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Will you be ready when a loss happens to you?

What supply chain professionals need to know about insurance.

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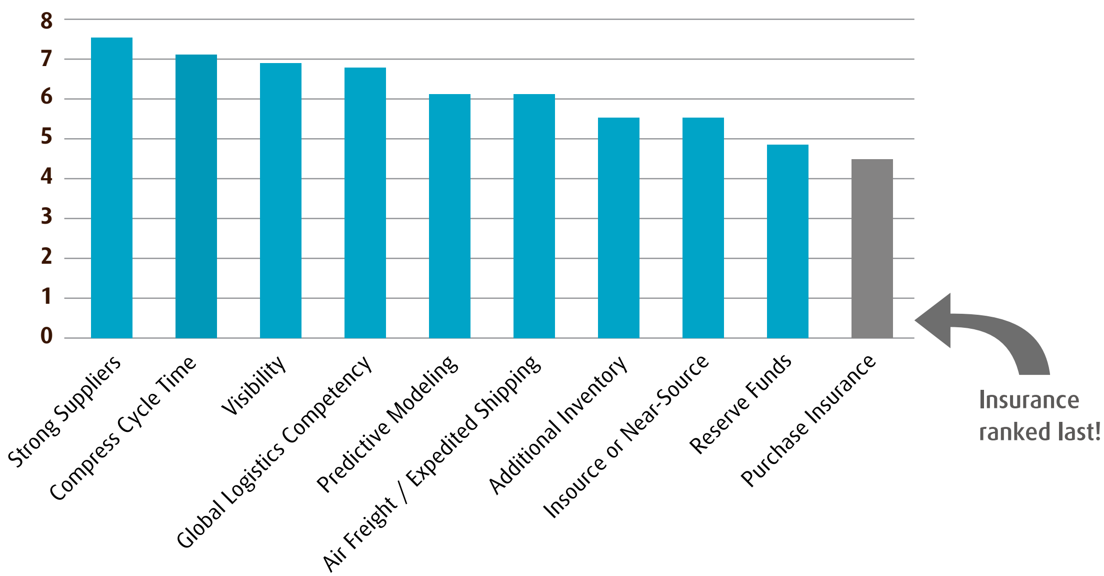
Introduction

Transportation risk comes in many forms and can be very hard, if not impossible, to predict. These include extreme weather, theft, hijacked trailers, global crises, cargo lost at sea, catastrophic truck or rail accidents, truck fires and a whole lot more.

In 2014, the University of Tennessee Global Supply Chain Institute published a white paper titled Managing Risk in the Global Supply Chain. The most surprising finding in the research was that even though 100% of supply chain executives acknowledged insurance as a highly effective risk mitigation tool, it was simply not on their radar screen, nor in their purview.

Yet, the National Cargo Security Council estimates that there is an annual global financial impact from cargo loss of $50 billion.

Risk mitigation techniques used by supply chain professionals.



$50 Billion

Estimated annual global financial impact from cargo loss[1]

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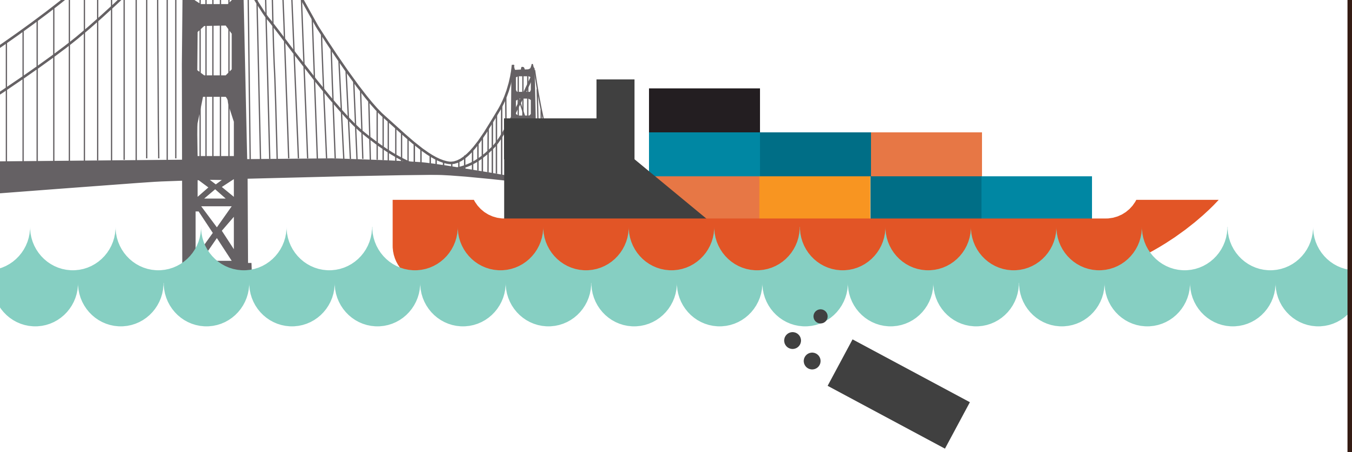
Sometimes bad things happen to good cargo.

Many importers and exporters are not familiar with the rule that governs coverage for cargo that is jettisoned to save a ship and it's crew. The law of general average is a legal principle of maritime law in which all parties in a sea venture proportionally share any losses resulting from a voluntary sacrifice of part of the ship or cargo to save the whole in an emergency. According to Lee Meyrick, the Global Marine Chief Underwriting Officer for Zurich Financial Services, "General average is the main driver of marine insurance claims."[2]

It's also been reported that as many as 20% of companies who experience a supply chain disruption go out of business within 18 months.[3] That's why it's important for businesses to understand the true impact of cargo loss, where their liability is and how they can help mitigate risk with insurance.

An average of 52 containers are **lost** or **damaged** at sea each week.[5]



794

Reported cargo thefts in the U.S. in 2014. (2.2 per day)[4]

$233,000

The average loss per incident.[4]

Without insurance, it can take a lot of new sales to cover one bottom-line loss.

Assuming a company makes a 6% profit margin on its goods...

And loses $233,000 in a cargo theft incident...

It would take **$3,883,333** in new sales to recover the loss of those goods.

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The real cost of loss or damage.

The real cost of cargo loss may be much larger than you think. Goods lost or damaged in transit inevitably result in reduced inventory to serve customers. This can result in lost sales, lost market share and a negative impact on your brand image. Many supply chain professionals think, “That won’t happen to me.” Yet 76% of companies reported at least one supply chain disruption in the past 12 months.[6]

Whether a firm is large or small, shareholders and business owners greatly value the ability to accurately forecast financial performance. Insurance makes this more predictable, immunizing businesses from random, extreme spikes that could have a huge negative financial impact.

Insurance also makes hard-to-forecast events very survivable, plus it can be budgeted for annually. Some firms even pass the cost of insurance on to customers, as it’s often a minor fee when spread across all shipments.

“That won’t happen to me.”

76%

of companies reported at least one supply chain disruption in the past 12 months.[6]

What you don't know can hurt you.

Carrier liability is not really insurance. It basically protects the carrier from uncapped losses. The shipper has to prove negligence on the part of the carrier to collect on a claim. And that's usually hard to do.

The two major pitfalls associated with carrier liability are:

1. **Statutes limiting carrier liability**
Governing statutes allow carriers to set their own limits and are specific to carrier type and mode of transport. Statutes vary in carrier requirements and allow a carrier to limit their exposure as they see fit, including claim and lawsuit filing limitations and total claims exposure.

2. **Carrier liability coverage is often inadequate**
Generally, an ocean carrier is only responsible for up to $500 per container. Major package carriers limit standard coverage to $100/parcel. International air carriers generally have a minimal limit (e.g. $0.50/lb). Trucking company carrier liability is also at very low rates per pound, sometimes as low as $5/lb but often up to $25/lb, as specified in the bill of lading and their tariff rules. Each shipper will limit standard coverage based on weight, which can be detrimental to companies shipping high-value goods. And, most carriers don't pay for consequential damages, or the full invoice value of the goods.

A truck carrying a pallet of smartphones is robbed.

Each phone is worth $300, and each of the eight boxes weighs 50 lbs. That's 400 pounds of smartphones worth $480,000.

Standard carrier liability for smartphones is generally around $10/lb., so the shipper would be reimbursed $4,000 (400 lbs. x $10/lb.).

Who will cover the other

$476,000?

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Insurance as a risk mitigation tool.

Self-insurance

Self-insurance is a risk-management method in which a calculated amount of money is set aside to compensate for potential future loss.

Companies that self-insure should consider the following:

1. Is setting aside funds for loss or damage the best way to use free cash flow? Could they receive a better return on investment elsewhere?
2. What will happen in the event of a catastrophic loss and how will the company survive?

Business owner policy

This is the standard property and casualty liability (P&C) insurance coverage held by business owners to cover property and accidents. These policies may come at a premium because they cover so much but may not meet a specific need, such as in-transit inventory. If they do, coverage still may not fully take into account the complexities of a supply chain.

Cargo Insurance

Cargo insurance can apply to ocean, land and air transportation modes. The policy can cover loss and damages, ocean general average claims and even consequential coverage.

1. Cargo insurance can cover your cost or replace your revenue stream.
2. The cargo insurance carrier should understand your supply chain.
3. The cost of cargo insurance doesn't have to be a mystery.

Self-insurance lacks the advantage of pooled risks for catastrophic losses that threaten the existence of your business.

Business owner coverage may not fully contemplate the complexities of your supply chain.

Summary

Over the past decade, many companies faced extreme supply chain challenges that stretched their capabilities to the breaking point. Both the preponderance of natural disasters and huge economic swings caused extreme challenges across the supply chain. These challenges have not diminished. Supply chains, which once functioned almost on autopilot, face many dangers today in both global and domestic markets. When surveyed, 100% of supply chain executives acknowledged insurance as a highly effective risk mitigation tool. Yet most said it was either not on their radar screen or not in their purview.[7]

Conclusion

Low probability/high impact loss events are by definition unpredictable. Even after other risk mitigation strategies have been considered, risk will still exist in critical areas of the supply chain, and those are prime candidates for selective use of insurance. Insurance solutions providers such as UPS Capital Insurance Agency, Inc. are willing and eager to share best practices, and they have a vested interest in avoiding losses. They can be key partners in working with firms to minimize the financial effects of both daily supply chain risks and catastrophic disruptions.

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SOURCES:
[1]The National Cargo Security Council
[2]Marine Insurance – Care and Protection of Supply Chain Cargo at Sea, May 1, 2011
[3]Supply Chain Brain, Supply Chain Risk Awareness, Assessment & Benchmarking, March 18
[4]FreightWatch International, Supply Chain Intelligence Center: Annual Cargo Theft Report 2014
[5]The World Shipping Council, The Survey Results for Containers Lost at Sea – 2014 Update
[6]Business Continuity Institute and Zurich Insurance Group, 2014 Supply Chain Resilience Survey 2015
[7]Managing Risk in the Global Supply Chain. A Report by the Supply Chain Management Faculty at the University of Tennessee. Summer 2014.

100% of supply chain executives acknowledged insurance as a highly effective risk mitigation tool.

To download the full white paper, click here.

UPS Capital Risk Mitigation Solutions

Cargo Insurance
Safeguard the condition of your goods in transit anywhere in the world, no matter how they move or where they are in your supply chain.

Flexible Parcel Insurance
The ultimate protection for highly sensitive shipments. Safeguard time-critical goods and other hard-to-value items in the event of loss, damage or delay.

UPS Proactive Response® Secure
Safeguard the delivery of your high value, time sensitive or perishable packages with this one-of-a-kind solution that combines package intervention and remediation and proactive monitoring for your packages.

Credit Insurance
Preserve and expand sales while minimizing credit risk through the protection against non-payment of your receivables.

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