# FINANCIAL AND RISK MANAGEMENT CONSIDERATIONS FOR FOOD BUSINESSES

FOOD AS A BUSINESS
Disaster Preparedness for Food Businesses

Disasters have significant impacts on businesses. According to the Federal Emergency Management Agency (FEMA), many businesses do not reopen immediately after a disaster, and several of the remaining businesses will not be able to stay in business longer than 3 years without a continuity plan in place.

While preparedness can't keep a disaster from happening, you can identify potential disruptions and develop plans to acquire resources and restart operations after an event. Having a plan in place can help minimize losses and make the recovery process easier.

This publication reviews financial and risk management considerations for business owners as part of their disaster preparedness plans. Disasters can be natural or manmade events that disrupt business operations (e.g., hurricanes, floods, tornadoes, power outages, technological threats, workplace accidents, illnesses, pandemics). These general principles can apply to any type of agricultural or food-based business and help you prepare for unforeseen events.

## DISASTERS AND THEIR IMPACTS

Disasters can happen suddenly or over a period of time. A good example of an unexpected disaster that extends for a long period is the COVID-19 pandemic that has lasted several months. Many businesses were forced to close or operate at a reduced capacity. This event has dramatically impacted sales and, in some cases, access to labor and inputs. The disruptions in operations, supply, and demand can quickly exhaust a company's savings and capital.

The agricultural and food sectors are particularly susceptible to weather and other unforeseen disasters that can result in losses and financial stress. Disasters can result in direct, indirect, or tertiary losses.

*Direct losses* impact your capital and can be directly quantified. In an agricultural context, examples include losses to buildings and infrastructure, machinery and equipment, livestock, crops, and products.

*Indirect losses* arise as a result of the disaster and impact production, income, or operating costs. Disasters can also affect the quality of products and services due to disruptions in transportation and potential food safety issues. Even if the business is not directly affected, it can be indirectly impacted when employees, suppliers, distributors, or ultimate customers are impacted.

*Tertiary losses* are the overall impacts to the economy that could impact the business.

It is important to keep in mind that preparedness is part of the cost of doing business. Some preparedness steps require a large investment (such as building improvements and protection systems), while others do not (such as adopting safety protocols). Include the costs of mitigation activities in your annual budget. A financial preparedness plan should include measures necessary to avoid, mitigate, and transfer risk.

## FINANCIAL IMPACTS

Disasters can affect your business finances through their impact on revenues and costs.

- Revenues can be impacted by interruptions in operations that reduce your ability to generate sales.
- Businesses also face the unexpected expenses of emergency response, reconstruction and restoration efforts, or the need to adopt new safety measures (such as personal protective equipment and additional sanitation costs during a pandemic).

It is possible that cash outflows will surpass cash inflows during an emergency, making it difficult to cover normal business operations. It is important to identify mitigation strategies to keep the business in operation during and/or after such events.

## EVALUATE RISKS AND POTENTIAL IMPACTS

To develop a preparedness plan, start by identifying the types of emergencies or hazards that could affect your business and assess the vulnerabilities and potential severity of their impact. You can then identify cost-effective ways to address the risks, focusing efforts first on events that are more likely to happen.

MISSISSIPPI STATE UNIVERSITY™ EXTENSION

**Identify potential risks and hazards** → **Identify the likelihood and severity** → **Identify strategies to avoid, mitigate, and transfer risks**

When identifying potential risks for the operation, consider the following:

- The likelihood of a disaster: Is the event likely or unlikely to happen?
- The severity of the impact: Will the likely impact be minor or severe?

Identify strategies based on the likelihood and severity of the event. If the risk is both severe and very likely to happen, then you should avoid that risk altogether. For example, do not construct or purchase a production facility in a floodplain. If the likelihood of an event is high but has low severity, then you should invest in infrastructure or other strategies to reduce and mitigate that risk. For example, if heavy rains could cause minor power interruptions, invest in a generator to mitigate that risk. If the likelihood of a disaster is low but the severity is high (such as a hurricane impacting the northern part of the state), purchase insurance to transfer that risk.

| Likelihood of disaster | Severity of disaster | | Strategy |
|---|---|---|---|
| High | Severe | ➡ | Avoid risk. |
| High | Low | ➡ | Invest in mitigation strategies. |
| Low | Low | ➡ | Monitor risk and invest in mitigation strategies as needed. |
| Low | Severe | ➡ | Purchase insurance. |

Different tools can be used to assess risks. You can develop your own risk evaluation tool or adapt and use publicly available tools. For example, the Hazard and Vulnerability Assessment (*https://www.readyrating.org/Resource-Center/All-Resources/acat/1/tag/hazard-assessment*) developed by the American Red Cross can be used to evaluate the likelihood of different events and their impacts on different aspects of the business (such as operations, infrastructure and facilities, suppliers and customers).

It is also important to evaluate the risk of financial impacts to the business. Disasters can affect a business by delaying or interrupting production, which can result in lost sales and income. You may face additional costs or new expenses, such as reconstruction, equipment or building replacement and repair, replacement of damaged inputs, overtime labor, and outsourcing services or production, among others. An example of a tool that can provide a risk assessment of scenarios and potential impacts is the Ready.gov Business Impact Analysis Worksheet (*https://www.ready.gov/sites/default/files/2020-07/business-impact-analysis-worksheet.pdf*).

As you analyze the business's vulnerabilities, evaluate the different scenarios that could take place after a disaster. Factors to consider include lost production, lost inputs, infrastructure or equipment damage, and cost of equipment repairs. Here are some example scenarios:

- Planting cannot occur or is delayed.
- Inventory or crops are lost or damaged.
- Inventory is contaminated.
- Buildings are damaged and not safe to use.
- Business records are destroyed.
- Business computers are damaged.
- Input suppliers or service providers cannot be accessed.
- Employees are unable to work.
- Utility services (internet, gas, power, water) are interrupted.

Consider these important questions for each scenario:

- How will income and costs be impacted?
- Will the business still be operational?
- Will you be able to meet obligations like loan payments or payroll?
- How long can the business stay in operation with little or no income?

## MANAGE BUSINESS FINANCES

Regardless of unforeseen events or disasters, managing your business finances is important. Consider the following:

- **Have a budget, monitor income, and control expenses.** Understand how much money it takes to run your business.
- **Monitor indebtedness.** Understand the level of indebtedness that the business is currently subject to and whether the business has the capacity to assume more debt in case of an emergency. Also monitor credit cards and available balances that you could use in an emergency.
- **Maintain a good credit score and good relationship with bankers.** It is important to be in good standing with credit institutions in case you need to apply for loans. Also, maintaining good communication with your local bank can help you stay informed about relief programs.
- **Monitor cash flows to ensure adequate liquidity** (enough cash to keep your operation going). Understand how much cash is needed to operate the business, especially when it is not earning income.
- **Have an emergency fund.** Building and maintaining an emergency fund is critical because you may still have business expenses but no income. Keep a separate savings account that the business adds to every month to gradually build a cushion that would allow the business to run for at least 3–6 months with no income. Another good practice is to have a small amount of cash on hand and credit cards with available credit (these should be a last resort).

## EVALUATE INSURANCE

Insurance is a key component of a risk management strategy for any business. As you identify potential risks and their impacts, it is important to examine the need for insurance, whether coverage is adequate, and how current or potential policies work.

Discuss your business's specific needs and risks with a business advisor or competent insurance agent or broker. Some insurance products are listed below, but others may apply, as well.

- **Product liability insurance** protects from liability resulting from a defective product that causes injury or harm. This is particularly important for food businesses. Many buyers (such as large supermarkets) require this type of insurance from food suppliers.
- **Commercial property insurance** covers costs to repair or replace lost or damaged company property.
- **Business interruption insurance** covers lost revenue in case of disasters.
- **Flood insurance** covers flood damage to buildings and building contents.
- **Crop insurance** covers lost revenue resulting from yield losses to natural disasters and/or low market prices.
- Some "umbrella" insurance packages include many different types of specific insurance products that are needed for a particular type of business (such as a business owner's policy for small businesses).

As you review insurance policies, make sure you obtain adequate coverage. Review insurance coverage at least annually. Make sure you understand the different parts of a policy:

- coverage limits
- what is covered and what is excluded
- deductibles
- coinsurance requirements
- documentation needed for claims
- policy expiration dates

Maintain a good inventory of buildings, equipment, machinery, and other insured assets in case you need to make a claim. *FEMA's Ready Business toolkit* has an excellent Insurance Discussion Form at *https://www.fema.gov/media-library-data/1389017324674-9b45706d0f7cb9bccef9c3e4dd4a64dd/Business_InsuranceDiscussionForm_2014.pdf*. In addition, a qualified insurance sales representative is invaluable in compiling this inventory.

## CONTINUITY OF OPERATIONS

Another critical component of a preparedness plan is having a business continuity plan complete with steps on how to restart operations after a disaster. Identify the people, resources, and equipment necessary to run the operation and backups to each of these in case of an emergency. For example, for a backup facility to continue operating, it must have backup suppliers/distributors and buyers. Also develop a backup plan in case you or key employees are not able to work as normal.

Document workflows and logistics so that production processes can be maintained or adjusted in an emergency. Also document a business succession plan so that it is clear who will manage the business and operations if the business owner becomes incapacitated. A template that can help you think through these issues is the Business Continuity Resource Requirements worksheet at *https://www.fema.gov/media-library-data/1388787050811-3e1d543d2d810f9194b930caaf4993dd/Business_ContinuityResource_Worksheet_2014.pdf*.

## PROTECT FINANCIAL AND BUSINESS DOCUMENTS

Always keep important financial business documents in a secure location that is both fireproof and waterproof in case a disaster or other unforeseen event occurs. Here are some examples of these documents:

- deeds
- mortgage and lease agreements
- loan documents
- insurance policies
- titles for vehicles and other equipment
- previous tax returns
- bank account information
- inventory of assets
- other financial and legal documents (such as wills and trusts)

Keep these important documents in a safe deposit box, in a waterproof and fireproof grab-and-go file box, or saved electronically and backed up at a remote location. Electronic recordkeeping (such as a cloud-based backup system) is a good option so that documents can be accessed from any location. You can scan paper copies of documents and save them electronically.

Document valuable assets and keep a list of important contact information for buyers, suppliers, insurance providers, and banks. In addition, make sure useful information is available to trusted individuals who may need it in an emergency. This includes the location and content of stored documents as well as the necessary passwords to access electronic accounts.

## SUMMARY

A business plan, business disaster plan, and business continuity plan can help you identify risks and strategies to address those risks and mitigate their impact. Get feedback from employees as you create these plans; they may have good insights about processes they are responsible for. Review the written plans and update as needed at least annually.

## RESOURCES

Ready Business – Preparedness Planning for Your Business Toolkits. *https://www.ready.gov/business*

Ready Business – Risk Assessment. *https://www.ready.gov/risk-assessment*

Ready Business – Business Impact Analysis. *https://www.ready.gov/business-impact-analysis*

Ready Business – Make a Plan. *https://www.ready.gov/plan*

Ready Business – Financial Preparedness. *https://www.ready.gov/financial-preparedness*

Ready Business – Business Continuity Plan. *https://www.ready.gov/business-continuity-plan*

Small Business Resilience Toolkit. *https://www.blountchamber.com/lib/file/manager/resource-hub_tool1.pdf*

For more information, contact elizabeth.canales@msstate.edu.

This material is based upon work supported by USDA/NIFA under Award Number 2018-70027-28585.

**Publication 3546** (10-20)

By **Elizabeth Canales**, PhD, Assistant Professor, Agricultural Economics; Courtney A. Crist, Assistant Extension Professor, Food Science, Nutrition, and Health Promotion; Carley C. Morrison, PhD, Assistant Professor, Human Sciences; and J. Byron Williams, PhD, PAS, Associate Extension Professor, Food Science, Nutrition, and Health Promotion.



Produced by Agricultural Communications.



Extension Service of Mississippi State University, cooperating with U.S. Department of Agriculture. Published in furtherance of Acts of Congress, May 8 and June 30, 1914. GARY B. JACKSON, Director