becomes insolvent and defaults financially, the right policy would pay out. Companies can also insure against incurring contractual penalties if a delivery is delayed by a weak link in the chain.

The cost of insurance depends on the degree of cover from a "sleep-easy" policy to a more workaday schedule. But policies are invariably bespoke to suit the differing needs of different companies.

"Customers have usually worked out their contingency costs, in the event of a problem, and want to cover that amount," says Kiln's Mr Culham. "They already know what extra costs would be incurred and want a policy to pay for them. We find that people buy between 0.5 per cent and 5 per cent of their limits. That may sound as though it's expensive, but what it does for a business is put a cap on losses."

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Natural disasters can be covered by insurance

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