RISK in Focus

Manufacturing

RISK in Focus

Table of Contents

Background

Background

During the pandemic, the manufacturing industry fared better than many other sectors. In fact, the number of manufacturing companies increased modestly in 2020, even in the face of reduced revenue and employment levels. The decline in world oil prices had a significant negative impact on those manufacturers supporting energy producers, however.[1]

In 2020, the Centers for Disease Control and Prevention (CDC) declared manufacturing to be an integral part of the U.S. supply chain. Many manufacturing facilities were categorized as "critical" and were permitted to remain open throughout the pandemic.[2]

Manufacturers adapted to the COVID threat as best they could, maintaining employee testing requirements, allowing certain office staff to work from home, and implementing distancing requirements.[3]

The manufacturing sector performed well in 2021 with a strong boost from the rebound in oil prices. In fact, total revenue and total wages paid exceeded 2019 levels.[4] The National Association of Manufacturers (NAM) predicts, however, that employment in manufacturing will not return to pre-pandemic levels until after 2022, due in part to retirements and ongoing external disruptions such as school closures and the difficulty of finding childcare.[5]

In this paper, we'll explore some of the primary risks owners of small and midsize manufacturing companies continue to face in the current environment, and we'll identify strategies they can adopt to reduce those risks.

RISK in Focus

Supply Chain Disruptions

Supply Chain Disruptions

Supply chain disruptions are hampering a more robust economic recovery.[6] The U.S. Census *Small Business Pulse Survey* in October 2021 found that in January 2022, 22% of manufacturers (NAICS Codes 31-33) were experiencing domestic supplier delays.[7] The challenge is greater for small and midsize manufacturers, who report that raw materials like cotton, paper, and LED lights are being snapped up by larger competitors, who are offering unprecedented incentives to suppliers to fulfill their orders first.[8]

Strategies to Minimize this Risk

Revise Inventory Models

Many observers suggest that the days of "just in time" inventory management are over – for the near future if not forever. The luxury of maintaining small inventories to reduce costs and increase cash flow has been overtaken by the many disruptive situations in today's world: the pandemic, ransomware attacks, political upheaval, natural disasters, extreme weather, shipping accidents, port congestion, labor unrest, and more.[9]

To survive in this new uncertain environment, small and midsize manufacturers are streamlining their product offerings in a way that requires fewer diverse inputs. They're also maintaining higher inventories of those inputs.[10] Each manufacturer will want to consider their own risk/benefit trade-off that balances the costs and risks of maintaining higher inventory levels with the costs and risks related to insufficient access to key components and other inputs at critical points in the manufacturing process. Many are leaning toward stockpiling these items when possible, choosing to incur additional warehousing, storage costs, and related risks.

Thus, the new model that's replacing "just in time" could be characterized as "resilience": being relatively confident that inventory levels can minimize the impact of, or help the company quickly recover from, destabilizing events.[11]

Ensure Prices within Contractual Provisions

When possible, manufacturers can seek to negotiate contracts with their suppliers in advance and lock in pricing, or at least minimize the possibility of price increases between the time the order is placed and when it's shipped.

Increasingly, manufacturers are seeing contractual terms and price acceleration clauses that require them to pay at a price that will be determined when the material is shipped, with no assurance about *when* the material will be shipped. It's important that manufacturers try to place limits within these kind of open-ended arrangements – for example, by establishing time horizons or setting a cap on the future price escalations.

Appropriately Insure Materials and Inventory.

In the face of uncertain supply chains and transportation bottlenecks, manufacturers are storing more supplies and fully or partially finished products onsite or in offsite warehouses.

When it comes to onsite storage, these manufacturers are advised to inform their insurance broker when storage amounts significantly increase or decrease. In the case of stored finished goods, it's important that their policies include a manufacturer's price endorsement that reflects the eventual sales price of the product, not simply the sum of the costs of the materials used in its production.

Contracting with warehouses for storage can raise additional insurance risks. Warehouses typically carry liability insurance that values contents on a per-pound basis. Depending on the stored material, though, and especially for finished products (perhaps that are waiting for a shipping window), these valuation rates may be inadequate. Either the warehouse or the manufacturer can supplement this coverage to reflect the actual value of the items.

Develop Redundant, Closer Supply Sources

It won't be easy for manufacturers to reverse their reliance on foreign suppliers, but across the U.S. economy, entrepreneurs are noticing a demand for "reshoring" and they're seeking to meet it.[12]

Supply chain evaluation ideally is a continuous exercise, based on candid communication with the company's current vendors and reaching out to potential new sources to learn about their products, processes, rates, and contractual arrangements. Increasingly, the supplier's location and transportation modes are an important part of this evaluation.

The best time to do this legwork, of course, isn't in the midst of a supply emergency. Instead, manufacturers can "try out" a new supplier in advance of a crisis to determine if they might serve as a good source in the long term and be a reliable, alternative partner.

Manage Customer Expectations

A manufacturer's customers may order more than they need and ask for it sooner than they truly need it. Like everyone else, they're hedging against future shortages and delayed deliveries.

The manufacturer may have trouble meeting those terms due to their own supply chain, storage, or labor challenges. If they suspect the customer is "over-asking" due to future uncertainties, they can reach out to them, explain the challenge, and try to come up with a mutually beneficial solution – multi-staged shipments on a specified schedule, for example, to ensure the customer will have what they need when they need it.

Customers tend to appreciate those conversations and they'll be more confident in these kinds of negotiated assurances. Reasonable companies know that "we're all in this together" and they seem more willing than ever to make these kinds of accommodations.

RISK in Focus

The Difficult Insurance Market

The Difficult Insurance Market

Whether it's referred to as "exposure management" or a changing "appetite for risk," it's becoming more challenging for insurers to offer sufficient property and liability insurance to some manufacturers.

For these manufacturers, this translates to far higher premiums or even the inability to obtain this insurance at any price due to past claims, location, industry type, and other factors in or outside their control. And once a company has been subject to a non-renewal, it's far more difficult for them to obtain coverage moving forward.

Large insurers seem to be taking an "all-or-nothing" approach to offering property insurance to manufacturers, as they make their determinations simply based on building design, age, and location. Proximity to flood and wildfire zones is more relevant to them than ever, and thanks to climate change and other factors, those zones change over time. There's an increasing realization that more areas than previously thought are subject to devastating wildfires[13] and floods.[14]

A similar situation is evident regarding access to product liability, errors and omissions, and general liability insurance. In addition to past claims history, factors like a weak supply chain, for example, can trigger a policy non-renewal. Also, simply being in an industry where one company has experienced a nuclear liability verdict (typically defined to be in excess of $10 million) can taint the other companies in that space in the eyes of an insurer.

Strategies to Minimize this Risk

Maintain a Strong Risk Management and Mitigation Program

The best way to build a strong record of insurability is to minimize claims through risk management and mitigation programs that reflect the unique conditions of the facility. These efforts can include employee training regarding safety, emergency response, codes of conduct, and other matters that reduce the likelihood of liability or property insurance claims. The company owner will want to take note of suits and nuclear verdicts within their industry and develop strategies to ensure those kinds of situations never occur in their operations.

Manufacturing facility property can be maintained to limit the impact of nearby natural disasters. Removing brush and debris from around the building will reduce risks from nearby wildfires. Bow truss roofs often can be reengineered or reinforced since they're more likely to collapse under heavy snow and ice. Where possible, companies may consider arraying critical manufacturing processes and offices within the manufacturing facility in a way that would limit damage from minor flooding.

Begin Renewal Activity Early and Prepare Thoroughly

Ideally, manufacturers begin discussions with their broker at least 120 days in advance of the renewal date. They will want to be prepared to present all possible information about their risk mitigation and risk management efforts so brokers can ultimately present a more accurate and positive picture of insurability to the underwriter.

If the manufacturer has experienced recent claims, they will want to be prepared to explain any unavoidable factors that contributed to that experience and the steps they've taken to minimize the likelihood of a re-occurrence.[15]

Cyber Attacks & Data Security

Cyber Attacks and Data Security

Increasingly, manufacturers rely on software as a service (SaaS) and cloud technologies to reduce costs and closely integrate with business units, customers, and suppliers.[16] This inevitably increases the risk of cyber intrusions in the manufacturing sector.

According to a survey of manufacturers, almost 25% experienced weekly cyber attacks at their facilities. These included ransomware attacks, attempts to obtain financial and personal information, and infiltration to obtain trade secrets. Manufacturer cyber attacks are expected to increase as these companies shift employees to offsite working arrangements as much as possible.[17]

Experts point out that as companies in service industries like telecom and finance become more sophisticated and secure from cyber attacks, cybercriminals are shifting their attention to manufacturers and the vulnerabilities within their operational technology systems.[18]

Strategies to Minimize this Risk

Ongoing Staff Training

In nearly every working environment, user error proves to be a critical weak link that opens the door to cyber infiltration. When an employee clicks a link or opens a document within a phishing email, they can grant cybercriminals access to the user's account and ultimately to the manufacturer's systems.

This vulnerability extends outside the walls of the manufacturing facility as that employee works offsite or from home while accessing the company's IT systems via public Wi-Fi or poorly secured home networks.

Cyber criminals are experts at social engineering,[19] the art of subtly leading an employee to reflexively divulge sensitive information or take other risks they would never consider if they thought twice about that action. These kinds of attacks will continue, and valuable information will be vulnerable, unless manufacturers offer exceptional, ongoing employee training about cyber risks and what to look for in these phishing emails. Some organizations go so far as to periodically send test phishing emails to their staff to evaluate vulnerability and provide training moments.

Cybertheft prevention training should stress the need for strong passwords, the risks from using removable media like USB sticks, the importance of keeping personal account and company account activity separate, how to adhere to rigorous backup protocols, and how to report an issue or incident.[20]

It's important to also remind employees that not all data breaches are due to active hackers. "Inadvertent insider" missteps can expose operational and personally sensitive information. These lapses include:

- Attaching confidential data within unsecure messaging or sending secure information to the wrong party
- Failing to protect property like laptops and USB drives from theft
- Neglecting to shred confidential written information
- Misplacing material and devices

Be Aware that Change Increases Vulnerability

Employees must be extra vigilant about IT issues that fall outside the scope of their day-to-day activities. For example, companies can be quite vulnerable to IT threats when they're in the process of installing new equipment or connecting with new suppliers, customers, contractors, and service partners. Every step in these and similar processes should be taken carefully and with full knowledge of the process. There can be no guesswork or assumptions.

If employees have questions about the reliability of these kinds of integrations or linkages, verbal conversations can provide authentication.

Consider Obtaining Reverse Social Engineering Insurance Protection

In some cases, a manufacturers' supplier or customer might be hacked without that entity even being aware of it. In these cases, a Reverse Social Engineering insurance policy can provide a level of protection to that manufacturer when one of their partners is successfully attacked and the impact extends to the manufacturer.

RISK in Focus

Reputational Harm

Reputational Harm

Local manufacturers can find themselves in the news or called out in a social media post for all the wrong reasons – there are far more opportunities for bad stories than good. Workplace accidents, driver negligence, labor disputes, controversial product lines, accusations about employment practices, exposés on emissions or other environmental impacts, and other stories can turn the public against a manufacturer and damage its ability to recruit employees and retain customers – whether the story is true, false, or taken out of context.

Strategies to Minimize this Risk

Review Operations and Training

First and foremost, manufacturers can prevent reputational harm by addressing potential areas of operational risk and engaging closely with their employees.

To help create this kind of environment, employers can:

- Immediately address EHS deficiencies in their organization
- Review primary areas of reputational risk and develop training modules (e.g., onsite safety; driver safety; Diversity, Equity, and Inclusion (DEI); and Environmental, Social, and Governance (ESG)) for each category. The training cycles and frequency should be based on the level and likelihood of the risk.
- Install telematic systems in company vehicles to monitor driving habits
- Conduct frequent all-hands, department-level, and one-on-one meetings in which employees are encouraged to raise concerns about working conditions and company policies
- Establish a DEI committee to review the company's hiring and promotion practices and address employee concerns in this area
- Establish an ESG committee to uncover opportunities to improve environmental stewardship, engagement in appropriate community causes, support for employees, and leadership practices

These activities not only decrease the likelihood of a negative event, but they can cast the company in a more favorable light in the event of a lawsuit or incident. Meaningful DEI and ESG engagement can also increase the commitment of younger employees in the company.

Proactively Establish Community Goodwill

At the same time, manufacturers can continually promote positive stories about their company within traditional and social media. These can be accounts, for example, about their sponsorship of community activities like youth sports teams and holiday events as well as environmental initiatives that engage employee volunteer time and utilize company equipment and supplies. Manufacturers can seek opportunities to be involved with local schools with internships and work-study opportunities and then make sure potential participants and the community at large are aware of these efforts.

It's also important for manufacturers to build relationships with local news media. Company owners can invite reporters to tour their facility and inform them about new innovations, business expansions, and new product lines, for example. Good news stories can follow, and these media contacts may prove valuable when the company needs to publicize its side of a story if a negative event occurs.

Establish Response Policies/Protocols in Advance

The time to figure out how to respond to a specific PR challenge is not after the incident happens. With the guidance of attorneys, insurance professionals, and other outside service providers with a stake in the company's success, manufacturers can develop a high-level strategy appropriate to address nearly any reputational PR hit.

It can include these fundamental steps and principles that can be fine tuned within detailed action plans addressing specific situations:

- Appointing a response team.
- Crafting and sticking to a coherent message.
- Identifying and attempting to provide redress to the affected parties.
- Publicly acknowledging responsibility and committing to do better.
- Responding to law enforcement and media inquiries.
- Responding to social media comments.
- Contacting outside resources (e.g., attorneys, PR consultants, insurance representatives, etc.).
- Communicating with employees.

Many leadership teams maintain and frequently revisit a more detailed PR playbook that covers various reputational harm scenarios and lays out directives and assignments within each of the points mentioned above.

As we'll see below, ideally these activities can be coordinated through a professional PR firm. In some cases, this kind of preliminary coordination and planning may be covered in the context of a company's liability insurance policy.

Maintain a Relationship with a PR Firm

Manufacturers may want to consider placing a local, well-qualified PR firm on retainer at all times, ready to address any potential reputational issues. Designated representatives of that firm ideally will be familiar with the company, the members of the leadership team, and the possible areas of risk that might initiate a reputational crisis.

This PR team or their assigned professional will want to periodically meet with the manufacturer's leadership team to share information about trends in public sentiment, review and update the company's PR response playbook, and be updated on company activities.

In the event of an incident, it's preferable that one person from the leadership team serve as the liaison with that PR representative to make sure they receive accurate and consistent information and be the single conduit for the PR firm's instructions flowing back to the company.

RISK in Focus

Managing a Remote Workforce

Compared to service industries in general, manufacturers are less able to shift many of their jobs to remote status. Still, some positions certainly can be. Back-office work, including ordering, accounting, scheduling, payroll, client service, and other tasks can often be done off site. Increasingly, with the right technology and training, so can many monitoring and supervisory jobs.[21]

An April 2020 report by the Bureau of Labor Statistics found that 41% of employees in manufacturing positions reported they felt they could do some of their work remotely.[22]

"Out-of-sight" shouldn't slip into an "out-of-mind" approach to management and oversight, though. Off-site employees who opt to work out of state and don't tell their employers about these arrangements can trigger employer violations of payroll and workers compensation tax requirements.[23]

Strategies to Minimize the Risk

Know Where Your Employees Are

In order to compliantly administer various HR and payroll functions, it's critical that a manufacturer knows where their employees are working from on a daily basis – especially when they travel outside their home state.

Manufacturers can develop and enforce mandatory location self-reporting systems for their employees. Employers also may choose to reinforce these with automated monitoring systems linked to the electronic devices the company supplies the employee.[24] In the interest of avoiding misunderstandings and resentment, though, it's best that this tracking tool is used only if the manufacturer suspects the employee is not being truthful and then only after advising the employee in writing that this monitoring system is being utilized.

The manufacturer's HR team needs tools and resources that enable them to manage the taxation, withholding, and workplace requirements for all the authorized workplace locations. To minimize this burden and expense, the company might consider prohibiting or appropriately limiting extended out-of-state, work-from-anywhere activity.

Manufacturers will also want to advise their insurance providers of their work-from-home/anywhere policies. It's best to work with an insurance broker that has a multi-state perspective and the resources to provide this coverage.

Develop Clear Remote Working Policies

One of the most important steps a manufacturer can take to minimize liability while accommodating remote work arrangements is to maintain clear policies.[25] These can include details like core working hours, how to apply for overtime, IT security requirements, and more. These policies should avoid the appearance of discriminating against remote employees. In all reasonable ways, it will mirror the employee handbook for onsite workers.

As noted, manufacturers with off-site employees might choose to require self-reporting of work locations on a daily basis. If the company is not able to administer payroll and other matters in certain other states, their remote working policy can be drafted to clearly define the geographic limits of extended "work from anywhere" arrangements.

Some attorneys recommend that remote employees maintain dedicated, separate workspaces in their homes to address potential safety issues.[26] In general, however, remote workers who are injured while working remotely are entitled to workers' compensation, and courts have found that employer ignorance about a remote employees' working conditions does not limit the employer's liability.[27]

Ensure Secure Electronic Communication

As part of their remote work policies, the manufacturer can encourage their remote workers to maintain secure and robust Internet access. Companies might also consider reimbursing remote workers for an upgrade to a "Business Class" Internet service level.

Manufacturers are also well-advised to implement a company-wide encrypted VPN connection for safe access to company IT systems from outside the facility.

Maintaining Staffing Levels

Maintaining Staffing Levels

In the closing months of 2021, resignation rates in the manufacturing industry were outpacing those of any other sector (including healthcare and hospitality) and they were 60% higher than pre-pandemic levels.[28]

One factor contributing to this is the ongoing concern of some employees about the risk of virus transmission when working in close proximity with co-workers. Staffing shortages and high resignation rates also may be related to the fact that manufacturing wages continued to drift lower relative to non-manufacturing jobs during the pandemic, a trend that actually began in 2007.[29]

Improve Hiring Messaging and Strategies

Manufacturing provides good jobs and careers. In the course of school recruitment fairs, candidate interviews, and other opportunities, manufacturing company representatives are can emphasize the stability of the industry and the opportunities their company offers for advancement and a stable career. According to U.S. government data, manufacturing jobs offer more job security than any other segment in the private sector.[30]

Manufacturers can also explore creative ways to share this information in non-traditional ways, for example with videos on social media and by teaming with organizations such as multi-cultural groups and communities hosting newly arrived immigrants. In these settings, manufacturers may want to be prepared to make offers on the spot (pending background checks) and be able to offer appropriate training.[31]

Enhance Pay and Benefits

As noted previously, manufacturing wages have been declining for more than a decade relative to other industry sectors. In addition to offering more competitive wages and benefits packages (not just in relation to other manufacturers but also compared to other wage-based industries), manufacturers can offer hiring and longevity bonuses structured to ensure the employee remains with the company for an agreed-upon period of time.[32]

Benefits are not always a primary concern for wage employees, and this gives manufacturers an opportunity to differentiate themselves by publicizing, explaining, and encouraging the use of these benefits. The more that employees come to rely on these benefits, the less likely they are to leave for perhaps another dollar per hour.

Traditional employee benefits might also be augmented with certain informal benefits and amenities, such sponsoring a food truck periodically to provide a free lunch, providing beverages and snacks in the breakroom, and sponsoring company family events. These and similar activities add to the perceived value of the employment experience.

Improve the Workplace Environment

Manufacturers can also go the extra mile to offer an attractive work environment with appealing and well-appointed break rooms, clean and well-lit workspaces, and secure parking areas.

"Environment" extends far beyond the physical workspace, though. Manufacturers can take steps to maintain a positive working environment free of prejudice and one that's protective of the rights of all workers.

To that end, DEI programs aren't just for corporations. An analysis by the National Association of Manufacturers points out that DEI programs in the manufacturing space can have a tremendous impact on recruiting and retaining women in this historically male-dominated industry sector.[33]

Endnotes

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More Than Just Insurance

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