CONNER STRONG & BUCKELEW

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Managing Pharmaceutical Supply Chain Risks

No matter how complex the supply chain, a careful, methodical process can identify, value and manage those risks, and lead to an insurance policy tailored to your unique needs.

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Pharmaceutical manufacturers' supply chains have become increasingly complex in a globalized economy. There may have been a simpler time when insurance was viewed as a commodity, but today's policies should be intricately tailored to a company's specific operations.

In other words, a one-size-fits-all approach to supply chain risk is becoming less and less likely to fit anyone.

Just one example of the existing disconnect is the Business Continuity Institute's 2014 Supply Chain Resilience Survey, which asked more than 500 stakeholders across 71 countries about supply chain disruptions. More than 80 percent of respondents experienced at least one disruption in the past year, and almost a quarter reported losing $1 million a year from such disruptions. However, 40 percent of respondents did not insure their losses at all, and less than 20 percent insured at least half of their losses due to supply chain disruption.

"This is a worrying finding," the report states, "as it suggests that most losses from disruption are not recoverable due to the lack of insurance."

The good news is that firms shouldn't have to bear the burden alone. An experienced commercial insurance brokerage should be able to clearly identify potential risks throughout the supply chain to ensure proper coverage.

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A careful and comprehensive risk analysis can not only provide peace of mind and provide financial backing in the case of loss – it can actually lower your premium in some cases. For instance, if a firm is seeking spoilage coverage, an insurer may price the product for spoilage risk, but what if that product is particularly resistant to spoilage? A proper policy should reflect that, and could ultimately result in a better deal.

The first step in managing risk is understanding risk. While no production or distribution sequence is exactly the same as another at this point, here are some potential risks at each stage of a simplified supply chain, with an overview of how insurance can play a role in reducing potential losses.

1. Raw Material Supply: One of the initial issues to understand at the raw material supply stage seems like one of the most obvious – identifying when the material becomes yours to insure. This will require carefully examining contractual agreements, and making sure that this important distinction is reflected in the construct of your policy.

Once that's clear, it begins the process of evaluating the product's worth at each stage of the process, from its raw state through manufacturing, filling, finishing, packaging, storing and delivery. It's crucial to understand the value of the product as its value changes throughout the process, in order to understand how a loss impacts a company.

This sort of analysis should take place on a product-by-product, and even ingredient-by-ingredient, basis. A carefully crafted policy should build in an understanding of what goes into each product, and how the unique features of each ingredient affect the risk profile of each product.

2. Manufacturing/Processing: The obvious questions to ask about risks facing the manufacturing and processing of a product involve where your facility is located, such as whether it's a flood zone or earthquake zone. But beyond where your facility is located, a savvy broker will want to understand what's going on inside your facility.

How large is a particular manufacturing run? How much time does it take to process a manufacturing run? What's the value of the product before and after processing? Once manufactured and ready to move on, what's the accumulation of product at that facility? A pharmaceutical manufacturer should ask themselves these types of questions to better grasp their own risks – and they should expect their insurance broker to be asking them as well.

3. Quality Assessment and Stability Testing: This is an often overlooked aspect of the supply chain from an insurance perspective because it's often a smaller component of a much larger picture. But it's precisely because it's so prone to being ignored that it deserves special attention. While it's a seemingly smaller risk, because of the value of the product you have there compared to the rest of your supply chain, that doesn't mean it's completely unimportant if you experience a loss.

Actually, this stage of testing can mean more to your overall program than its inherent value, which many firms misunderstand. Because this testing affects other processes, what happens if you lose all your stability testing data, and then run into regulatory issues? For this reason, these are often called hidden risks.

4. Final Packaging and Storage: Packaging and storing is another deceivingly complex part of the supply chain when considering the risks of loss. Beyond valuing property, what about the potential for business interruption if you lose finished stock in a warehouse? What's the outside range of temperature, from a regulatory filing perspective, that the product can stand before it's officially damaged? How long does it take to resupply and restock? What's the manufacturing cycle, and can you meet demand in the meantime?

Furthermore, if there is a loss, should you value your product at the selling price, or the replacement price? Your particular insurance policy should actually define when property qualifies for a selling price valuation.

To better grasp just how complex these issues can be – and in order to be sure you're getting properly covered – consider what's called "condemnation." If, for instance, there is a warehouse fire and the building fills with smoke, what happens to your packaged product if it's covered in soot, but otherwise undamaged? Well, the product may be undamaged, but the government may say it's unsalable. At the same time, many policies have exclusion for decisions by government agencies.

You would much rather talk through these issues ahead of time, rather than only when a loss occurs.

5. Delivery to Customer: At the final stage, there are transportation risks that relate back to those from the earlier stages. How prepared is the product for transit? What are the contamination risks? And whose property is it when it travels through different parts of the delivery process? If there is a loss, how does that impact the overall ability to meet customer demand?

These issues shouldn't sound overwhelming. No matter how complex the supply chain, a careful, methodical process can identify, value and manage those risks. It is important it is to ask these questions, and make sure that your firm is protected by an insurance policy tailored to your unique risks.

Daniel Brettler is a managing director and senior vice president at Conner Strong & Buckelew, where he leads the Life Science and Technology Practice. He has 25 years of industry experience, and is recognized for his innovative ideas for creating coverage enhancements that respond to emerging industry risks. Learn more at www.ConnerStrong.com.

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