The Economist

Business continuity

Making it through the storm

Hurricane Sandy was another test of how well businesses can keep going when disaster strikes

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GOLDMAN SACHS'S latest shrewd investment was in sandbags and back-up electricity generators. As Hurricane Sandy approached New York, the bags were stacked around its headquarters. It was one of the few offices in downtown Manhattan to remain dry and well-illuminated as "Frankenstorm" battered the city.

Meanwhile, a block farther down West Street, the headquarters of Verizon were awash with salty flood water, soaking cables delivering phone and internet services to millions of customers. The firm was able to reroute much of the traffic through other parts of its network, but local service was disrupted.

ConEdison, the electric utility which serves New York City and Westchester County, left 960,000 customers without power, after underground equipment was flooded and power lines came down. It had designed its facilities to withstand a tidal surge of 3.8 metres; Sandy caused a surge of 4.3 metres. Nine days after the storm 79,000 ConEd customers were still without power.

Sandy is the latest catastrophic event to test the readiness of the world's leading firms to cope with disaster. Most firms have improved "business continuity" preparations over the years. The Y2K scare at the turn of the century moved IT risk high up the list of worries. The attacks of September 11th 2001 warned firms of the danger of putting all their computers (and staff) in the same place.

Last year's Japanese tsunami reminded many companies that moving to "just in time" manufacture through global supply chains, particularly when they involve outsourcing, can bring new risks. American carmakers found that they could not get essential parts made in Japan. Floods in Thailand in the same year surprised many buyers of hard-disk drives, who found a large proportion of global supply comes from a rather small area near Bangkok.

A survey published on November 7th by DHL, a logistics firm, reported that 23% of big companies did not include their entire supply chain in their business-continuity plan. If disaster risk-management stops at the borders of the "enterprise" and does not include, say, suppliers further down the chain, it may provide false comfort.

Each new disaster tends to surprise firms that thought they had good plans in place.

Hospitals in New York that had moved their back-up generators above ground nonetheless lost power during Sandy because they had failed to put fuel and pumps where floods could not reach. Running disaster-readiness drills regularly, it turns out, is a common-sense idea practised all too rarely.

“Firms are increasingly reliant on networks, but often fail to understand the risks that networks bring,” says Don Tapscott, a management guru. Global supply chains, just-in-time and shifting to the “cloud” tend to bind once unrelated activities ever closer together, making them more prone to failing at the same time. The current fad for moving data to the “cloud” may appear to reduce risk because there is so much spare capacity in the web. Yet some firms offering cloud services have more concentrated operations than others.

Firms are starting to recognise their vulnerability to cyber-attack, but few have much idea what they would do if it happened. Mr Tapscott thinks boards should have a committee explicitly focused on understanding IT and network risks and ensuring they are properly managed.

The best-laid plans

Dutch Leonard, a risk expert at Harvard Business School, says that the best-prepared firms use a combination of planning for specific events and planning to cope with specific consequences, such as a loss of a building or supplier, regardless of the cause. He also recommends copying an approach used by the armed forces: using a group of insiders to figure out how the firm could be brought down.

Sandy showed that when disaster hits firms depend on how the various arms of government respond. Equally, government efforts can depend on the willingness of private firms to join in. Hurricane Katrina showed that the logistical capabilities of a big private firm, such as Walmart, can deliver essential supplies better than the Federal Emergency Management Agency. Monopolistic utilities are often the least ready for disaster, as Sandy showed. But at least in New York and New Jersey, AT&T and T-Mobile put their rivalry on hold to improve cellphone availability after Sandy hit by sharing wireless masts.

America's poor physical infrastructure makes the problems worse. Firms should make lobbying government to invest heavily in upgrading that infrastructure a core part of their risk-management strategy, argues Irwin Redlener of the National Centre for Disaster Preparedness at Columbia University.

Goldman Sachs has long been a leader in disaster planning because it understands that the situations in which it might not be able to function are exactly the sort of events when very large changes in the value of its investments could occur, says Mr Leonard. Yet too many firms underinvest in planning for disaster because they don't think it will pay, at least within the short-term timeline by which many now operate, reckons Yossi Sheffi of MIT. A boss who expects three or four years in the job may calculate that there is a small chance of disaster in that time and that preparing for it is expensive, "so why not save the money and hope to move to another job before something happens?" Alas, all too often firms will be prudent only if prudence pays off quickly.

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