

Learning from Katrina and Rita

Recent natural disasters highlight the importance of effective risk strategies. **By Marc Shuster**

Companies of all sizes, whether public or private, have begun reporting adverse financial consequences as a result of hurricanes Katrina and Rita. While some companies have been directly impacted through property damage and business interruption, many others have been hit by the resulting higher prices for gasoline and other petroleum-based products.

Every business is impacted by, and must deal with, elements that are beyond their direct control. No company can control the weather, the price of major commodities or the hundreds of other complex variables impacting businesses that operate in an increasingly complex global marketplace.

Although these elements cannot be directly controlled, the financial impact can be mitigated, if not eliminated, by the prudent use of techniques for controlling effect. Savvy executives will take the double hit of Katrina and Rita as a wake-up call that it is again time to review the risks in their businesses and to craft techniques to protect their companies.

Fundamentally, there are three principal ways a business can protect itself from the adverse financial consequences that result when uncontrollable events or circumstances occur: insurance, hedging and business diversification. Each of these carry their own endemic risk, but when properly structured, can provide worthwhile protection.

Insurance

Historically, the most classic form of risk protection is through insurance. For a defined premium, one gets defined financial protection for a defined period of time. Over the years, the forms of insurance have multiplied substantially as the list of general policy exclusions has increased.

Today, commercial insurance buyers must assess their risks and be sure to get specific coverage for the risks they choose to insure against. In assessing risks, be sure to think out of the box with regard to potential occurrences, as property owners impacted by Sept. 11, and



more recently by Katrina and Rita, have learned.

Risk assessment must cover not only tangible property but also intangible property that can be subject to claims by others. In addition, there must be a comprehensive assessment of potential claims by the host of different groups (e.g., employees, vendors, customers, etc.) who will come in contact with the business. And there must be an assessment of the risks of interruption of the business.

It is important that the employee charged with reviewing various policies will exercise the same scrutiny that would be provided to any important contract affecting the company.

Hedging

Over the last 20 years, an amazing array of hedging instruments has been brought to market to provide protection for occurrences not generally covered by traditional insurance. Hedging is most often used with commodities wherein futures contracts can be purchased to hedge against future price increases. But hedging products have also been designed for a wide variety of other circumstances.

As with insurance, hedging is accomplished through a contract. As such, one must be diligent in reviewing the precise nature and structure of the hedge. Many a sophisticated business executive has sub-

sequently learned that the hedge contract that had been executed does not provide the protection originally contemplated.

Business diversification

An alternative to insurance and hedging is business diversification. Businesses can diversify their client bases, their vendor bases and even their physical location(s) or product/service lines.

It is important to note that diversification brings its own set of risks that can potentially offset much, if not all, of the potential benefit of diversification. Changing your business strategy is never without risk.

The catastrophes wrought by Katrina and Rita are reminders that businesses must continuously assess their risks, including those beyond their immediate control.

Prudent executives will want to carefully select from available methods to reduce their company's financial exposure to such risks. And they will want to make sure that the methods selected are appropriately structured and documented so that intended protection works as planned in the event of those unpredictable risks.

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