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RISK AVOIDANCE AND PRODUCT RECALL PREPAREDNESS IN THE CONSUMER PRODUCTS INDUSTRY

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Risk Avoidance and Product Recall Preparedness In The Consumer Products Industry

Introduction

U.S. manufacturers, and especially producers of consumer products, are acutely aware of the multiplicity of government regulatory and reporting requirements to which they must adhere. Moreover, with the rapid growth in product liability litigation in recent years, they are even more painfully conscious of the need to aggressively manage the risks they confront in operating in this arena. Indeed, as revealed in a Conference Board study last year, of large and small manufacturing companies, many companies have closed some operations, cancelled plans for new products, laid off employees engaged in making certain products, backed off from making promising acquisitions, or curtailed new products research because of fears and uncertainties related to product liability.

It was against this backdrop that A.T. Kearney, a worldwide management consulting firm, undertook an assessment of product recall preparedness and management.

A key element of this assessment was a survey, completed early last year, of the product recall practices of 529 U.S. consumer products companies.

Survey Methodology

The 529 companies which participated in the survey were selected based on two criteria:

- At least $50 million in annual sales; and
- Production of consumer goods in one of 14 target categories.

The categories of consumer goods addressed included:

1. Automobiles, automotive parts, and tires.
2. Motorized recreational vehicles.
3. Household appliances.

- Nearly one in four (120) of the respondents had experienced product recalls.

- Seventy-five percent of the companies had some form of recall procedure in place; but the procedures tended not to be sophisticated.

- Seven percent of the companies said they were in the process of developing recall policies or procedures.

- Eighteen percent had no recall policy and no plans to develop one.

- Relatively few companies have thoroughly reviewed their safety procedures to prevent defective products.

- Few companies have established a quick, thorough means of repairing, replacing or recalling potentially defective products from the marketplace if a problem occurs.

- Most companies have not gone beyond the most rudimentary steps in managing risks and are not adequately prepared for the liabilities they may face.

- Food, pharmaceutical and automotive companies, whose products if defective can do great harm, were among those having the most comprehensive plans to mánage product liability and recall issues.

2. Company Motivations

Without exception, company executives emphasized concern for safety and product or company reputation as the key factor motivating a recall action. Regulatory action, consumer pressure, and potential liability were cited as secondary concerns. They disclaimed any appreciable consideration for the costs of a product recall. They indicated that their goal was a comprehensive and effective effort to correct the problem.

3. Objectives of a Successful Recall

The companies who participated in Kearney's survey said that their most important objective in initiating a recall is achieving a high rate of return for the defective product. This purpose significantly outranked three other objectives: maintaining product reputation; preserving market share; and cost containment.

4. Factors Important to the Success of a Recall

The most important factors cited in assuring the success of a recall were product identification and locating the product in the distribution network. The most challenging aspect is persuading the consumer to return a faulty product.

5. Appropriate Corrective Actions

For products which are inherently defective or potentially dangerous, the most appropriate action is repair or redesign. Twenty percent of the companies with recall experience said they took this action.

If repair isn't feasible, the next level of response is to provide consumers with a safe replacement. Thirty-seven percent of the companies with recall experience took this action. Replacement can be less time-consuming and less burdensome from a practical standpoint, although generally more costly, than repairing a product. Repairs may require meticulous and often confusing directions or close supervision. Repairs may themselves create safety concerns if not performed properly.

The most dramatic action, reserved for the most serious safety risks, is a total withdrawal of the product from distribution together with action to reclaim it from consumers.

Whatever the corrective action taken, it should be decisive to avoid negative consumer response. It should be reassuring rather than raising concerns. If handled properly, it will confirm a company's commitment to product safety and enhance its reputation.

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Results of the Kearney Recall Assessment: Thirteen Management Functions To Avoid Risk and Improve Recall Preparedness

Based on A.T. Kearney's experience and the results of the survey data, Kearney developed 13 specific management functions to reduce product risk and improve recall preparedness:

1. Corrective action planning. Develop a formal risk management plan which integrates a pro-active emphasis on quality assurance of product design and manufacturing with a detailed, systematic, and tested corrective action program.

2. Safety and risk management committee. Establish a Safety and Risk Management Committee with clearly defined duties which include overseeing both preventive quality control procedures and corrective action efforts.

3. Scheduled and unscheduled preparedness audits. Place a high priority on unscheduled audits of a corrective action plan or crisis preparedness.

4. Incremental decisionmaking. Follow a pro-active, step-wise process of reviewing product quality and safety issues at the design, production, and post-sales levels, arriving at decisions on a deliberative basis and not in response to outside pressures.

5. Familiarity with regulations and regulatory authorities. Ensure that the company's key managers possess a finely-honed understanding of pertinent product safety regualations, make systematic ongoing efforts to become familiar with and comment on possible impacts of proposed regulations, and understand how best to work with regulatory authorities during a corrective action effort.

6. Pro-active attitude toward consumers and the news media. Establish an integrated system for the collection and analysis of consumer complaints and other critical input, maintain a toll-free hotline to encourage consumer input, and have a Customer Relations staff trained to effectively respond to inquiries and gather product performance or accident data. Use the media pro-actively to

alert consumers to corrective action and to help shape product and company image. Have spokespersons trained to effectively communicate the facts of any corrective action plans. Have generic press releases available to announce corrective action campaigns and other safety-related issues.

7. Product identification and tracking systems. Develop a sophisticated, on-line system which allows for the instantaneous identification of any suspect product or batch and for their prompt recovery, if necessary.

8. Learn from experience. Carefully conduct post-recall and litigation reviews, making modifications as appropriate in safety procedures and product designs. Learn from the experience of other industry members. Seek improvements even when recalls or litigation have been favorably concluded.

9. Risk awareness. Appraise inherent and newly developing industry risk factors. Consider the necessity for additional measures to counteract such risks, and provide adequate insurance or reserves to cover such potential risks.

10. Safety training. Administer an ongoing employee education program which sufficiently trains employees to ensure their on-the-job safety and to implement procedures and precautions which help ensure that products are constructed, handled, and shipped properly and safely.

11. Recordkeeping. Retain a detailed "paper trail" of all safety-related operations and decisions (e.g., require a synopsis of safety concerns considered by design staff and their resolution to accompany product designs submitted for review).

12. Design review procedures. Establish clear and operational procedures to ensure that product safety concerns are considered and addressed at every stage of the design process.

13. Quality control efforts. Establish formalized quality control and quality assurance procedures. Ensure that top management, by word and deed, reinforces the company's commitment to quality.

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Results of the Kearney Recall Assessment: Four Stage Model of Recall Preparedness

Based on the results of the survey, Kearney developed a four-stage model of a company's preparedness to deal with faulty products. The model provides a measure of the company's relative sophistication in managing product liability risks and promoting effective recalls. To construct the model, Kearney evaluated survey respondents against the 13 effective management functions. The results indicated 4 stages of development:

- Stage I. The least sophisticated stage, characterized by informal planning, limited policies for evaluating and reacting to potential product hazards. No focused organizational responsibility, authority or accountability below the CEO. Limited or no recall experience. Low level of knowledge or understanding of regulatory requirements, product risks/liabilities or logistical demands of recalls.

- Stage II. Companies which have a formal, but unsophisticated, corrective action plan. Part-time safety coordinator. Sporadic and informal evaluation of corrective action preparedness. Routine regulatory compliance. Limited working relationship with regulatory authorities. Moderate level of product tracking techniques.

- Stage III. Companies which have a formal, comprehensive program for applying corrective action and some measure of integration with risk management efforts. Safety Committee. Corrective action preparedness through regular unscheduled audits and mock recalls, sound understanding of pertinent regulations, effective communication with regulatory authorities, pro-active use of media for communicating with consumers, and sophisticated product tracking system.

- Stage IV. Companies with formal risk management plans that emphasize pro-active quality control, a detailed, systematic and tested corrective action program, and senior management involvement. Safety committee with clearly defined duties and sufficient authority to perform them. Regular mock recalls and unscheduled audits, with implementation of necessary modifications. Finely honed understanding of pertinent regulations. Interact well with regulatory authorities. Pro-active use of the media to alert consumers to corrective action and to help shape product and company image. Trained company spokespersons. State-of-the-art, on-line product tracking system.

Employing this model, Kearney classified each of the 529 companies which participated in its survey into the most applicable developmental stage. The results indicated that fully 95 percent of the companies fell into Stage I (272 or 51 percent) or Stage II (233 or 44 percent), with only 24 companies (5 percent) qualifying for Stage III, and only one company having Stage IV attributes.

Conclusions

The results of the Kearney survey suggest that product liability and recall preparedness are fundamentally management rather than legal issues--although there will always be a critical role for lawyers in the process. Where management breaks down, legal problems begin. It is critical that companies not wait for disaster to strike, and then call in their lawyers to try to bail them out. Rather, the prudent company will develop a proactive, advance plan to minimize product risks and manage them if they do occur.

The data also suggests that, despite the almost universally recognized major business impacts of inadequately managed product liability risks, the majority of consumer products companies fail to do an effective job of managing these risks. Indeed, it appears in many instances that major corporations, rather than attempting to manage their risks, decide to simply walk away from them; choosing to abandon product lines, close plants, and forego promising opportunities--viewing the certainty of lost profits as preferable to the uncertainty of potential litigation, recalls, and bad publicity.

This is unfortunate. It is unfortunate to the businesses involved, because of the lost profits. But it is also unfortunate to the American consumer, who is deprived of new products which could enhance the quality of life. And it is unfortunate to the American economy as a whole. Not only does it mean a lower Gross National Product, but it contributes to our negative Balance of Trade and reduces our competitiveness with foreign industry.

It is easy to blame the lawyers and litigation, but the fundamental failing is one of management. It will take our combined energy and creativity to set things right.