INDUSTRY REPORT

How Fires and Natural Disasters Can Affect Business and Insurance

Extreme weather events are becoming more frequent, severe and costly every year. The average number of extreme weather events per year between 1980 and 2020 was 7.1, but that figure skyrockets to 16.2 when examining just the 2016-20 period.[1] Those events are having a direct economic impact: The financial toll in 2020 was $98.8 billion, up from $18.4 billion in the 1980s.

Extreme weather events — including wildfires and natural disasters — have a serious and long-lasting effect on businesses and insurance companies. On the business side, both direct and indirect losses can destroy property, drain revenue and leave lasting reputational damage, whereas insurance companies are being forced to reconsider doing business with policyholders in high-risk areas.

As the threat of climate change grows more acute, it's important for businesses and insurance companies to understand the challenges posed by worsening natural disasters and wildfires.

Direct losses for businesses

Property damage

The most obvious and immediate effect of wildfires and natural disasters on businesses is the direct property damage they cause. In 2019, total economic losses resulting from natural disasters were substantial, amounting to $232 billion.[2] Property damage can vary both in kind and severity, but it most commonly includes:

- Loss of inventory.
- Loss of critical documents.
- Loss of machinery.
- Loss of technical equipment.

Of course, the growing incidence of extreme weather events has made this problem substantially worse. Beyond climate change, however, one of the underlying factors contributing to damage due to natural disasters is the fact that many property developers continue to build in high-risk areas despite the risks it poses. Almost 57% of all properties in the contiguous United States — including commercial properties — are located in hotspots for natural disasters.[3]

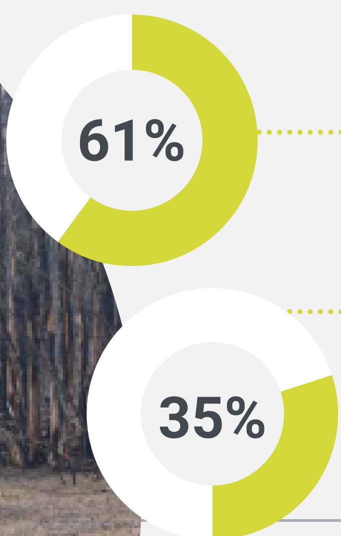
This pattern of development appears unlikely to change in the near future. Property developers still prefer to build in areas that are already established, despite the medium- and long-term risk of natural disasters.

Worse still for businesses, a significant insurance gap helps to compound the problem and place them under even greater financial strain when disaster strikes. Out of the $232 billion total financial losses, insurance companies were on the hook for just $71 billion, leaving businesses themselves to cover the remaining $161 billion.

Loss of income

Businesses don't just suffer from the consequences of direct property damage caused by wildfires and natural disasters.

Forced evacuations of employees/clients in an emergency, disruption of local and international supply chains, and damage to client businesses/income can also cause severe and lasting damage to normal business operations, leading to loss of income long after the extreme weather event has passed. According to one study on small businesses affected by natural disasters:



61% reported revenue losses of less than or equal to $25,000.

35% saw losses of more than $25,000.[4]

Indirect losses for businesses

Loss of power, communication and other utilities

Even if a business's commercial property is untouched by a natural disaster, extreme weather events can cause damage to external entities (like communications infrastructure) that companies rely on to conduct their day-to-day business smoothly.

Among small businesses affected by natural disasters, 65% of them reported revenue losses due to power or utilities failures.[5] Shockingly, only 17% of them had business interruption insurance to help them recover those losses, drastically worsening the financial toll on their business.

65%

of small businesses affected by natural disasters reported revenue losses due to power or utilities failures.

17%

of them had business interruption insurance to help them recover.

In addition to making it exceptionally difficult to communicate recovery plans, ensure adequate safety responses and protect employees[6], power outages can also make it hard (and sometimes impossible) for businesses to communicate the situation to their customers and suppliers, resulting in:

- Lost business.
- Lost consumer trust.
- Damaged reputation.

Supply chain disruption

In highly globalized societies and industries, even local natural disasters can have far-reaching economic consequences. This is especially true when local industries supply a disproportionately high volume of a specific product or service.

To use one example, automotive manufacturing is a significant part of the Japanese economy, and much of the global automotive industry sources parts and equipment in Japan. After the earthquake and tsunami struck the country in 2011, many auto manufacturers in foreign markets had no recourse and were forced to suspend operations, leading to global shortages.

30%

In fact, for weeks after the disaster, Toyota's North American arm was operating at just 30% capacity.[7]

As natural disasters and wildfires become more common across numerous different regions, and many companies continue to show an unwillingness (or inability) to reshore critical supply chains, similar disruptions are likely to create havoc in other industries. Worse still, business slowdown for regional stalwarts — like Toyota in the above example — can have a ripple effect that damages peripheral industries, even ones that strictly operate locally.

This is also true of port cities that facilitate trade between international suppliers and domestic consumers. Even if foreign markets are untouched by an extreme weather event, damage to critical intermediaries in port cities will still have a negative effect on the exchange of materials, products and goods with vendors in the domestic market.

The case of Houston is a recent example. The ravage brought by Hurricane Harvey in 2017 caused significant delays and shortages to several local and regional industries in and around Texas. That was primarily due to the important role Houston plays as a port city and the resulting damage the hurricane caused to warehouses, shipping lines and distribution centers, temporarily making it extremely difficult for foreign vendors to reach U.S. buyers.

How fires and natural disasters affect the insurance industry

Despite the enormous insurance gap ($161 billion in 2019) mentioned above, damage caused by fires and natural disasters are putting immense pressure on insurance companies. To use one example from a region frequently in the throes of natural disaster, losses and legal costs due to fires in California commercial properties exceeded $1.1 billion in 2017, 2018 and 2020.[8]

Combined with the figures for allied lines and commercial multi-peril coverage, total losses were in excess of $4 billion in each of those years. No other year recorded losses totaling more than $2.3 billion.

The resulting impact on the insurance industry is that many carriers are choosing to limit their coverage options for businesses operating in high-risk areas.[9] More specifically, most carriers are resorting to one of the following courses of action in high-risk areas:

- Completely suspending their services.
- Limiting the number of properties they cover.
- Increasing premiums for policyholders.

Although the above trends refer specifically to wildfire risk, the outlook appears similar for other types of natural disaster. In Florida, for example, private carriers are similarly showing themselves less willing to cover businesses operating in high-risk flooding areas.[10]

As the risk of flooding in those areas grows, the government's National Flood Insurance Program (NFIP) is increasingly stepping in to cover at-risk properties. According to data from the U.S. Department of Homeland Security and reported by the Insurance Information Institute, the 10 most significant flood events by NFIP payouts have each occurred within the last 20 years.[11]

What businesses can do to protect themselves

Despite the unpredictability of natural disasters and wildfires, businesses can mitigate the risk of natural disaster damage by combining effective resiliency planning with the right insurance coverage.

In terms of resiliency planning, businesses should invest time and resources into the following contingencies:

Business continuity plan: Craft a plan that ensures business operations stay running with minimal disruption. Leaders should consider forging relationships with vendors outside the disaster zone to ensure business needs can continue to be met.

Risk management plan: Consider the natural disasters that are most likely to affect the business and the specific effects they could have. It's important to not only consider the business's geographic location, but also that of suppliers and customers.

Disaster recovery plan: Collaborate cross-departmentally to ensure all stakeholder viewpoints are properly accounted for and consider all possible disaster scenarios. Use this information to craft effective responses that reflect all critical business needs.

In addition to the above contingency planning, businesses should also consider some combination of the following insurance coverage options, depending on their specific circumstances:

- General liability insurance.
- Commercial property insurance.
- Flood insurance.
- Supply chain insurance.
- Business interruption insurance.

Partnering with the right team of insurance professionals

Climate change is worsening extreme weather events, meaning businesses and insurance companies will have to deal with wildfires and natural disasters into the foreseeable future. There are, however, important steps they can take to navigate the specific risks facing their organizations and ensure long-term growth.

It starts with partnering with the right team of insurance professionals. At NIP Group, we're committed to providing customers with a wide range of brokerage, underwriting and risk management services across a number of different industries to overcome the specific challenges they're facing and deliver business success.

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