PROMOTING PRIVATE SECTOR EMERGENCY PREPAREDNESS

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PROMOTING PRIVATE SECTOR EMERGENCY PREPAREDNESS

TUESDAY, NOVEMBER 1, 2005

HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
Washington, DC

The Committee met, pursuant to call, at 2:00 p.m. in Room 2360 of the Rayburn House Office Building. Hon. Donald Manzullo [Chairman of the Committee] presiding.

Present: Representatives Manzullo, Akin, Sodrel, Christensen, and Bordallo.

Chairman MANZULLO. Good afternoon and welcome to this hearing on an important and unique topic. In the United States today business face considerable challenges on several fronts. These include burgeoning health care costs, high tax and regulatory burdens, and rising energy prices, to name a few. These obstacles are expected by those entering the current market place, and through ingenuity and persistence, they must be dealt with and overcome by all involved.

Today however, this committee will focus on market challenges of a more unexpected variety. The direct and indirect effects that result from both natural and man-made disasters, including terrorism, can be economically devastating. As small businesses become part of national and international supply chains, even distant disasters can have very harmful consequences.

The human costs resulting from such events are immeasurable. And every government agency and institution of civil society must vigorously play their part in responding to individual needs that arise in the wake of such events. As America continues to pursue more effective means of public and private sector responses to emergencies, it is also important to bring to light how these emergencies affect the livelihoods of businesses.

The significance of emergency preparedness for businesses was just emphasized yesterday by the Secretary of Homeland Security, Michael Chertoff, as he called on businesses to invest in preparing their companies and employees for emergencies such as terrorism and hurricanes. The Ready Business campaign, which was initiated last year by DHS, is comprised of public service announcements aimed at educating small and medium sized businesses in emergency preparedness. This campaign was reiterated yesterday because the Administration recognizes the wide-ranging disparity between what is required presently of businesses for sufficient emergency preparedness and what is actually being done.

The primary purpose of this hearing is to get a sense of the level of threat posed by potential emergencies to the business community. What are the current private sector responses to these emergent threats in contrast to the suggestions of experts in emergency preparedness? What preparedness measures can small businesses take, despite limited resource availability for such preparation? Finally, what can Congress do, however limited in scope, to encourage and facilitate more robust emergency preparedness by private sector firms in this country? For example, in the past, Congress passed a loan program to help small businesses deal with Y2K concerns. This year, the SBA proposes to increase the size of disaster mitigation loans.

This Committee, the Administration, members of academia, and many in the business community realize how important this issue is, and I hope this hearing will provide clearer understanding of what businesses should prepare for, how they should implement this preparation, and suggestions for Congress on encouraging this type of activity in the private sector.

I have been advised that our Ranking Member, Ms. Velazquez of New York missed her flight. And I would recognize for opening statement then Congresswoman Bordallo from Guam. Good to have you here.

[Chairman Manzullo's opening statement may be found in the appendix.]

Ms. BORDALLO. Thank you very much, Mr. Chairman.

And before I have just a few opening remarks, I'd like to ask that our Ranking Member, Ms. Velazquez, her opening remarks be placed in the record.

Chairman MANZULLO. Without objection.

[Ranking Member Velazquez's opening statement may be found in the appendix.]

Ms. BORDALLO. Mr. Chairman, first I want to thank you very much for having this hearing. Throughout our nation's history we have endured numerous natural and man-made disasters from earthquakes in California to the terrorist attacks of 9/11, to the recent hurricanes that plagued the Gulf Coast. Disaster preparedness for small businesses to me is an important topic. It is one of those issues that does not receive the attention they should until it is too late. Both terrorist attacks and natural disasters can have devastating affects on everyone, especially small businesses. They can ruin a lifetime of hard work in seconds. Terrorism on U.S. soil, unfortunately, has become a possibility for which every American, business owner or not, must plan. Natural disasters are no less threatening and require the same level of awareness of risk and advanced planning by business owners.

I represent the territory Guam, and I will say at this point, Mr. Chairman, that we have disaster meetings bringing in every segment of the community quarterly; disaster or no disaster, we meet continually.

The recent storms that devastated the Gulf Coast have brought the importance of disaster preparedness for businesses into sharper focus. Guam is no stranger to violent storms. Recent hurricanes, or we call them typhoons in the Pacific, of Katrina's destructive power

strike Guam on a regular basis. I would say a super typhoon occurs every three years on Guam, sometimes more frequently.

We have had super Typhoon Paka, December 1997. Typhoon Chataan, July 2002. Super Typhoon Pongsana, December 2002. To mention just a few, and these are typhoons with winds over 200 miles an hour.

We have built very well on Guam, all in concrete, so we do not have deaths.

It certainly has devastated the business community, and many businesses have left the island and never reopen following these storms.

So I look forward to your testimonies today. This issue of disaster preparedness and risk mitigation is of great interest to business owners on Guam and everywhere throughout the United States.

Chairman MANZULLO. Thank you.

We have some time. Dr. Christensen, did you want to make an opening statement coming from the great territories of the Virgin Islands? Virgin Islands and Guam.

Dr. CHRISTENSEN. Yes. And as you know, we have had our share of hurricanes as well.

I want to thank you for holding this hearing and welcome our panelists today.

This weekend I had the opportunity to travel with the Subcommittee on Emergency Preparedness in response to Houston, Beaumont and Port Arthur, Texas. And one complaint that we heard over and over there, as we have heard in Louisiana and Mississippi, is that businesses are closing because of the slow response of the Small Business Administration, which is one of the issues that we would be looking at today.

At this point in that area, and I am sure they are not alone in this, they are desperately asking at this point for bridge loans to carry them over until SBA finally comes through from FEMA. But, you know, we in the Virgin Islands are a project Impact site. And that was very, very helpful to us. The local businesses worked with the Emergency Management Council and it helped them to better prepare, to help themselves, to help their employees and to help the rest of the community in the event of a disaster. We fought it being discontinued, and today we are seeing the percussions of that ill-fated decision to close the program.

Throughout Katrina and Rita most of us, and most of us do not have a clue what happened Ophelia. I have really been applauded by the loss of institutional expertise knowledge and experience that has had us reinventing the wheel in the middle of a catastrophe. And I would add, you know, spending dollars that we probably did not have to.

The people in this country and the small businesses which employ people within our communities and keep the economies of those communities healthy deserve better. Private sector preparedness encompasses disaster planning, risk management, recovery preparedness and communications readiness. And this is really only possible through effective and meaningful dialogue among the stakeholders.

Last week I had the opportunity to attend a briefing hosted by BENS, Business Executives for National Security, a business orga-

nization. And I really regret that we could not have a representative of BENS on the panel today. They represent owners of some of this nation's critical infrastructure, would have been able to make a meaningful contribution, I think, to the hearing. But they do remain open to the offer with their offer of expertise, not only for the Committee but to help communities close those gaps in homeland security that neither government or business can fill alone.

And I am going to just shorten this and just say that when business and government do not work together, FEMA loses valuable time and wastes money when those relationships and the support from the local small businesses are not there in advance of the disaster. So dialogue such as the one conducted today will, hopefully, help at increasing and improving on this relationship. And therefore, our response and our recovery. And I look forward to hearing the testimony from the people before us this afternoon.

Chairman MANZULLO. Thank you, Doctor.

Our first witness is Dr. Michael Czinkota, who is on the faculty of Marketing and International Business at McDonough School of Business at Georgetown University.

We have a five minute clock here. Why don't you set it for 6° minutes because we do not have any votes coming up. All right. We will do it 6 minutes. We are not worried too much about the time.

We look forward to your testimony.

The complete written statements of all the witnesses will be made part of the record without objection.

And Dr. Christensen, BENS, is it B-E-N-S?

Dr. CHRISTENSEN. Yes.

Chairman MANZULLO. If they want to submit a written statement, as long as it is not a book. If they could keep it within a reasonable amount of pages, we would be glad to make it part of the record.

Dr. Czinkota? Czinkota, right?

STATEMENT OF MICHAEL CZINKOTA, McDONOUGH SCHOOL OF BUSINESS, GEORGETOWN UNIVERSITY

Mr. CZINKOTA. Thank you, Mr. Chairman. Yes.

Mr. Chairman, members of the Committee, I intend to talk about emergency preparedness in the context of terrorism, since that is the work we have conducted at the McDonough School of Business over the past years.

Terrorists direct their attacks against businesses far more than against any other target. And when they strike what they intend to do is to disrupt the flow of supply and demand, and of course to change our way of life.

Terrorism is the third most important concern to firms doing international business nowadays, after energy price and exchange rate volatility. And firms which we interviewed reported to have spent on average about $147,000 on terrorism preparedness and hired about five new employees to deal with the issue. Yet many corporations also tell us that their shareholders do not reward them for any investments into preparation against terrorism, and therefore they remain unprepared.

With today's global competition firms no longer have the luxury of just aiming at survival in the face of an emergency. Rather, they have to offer continuity to their suppliers, to their customers and their clients in order to inspire confidence in the relationship. Flexibility allows them to recover much more quickly in the aftermath of terrorism's direct and indirect consequences.

Now, preparedness, of course, is an overall concept that is key to any firm. For example, the benefits of contingency preparation became very evident to me at Georgetown University after Hurricane Katrina when students and faculty members from the New Orleans' area found continuity in our classrooms. But even relatively small and local events can cause major dislocations for companies. Suppliers can go out of business when if their facilities burn to the ground. Employees can be struck by illness or a labor dispute may ground shipments. To safeguard the investment of shareholders and the short viability of firms, managers must prepare contingency plans which respond to system shocks.

We propose a model of the different levels of corporate readiness for international terrorism. The model might also help to evaluate policy approaches to preparedness in general. It links people, activities and society and identifies opportunities for improvement.

We start with the terrorist threat or incident, which causes both direct and indirect effects. The direct effects, while very harsh at the moment, are far outweighed typically by the indirect effects which accumulate and take a long time.

Those, in turn, trigger the actions of responders who can be either external or internal to the firm. These responders and the media shape the information, experience and perception of society and the firm. The consequences of creation of friction that limits the transactions of international business, such friction becomes particularly notable for stakeholders and logistics.

The availability of resources and the firm's willingness to employ them results in a sequence of preparation stages. Managers start out being totally unprepared for the effects of terrorism on their firm and not willing to undertake any kind of investment. With sufficient input and prodding, managers may change their attitude but are still not ready for any action.

Next, management grows concerned about terrorism and searches for inputs such as checklists or readiness audits.

Then managers plan at a tactical and strategic level and integrate shareholders and stakeholders such as employees, suppliers, banks and legislators.

Finally, management implements steps to prepare the firm for terrorism. Provisions are made, for example, for emergency relocation and employment of staff and to ensure that they get paid when the ATMs are down.

We know that legislative preparation will be more advantageous than an overly reactive but unexamined response to a current emergency. Our model indicates three particular intervention areas: Information, resources and people.

There needs to be a much wider dissemination of preparedness information and then integration of preparedness materials into our daily lives; college courses, high school curricula, textbooks. We always make sure that our children know how to check for dan-

gerous traffic. They need to also be informed about terrorism and have an embedded sense for planning. Their preparedness might eventually lead to a national competitive advantage.

Web-based training media should disseminate training, just like late night shows hawking the latest in weight reduction techniques, there should be co-opted media time to communicate terrorism preparation activities. Why not think of video games and the soap opera dealing with preparation for terrorism? After all, terrorism is global and its threat is more real than any reality show.

Since many firms do not commit resources and their shareholders do not support spending on terrorism preparedness an incentive needs to be provided. Support can ease compliance with governmental rules or help firms pay for plans and preparation. For example, we should be aware that the cost of database management for matching one's customers and contacts with the prohibited persons list can be several thousand dollars a year. Such activities can be encouraged with funding or other fiscal measures.

Finally, security measures have introduced great friction into international marketing which decreases the efficiency and effectiveness of international logistics. Supply train costs have increased substantially. Our survey respondents tell us that their international shipments now take an average of three days longer to arrive. Timing is crucial when it comes to international competitiveness, merchandise shelf life, product quality and payment receipt. The new delays are evaluated to be the equivalent of a 2.4 percent tariff increase on goods, which is as large as the current overall level of protective tariffs imposed by Japan.

The gains from early preparation are high when compared to the costs. A capable response to firm disaster is of benefit to the public purse. If public order and processes fall apart, the Government will have to set things right at greater expense. Firms which stay in business, retain their employees and serve their customers can make a great difference in societal continuity. As the saying goes, "You can pay now or pay later."

Thank you, Mr. Chairman. And I'll be of course, happy to answer any questions you may have.

[Dr. Czinkota's testimony may be found in the appendix.]

Chairman MANZULLO. Thank you.

Our next witness is Dr. Gary Knight, Associate Professor and Director of International Business Programs at Florida State University.

Dr. Knight, I look forward to your testimony.

STATEMENT OF DR. GARY KNIGHT, FLORIDA STATE UNIVERSITY

Mr. KNIGHT. Thank you very much. I'm happy to be here.

Terrorism has important implications for business, but the great majority of businesses in the U.S. are unprepared to meet such risks and relatively few firms have developed plans to deal with terrorism. Terrorism poses direct effects for businesses such as loss of life and property, but really most important are the indirect effects of terrorism; falling consumer demand, interruptions in supply chains, new policies and regulations enacted by governments in

response to terrorism, and macroeconomic phenomena, such as falling stock markets.

The indirect effects of terrorism are cumulative and long term. Congress has limited ability to do much about terrorism's direct effects, but Congress has a great ability to deal with terrorism's indirect effects. And in terms of indirect effects, terrorism is similar to other emergencies such as hurricanes, floods, epidemics and supply sharks.

Small and medium enterprises, SMEs, are particularly vulnerable. They are companies, as you know, with less than 500 employees and account for over 90 percent of U.S. firms. SMEs have far fewer financial and human resources than large firms. SMEs are the most vulnerable firms to the indirect effects of terrorism and other emergencies.

This year we conducted a study of over 200 SMEs around the United States to better understand their relationship to terrorism and other emergencies. Results revealed that very few SMEs had responded to terrorism. Only a quarter had prepared a terrorism contingency plan. Less than 20 percent had included terrorism in developing business strategy. Only 12 percent said stakeholders in their firm reward company efforts to prepare for terrorism.

We also compared the SMEs to larger firms, companies with more than 500 employees and we found that on average SMEs are generally substantially less prepared to deal with terrorism an other emergencies than large firms.

Also, about 70 percent of respondents to our study were in the services sector with the rest being manufacturers which is a similar structure to the nation's economy where services account for about 80 percent of the U.S. economy. The services firms in our sample were more concerned about the affects of terrorism than manufacturing firms and had taken more steps to prepare for it. Overall however, in general, SMEs have responded little to terrorism or not at all. And there is relatively little stakeholders' support in these companies for such responses.

Also, very important, is the psychological impact of disasters which can be more harmful to the nation's interests than the disasters themselves. For instance, the panic and fear of the Avian flu is likely to harm our nation more than the actual disease itself. There are systems in place now to deal with the immediate impacts of disasters from organizations such as FEMA, caring for the injured, rescuing people and so forth. But there are very few systems in place presently to deal with the economic impact of terrorism and other emergencies especially as regards small businesses. Yet the economic impact could be much more serious for our nation as we have witnessed to a great extent following 9/11.

Let me now summarize a few of the specific policy ideas from my written testimony.

First of all, I think that we need to strengthen the partnership between the private and public sectors. The private sector is a potential fighting force of managers, scientists and venture capitalists and doctors and a strong public private partnership helps each side compensate for any weaknesses or shortcomings of the other.

We should also expand disaster recovery loans and loan guarantee programs. Perhaps the greatest problem that companies face

follow an emergency is recovery. As Hurricane Katrina demonstrated, companies may be out of business for weeks or months or may go out of business altogether, and certainly they have no revenue during a long period of time. The problem can be addressed, at least in large part, via low interest loans and loans guarantees.

As was already noted, the Small Business Administration already provides such loans, but the program needs to be greatly expanded and, frankly, marketed better to SMEs around the nation.

We should also provide better intelligence to companies to assist them in preparing for and dealing with the aftermath of emergencies. Homeland Security, for instance, has a website that provides such information to the private sector. But it should be expanded and enhanced and especially as regards businesses. And perhaps there's a role for the Department of Commerce to pay here as well.

We also need to encourage or continue to encourage free trade and economic development around the world. As the United States has done for over 50 years via the general agreement on tariffs and trades and the U.S. Trade Representative and so forth, we must continue to encourage and stipulate free trade and economic development around the world as it is the most effective means for alleviating poverty in developing countries. Poor countries with high unemployment rates are fertile ground for the recruitment of terrorists. The economic health and stability of poor countries depends on economic development that is stimulated by international trade.

We must take the lead to ensure not just the safety and security of the nation, but also the economic well being of our nation and to so some extent the world at large.

Thank you very much.

[Dr. Knight's testimony may be found in the appendix.]

Chairman MANZULLO. Thank you, Doctor.

My cousin used to teach piano at Florida State, James Stream.

Mr. KNIGHT. Piano?

Chairman MANZULLO. Piano. He was a concert pianist.

Mr. KNIGHT. Oh. Well, one of my very best friends is an opera singer at the University, so I'm sure they knew each. What is his name? James?

Chairman MANZULLO. Stream. S-T-R-E-A-M.

Mr. KNIGHT. Stream. Well, I'll ask about him when I get back.

Chairman MANZULLO. All right.

Mr. KNIGHT. I'm a big fan of piano.

Chairman MANZULLO. Very well. A little bit different than your area of discipline, but—

Mr. KNIGHT. Well, we are a liberal arts institutions.

Chairman MANZULLO. There you are. Great football team, too.

Our next witness is Dr. Neil Livingstone, CEO of GlobalOptions, an international risk management and a business solutions company which has headquarters in the Washington, D.C. area. And Dr. Livingstone, we look forward to your testimony.

STATEMENT OF NEIL C. LIVINGSTONE, GLOBALOPTIONS, INC.

Mr. LIVINGSTONE. Thank you, sir. It's a pleasure to be before this very important Committee and its very able membership.

I was asked you by the Committee staff to take, shall we say, a micro approach as opposed to a macro approach and look at some specific recommendations, particularly in the technology area and also practical things that small business could do to better prepare for natural disasters and terrorist disasters. In this regard I think every small business fears being victimized by a tornado, an earthquake a hurricane or a terrorist event. As I note in my testimony, there were 707 small businesses in the World Trade Center complex alone. Of the 14,000 businesses that were impacted by that one disaster, some as far away as Connecticut and New Jersey, over 5,000 were small businesses. So small businesses really don't have the capacity to do the things big business can do. The average small business doesn't have the large corporate reserves or borrowing power, they're not diversified like major companies are and so on.

The SBA website, and the SBA is a fine organization but the website says, you know, it offers you advice, some of it rather gratuitous. Like guard against the loss of your customer base by diversifying your product lines, sales locations or target customers. If you could do that, you'd be a big business. And therefore, you know, most small business have three or fewer locations and they're usually in the same region. And if they could diversity or reach out to other areas to do business, I'm sure they'd so do. So we really have to deal with the world as it is rather than the world that we would like it to be. And that means that small businesses when they are impacted are likely to be impacted in their totality by whatever the natural disaster or other disaster is at that point.

There are a variety of things that small business ought to do these days. And in trying to better defend themselves from the downsize of any type of natural disaster or the disaster. One of the things that I point out in my testimony that there are templates available on a number of websites and so on for crises management or business continuity plans. And this is a good way to start. And the Government makes these available, and they can be simply downloaded at no cost to them.

SBA, the problem with the SBA is primarily a reactive agency. And if you guys could do something that would be, I think, most helpful is to make them proactive. And I think as Dr. Christensen said, that you know it's basically that an ounce of prevention is, as I think as well agree, worth a pound of cure. That this is where the Government is going to save money and this is where we're going to better protect people is to try to help small business prepare in advance of natural disasters rather than simply making loans and other types of financial aid to them in the aftermath.

And I go around and I speak to a lot of conferences, help a lot of business organizations prepare. And the problem is that a lot of the software solutions today that you can get for, say, doing a risk for vulnerability assessment, which you really need to start with, those are very expensive. And I would say if SBA could buy that software, buy it once and make it available so it could be downloaded by small business on a self-help basis, that that would be extremely valuable so that they can begin to assess their own vulnerabilities and take steps to prepare and deal with those vulnerabilities.

Obviously, there are other solutions in the technology area. Communications was a huge problem after 9/11. It was in Oklahoma City as well. It's been a problem after every natural disaster. Satellite phones now you can buy for a $1,000. You know, as business deduction I think we ought to encourage small business to have some type of capability to have communication after disasters. No one's cell phone, again, worked even in Washington, D.C. because the whole system was overloaded on 9/11.

Other things that they can do. We need to make sure that they have the capacity to have backup storage of vital assets and business data. Because that's what business continuity is all about. And I would even open federal facilities under some cases so that you can withdraw your vehicles and even some equipment. If you're going to be in a storm surge area, make it available so that that equipment can be stored at some federal facilities. Not even the police department on the recent Gulf Coast hurricanes that were right in the storm surge area moved their vehicles back. It wasn't just the buses in New Orleans that weren't redeployed; there were a lot of things that weren't redeployed.

I also suggest that there are a variety of other things that are needed. And nothing is needed more than survival kits. You want a practical suggestion here, and I would invite the members of the Committee and staff to take a look at some of these survival kits. All cost under $1,000. And I've provided also to the Committee lists of the kits.

The office kit has the large plastic container for storage, first aide kits, flashlights, NOAA weather radio with extra batteries, plastic bags for refuse, water, blankets, utility knife, hand held compass, meals ready to eat, duct tape, plastic sheeting towels, large bucket with a lid and toilet paper, whistles, extra car keys. We didn't include the cash we recommend here, but it should be in small bills. Changes of clothes, toiletries, extra eye glasses, prescription drugs, family documents and hand held radios.

These are the kinds of things that are practical and we ought to be encouraging all small business and give them a limited deduction to have these kinds of things, as well as various types of car kits, travel kits for their employees so that they can get home and they can take care of their families because everyone wants to do that.

And there are also home kits that we have put the items in here.

So, again, I would be happy to take further questions. I've given a number of suggestions to the Committee, and would be happy to talk about those in greater detail. And I would invite you to take a look at these survival kits over here.

Thank you very much.

[Dr. Livingstone's testimony may be found in the appendix.]

Chairman MANZULLO. Do you have any spaghetti in there, Dr. Livingstone?

Mr. LIVINGSTONE. You know, I don't know what those meals ready to eat have in them.

Chairman MANZULLO. All right.

Mr. LIVINGSTONE. But, you know, if you're hungry I think most of us would be just happy to have a good hot meal.

Chairman MANZULLO. Appreciate your testimony.

Mr. LIVINGSTONE. Thank you.

Chairman MANZULLO. That's one of the testimonies that's practical, too practical. And, unfortunately, just some of the simple things that you've discussed could really prevent a lot of angst if people in the Gulf had had at least their insulin in their pocket, or something simple like that, heart medicine, things could have been saved.

The Committee will next hear from Dr. Barry Scanlon. He's Senior VP at James Lee Witt Associates, a crisis emergency management consulting firm based here in the Washington, D.C. area.

We look forward to your testimony, Mr. Scanlon.

STATEMENT OF DR. BARRY SCANLON, JAMES LEE WITT ASSOCIATES, INC.

Mr. SCANLON. Thank you, Chairman Manzullo, members of the Committee.

I appreciate the opportunity to come before you today to share my thoughts on private sector emergency preparedness, which come from my experiences serving as Director of Corporate Affairs at the Federal Emergency Management Agency as well as a partner at James Lee Witt, Associates, a public safety and crises management firm founded by former Director Witt.

I also want to thank and commend the Chairman and the Committee for its continuing focus on how to better improve private sector preparedness.

I would like to convey some of my ideas and lessons that we learned from my personal experiences at FEMA and from the experiences of Mr. Witt and some of my colleagues through 340 federal disasters during the 1990's, as well as some of our more recent experiences assisting Governor Blanco and the people of Louisiana as they work to recover from Hurricanes from Katrina and Rita.

At FEMA I saw up close the devastation of disasters. I traveled around the country as a disaster assistance employee to many states: California, Alabama, Louisiana, the Virgin Islands and Guam. I didn't get to go to Guam, but many folks in our firm have.

Chairman MANZULLO. Excuse me, but the Congresswoman wants to invite you personally—

Mr. SCANLON. I accept.

Chairman MANZULLO. —to come to Guam. We were there in the first week of August and what a beautiful area there. She does a lot of bragging about Guam.

Mr. SCANLON. Yes, it's warranted.

During most disasters the private sector, in our experience, is rarely considered when priorities are set or when actions are taken. Further communication and information sharing with the private sector is virtually nonexistent within the federal, state and local disaster response efforts leading to an under utilization of the cooperation influence and resources that the private sector can bring to bear.

Also at FEMA I was privileged to lead an effort called Project Impact, which was started by Director Witt to bring together the public and private sectors to work on emergency preparedness. We found it to be very successful. We started with seven pilot communities. And after 2° years we had 250 communities around the

country and about 2500 corporate sector partners, many of whom, obviously, undertook efforts of their own to make their businesses more prepared.

The impetus for Project Impact came from Director Witt's and the agency's desire to end what was called the damage repair/damage report cycle where we would go to the same communities over and over again who wanted to try and mitigate their losses. And interestingly, Project Impact was the first program ever funded by Congress that provided money for mitigation and prevention before a disaster. It was tied to any particular disaster. And much like the SBA programs that exist now, there's an opportunity to try and start some programs that aren't connected to a particular disaster.

In the Project Impact process we learned that the private sector was very willing to be a part of the process and, in fact, wanted to see that the communities that they were operating in were taking steps to better improve their preparedness and response efforts. Because, of course, the private sector would benefit from those.

In the last five years since we left FEMA we've been part of many projects that have been designed to bridge the gap between the public and private sectors. And we've helped to design the preparedness campaign here in the national capitol region. We've also been involved with the Illinois Terrorism Task Force which has brought together the public and private sectors, as well as working closely with utilities like PEPCO holdings here in the nation's Capitol, as well as nuclear facilities around the United States designed to bring together the companies and the communities in which they operate in in finding better ways to be prepared and to respond.

Each of these projects has shown the real gap that still exists, but it also shows the real potential for collaboration and improvement in the future.

Moving forward, I would respectfully like to present four idea or thoughts that you could or should consider while developing your agenda for future actions. Some of these could be done legislatively and some by the responsible agencies.

The first is in any of the efforts that you undertake that you do so within the all-hazards approach. This was something that was adopted by Director Witt and in partnership with state and local governments throughout the 1990's. And I think it's something that's been diminished the last few years. Doing this will hold two very important aspects for success.

The first is that it will increase the level of participation by business. Businesses are much likely to be affected by small business interruption than by a large or catastrophic disaster. So if they are preparing indeed for anything, they will be prepared for anything.

The second is improving the effectiveness of the preparedness actions that they take. Again, no business knows what crises they're going to face. And if they're prepared for all sorts of disasters or crises, be it a blackout or a large hurricane, they'll be better prepared.

A second thought is to establish a public/private preparedness initiative. Essentially reestablishing Project Impact, perhaps with a small business focus. It could be done within the Department of Homeland Security or within SBA. There were a lot of positive aspects to Project Impact. The first was that it was grassroots based.

It was communities dealing with their local businesses. There were some federal money involved, but in the end it turned out mostly to be seed money and was greatly increased by efforts in the private sector.

The third recommendation that I have is to establish an emergency support function for business. As you may know, within the federal response plan and the national response plan agencies like the Department of Transportation or the U.S. Army Corps of Engineers are responsible for transportation or public works in the wake of a disaster. No one's at the table with the responsibility of what's happening to the private sector, be it dealing with the Business Roundtable or the U.S. Chamber of Commerce for large business and critical infrastructure or even to the smaller scale dealing with the local Chambers of Commerce throughout the country. When we led Project Impact, and I started in seven pilot communities, the local Chambers of Commerce were the best partners. They brought in their most proactive members and most successful members. And that's something that there really needs to be an ESF for business.

The fourth recommendation is one that you've had before you in previous hearings and earlier today, and that I would like to second, which is strengthening or even expanding some of the SBA programs and even looking at a public/private partnership with local banks that I know has been presented before you that could move things quicker.

One thing related to this in closing, and I again appreciate the opportunity to appear today, I attached the testimony of my boss James Lee Witt from March of last year where he discussed his concerns with what was going on and the concerns that were raised to him from state and local emergency managers that the FEMA that they were dealing with is no longer there. And I think we've all seen some of that recently. And I would ask the members as they consider this and other programs on other committees and within the House as a whole that you look to make FEMA again fully staffed, fully funded and an independent agency that responds directly to the President.

Thank you, Mr. Chairman.

[Dr. Scanlon's testimony may be found in the appendix.]

Chairman MANZULLO. Thank you.

Sort of an intellectual discussion of how businesses prepare for emergencies coming from an academic and, obviously, a practical application. I appreciate it very much.

My question is more general. It may sound cynical, but it is not. Well, it is true. It is true. Let me give it a sound here.

I do not know how businesses, aside from the obvious things such as backup on your data system and things of that nature, can really prepare for not so much the disasters that come along, but for the acts of terrorism. I do not know how much money you can spend. My brother just left the restaurant business after 41 years. And when you take a look at the food that comes into this country, about 3:00 in the morning I ate a kiwi that came from New Zealand. New Zealand is a great country. I know John Wood quite well, the Ambassador. Look at garlic coming from China, which is horrible. You might as well eat marbles, it is just terrible. And

produce coming from all over the world. You wonder if every one of those items is examined? The answer is no. It is physically impossible to do that.

We have not even talked about food safety. It is obviously a huge part of what you do because it is, obviously, part of the food chain and water quality, etcetera. But I just do not know in how many directions. We exchange security for freedom in this country. You can do a modicum of security, for example, when you get on your airplane your constitutional rights end, and that is okay with me because you are trapped. And then nobody has the right to carry a firearm on an aircraft unless you are an Air Marshall.

But I do not know where you start on this, what the threshold is or how you address small business people and say, you know,"You guys are just not prepared." Does anybody understand my question here? Somebody want to take a stab at it?

Go ahead, Mr. Livingstone.

Mr. LIVINGSTONE. Well, if I could, Mr. Chairman. I understand your question completely. My firm deals with helping business prepare all over the world. And one of the things that we believe is that the Government has certain responsibilities and food inspection is one of those. We have responded to cases before where we have had tampering of food supplies in other countries before it got here to the United States. And that is something that concerns all of us. And so I think there a variety of things that the Government has the primacy, and the primary responsibility.

What business has is the responsibility of protecting its employees, its share value, the jobs and taxes that it provides to the community and so on. And I think that can best be done by taking steps to essentially make them more impervious to the downsides of any type of disaster, particularly terrorism.

Take the World Trade Center for example. One of the firms that had exercised evacuation planning and had a good evacuation plan where they took it seriously and they took time out of their billable hours that, you know, drive all firms that are in the service business and they actually exercised this kind of planning and preparation.

Chairman MANZULLO. Fire drill like in school?

Mr. LIVINGSTONE. Like a fire drill.

Chairman MANZULLO. Yes.

Mr. LIVINGSTONE. They saved every member of their firms. Other firms were not so successful. And similarly those firms that pre-deploy smoke masks. I got one the other day that a sample that a firm sent me, is now $12. It looks like a pretty good smoke mask. And if you are in a high rise building that can make the difference between life and death. It is all these little things that we are talking about with our chests over there and things like that. It is preparation, it is essentially having communications, it is essentially encouraging small business to do the things that they can do for themselves so that they do not become burdens on the Government later on.

Two-thirds of all the businesses in Hurricane Andrew that remained closed for three days never reopened again. Think of that blow to the tax base, to the jobs, to things of that nature. And we are going to see that again because of the Gulf hurricanes as well.

So I would say that in summary that if the Government can provide better informational resources, and I think we would both agree on that. Do those things that are out of the reach of small business. If there is a template for doing a vulnerable assessment of their business and those things cost too much, let the SBA provide those and let anyone download those kinds of informational resources. That is what the government does so well.

Chairman MANZULLO. But maybe we should look less to the government. There is a big lesson in all of this.

I had in my office a couple of years ago the fellows that represented the automobile insurers from the State of Illinois. And with three teenage drivers, you have a distinct interest in making sure that your kids are safe, especially driving in Northern Illinois is very challenging; icy roads, country roads with uncontrolled intersections, gravel with a high crown.

I said "Has it ever dawned on the insurance industry to offer skilled emergency driving courses for kids?" I understand in places in Colorado when a car goes off a shoulder, you know, get the kids out there. Teach them hands on how to do that. And you wonder about the role of the insurance companies. I know insurance companies are involved big time in fire prevention; seminars, hints to the householders and things of that nature.

But I look at government's response and I think the place to really start, you have to start with an awareness, right, Doctor? Perhaps something as simple as teaching your employees to do a fire drill.

Okay. My time is up.

Congresswoman Bordallo?

Ms. BORDALLO. Thank you very much, Mr. Chairman.

Listening to the witnesses here, I think you all had mentioned strengthening the partnership between the public and the private sector. I certainly agree with that.

In our disaster team in Guam, I always have to bring up my territory because we are so far out and many times forgotten, we have a Chamber of Commerce representative on that team. And we meet periodically. I think that is something, too.

For example, here in Congress, in case of an emergency here we have to vacate our buildings. We have a rep in our offices.

Chairman MANZULLO. We know where we go.

Ms. BORDALLO. Yes. The first time we ever had a drill, we all knew where we were to go. I was supposed to go down there by Tortilla Coast. Well, the second time we had an emergency, the police were directing us in all the different directions. So I think it has to be continuity that has got to be involved. Once we get something set up, whatever it is, it is got to be continued. It is like with anything else.

Homeland Security. Now I do a lot of traveling. At first they were very, very conscientious. Now sometimes they are talking while your bags are going through the x-ray machines. And, you know, it is just human nature. You have got to keep it up. So you mentioned, you all mentioned that, and I think that is a very good point.

Another thing is I think the reason that small businesses or rather any business, big or small, are left out of the loop here is

because people tend to think the general public, the federal and the state officials, they have got money, they can take care of themselves. They have got the employees. They can get back on their feet. I think that is the general, you know, consensus of the public. I may be wrong. But I know back home they always feel well businesses, you know, they are the ones that have got all the money and the influence and they can build up themselves and get back on their feet, as I said earlier.

But these are some of the problems that we are up against. And I want to know right now can any of you answer the level of coordination that exists today between the local, municipal and state first responders and local small businesses?

Mr. SCANLON. Well, I would say in our experiences it is geographically dependent and it is really a case by case basis. In some areas it does not exist at all and in other areas, you know, as you said in the Virgin Islands or in Guam there is actually a lot of activity. And in Southern Florida, Broward County and other counties down there, actually have both Broward County and Collier County have an ESF for business like we have discussed. So they have, Motorola and other companies were active that when there is a disaster coming into Broward County they are in the EOC, and they are not necessarily helping make decisions, but at least they are able to let their corporate brethren know what is going on.

Ms. BORDALLO. Yes.

Mr. SCANLON. Because while the first decision that needs to be made is for public health and safety by any emergency manager, if there is other steps that could be taken, which roads to clear first or other efforts like that that could help the corporate community respond, you know I think that is a positive.

Ms. BORDALLO. Yes. I thought your recommendations, Mr. Scanlon, were good. And I guess we just got a lot of work ahead of us. But we have got to include businesses in these disaster whether it is a terrorist attack or a hurricane or a typhoon or whatever. And I think the Chamber of Commerce is the key here. They should send representatives to our disaster groups, our teams.

And I think you very much for your testimony. I thought it was very good.

Thank you.

Chairman MANZULLO. Mr. Akin?

Mr. AKIN. Thank you, Mr. Chairman.

I figure things are getting a little bit sleepy this afternoon, so I got to toss out a good question. Do you think it is really a good policy for the Federal Government to have flood insurance to encourage people to build in areas that are going to flood? Is that a good thing? I mean, we got a lot of small business that are sitting below sea level or whatever it is. Is that a good policy? Are we really being compassionate to do that or are we really making a mistake in that?

A second question that is a little less obnoxious, maybe would be did you ever think of emergency preparedness planning including encouraging employees to have houses that have a certain amount of food or water or things like that in the homes so that your employees are in a secure position?

Two questions.

Mr. CZINKOTA. Well, if I may, I will address the second one.

Mr. AKIN. A wise—

Mr. CZINKOTA. I think one principle problem which has not been address sufficiently is the issue of expectations. What can one reasonably expect to have, for example, Government be providing? And I think in many instances there are totally unreasonable expectations because Government cannot and probably should not provide everything. And along the same lines there should be reasonable expectations as to what can we do for ourselves. What is the investment we should do into our own resilience to be ready to weather at least short term immediate effects, and that includes the insulin in the pocket and it includes having a little bit of food at home.

Of course, the other problem is we see in the media the focus on the very poor who may not have the resources to invest even in medium sized resilience inventory. But companies, if a company is not able to invest, let us say, a $1,000 to have some minimum preparation, then there is a problem at the corporate level. But at the same time, there are distinct things that companies in collaboration with Government should prepare for and Government should think about in terms of indirect effects. Let me give you two examples.

If a company has no idea what an escape route might be or where I can get alternate supplies, and has never thought about that, then of course it will be surprised by any shift. I am very happy to report, for example, with us a Georgetown University we were able after the hurricane in New Orleans to bring 80 students from the region and absorb them into our teaching without any charge because there had been plans in place beforehand what happens if there is a significant disruption nationally in terms of teaching capacity of some institutions. Obviously, we could not accommodate everyone. But 82, that's not bad. And, again, their home institutions received their tuition, we do not receive it. But that is solely was we were able to do that because there was some planning and preparation. And unless one does that, it is not going to happen by itself.

Mr. LIVINGSTONE. Could I just add something to that, sir, as well.

Mr. AKIN. Sure you can.

Mr. LIVINGSTONE. I think it is a terrific suggestion that you have made, and I know you were not here for my testimony, but there is a home kit over there. And there is at least one firm in the area that has bought all of its employees home survival kits as well as a car survival kit. Because we even have to look at those kinds of emergencies like a chemical and/or biological, even a radiological attack, which I have testified about before other committees up here, in which case you may be caught in your car. You may caught in a traffic situation. And we have worked with the District of Columbia on evacuation routes.

The District is one of the most difficult cities in the United States to evacuate because we have a lot of bridges here. And so people are going to have major problems reuniting with their families. And they need to have some survival gear in their car.

I am a Montanan. We always carried survival gear for fear you would have a breakdown in the winter up in our part of the country. But most people do not carry survival gear. So there is a home set over there. There is also a car kit and things like that. And we think that is one of the really responsible things that business can do to work with its employees.

Mr. AKIN. I see my time is just about up, and nobody has wanted to talk about federal flood insurance. I am so surprised that nobody really wanted to discuss it. Don is the one that puts us up to these things.

Thank you very much for your thoughts.

Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you, Congressman Akin.

Dr. Christensen, what hurricane did you suffer through about four years ago?

Dr. CHRISTENSEN. Well, we had '89 Hugo was the biggie and '95 Marilyn was a biggie. We have had small ones in between.

Chairman MANZULLO. Yes.

Dr. CHRISTENSEN. But we have learned from them and we have built better and stronger in our homes. And we did Project Impact that helped our businesses to become more resilient. And I really cannot over-emphasize the importance of what we are talking about today, that public/private partnership and that preparedness that needs to be in place. It not only helps the businesses to maintain some continuity of service and income, but it also saves the Government money. And that money can then be put back into helping.

We heard a story at this BENS breakfast that Homeland Security had where this probably was not a small business, but business in either Katrina or Rita offered communication trailers. They offered four free communication trailers. And FEMA could not figure out how to use them. They could not accept them. And they came back a couple of weeks later and said we cannot use the free ones, but we will buy 10. You know, the preparation in advance. And I think when we look at what we have spent after Katrina and Rita, we are going to find that there was a lot of wasted because the preparation was not really there.

Let me see if I can get in a couple of questions. I am going to start with I know the Chairman practiced your name before he came.

Mr. CZINKOTA. Czinkota.

Dr. CHRISTENSEN. Czinkota. And Dr. Knight as well.

I am going through a thing with my charter boat industry at home right this minute because of some security regulations and the businesses are really afraid some of them are going to have to close if we cannot get it resolved. So talking about the security measures and the delays being an equivalent of a 2.4 percent tariff rate on goods, you know we have to find a way to strike a balance. And I do not know if you have any ideas.

I mean, do you think that we have overreached and what can we do to bring this balance between security and allowing commerce to continue? Do you think security is overreached?

Chairman MANZULLO.

Mr. CZINKOTA. Well, it certainly is an important problem. And in many instances I must say we find that problems of that nature pop up as unintended consequences.

Dr. CHRISTENSEN. Yes.

Mr. CZINKOTA. So if nobody really wanted that to happen but here we are and all of a sudden here are these delays.

Dr. CHRISTENSEN. Is it another consultation?

Mr. CZINKOTA. What that means, of course, is that especially when it comes to regulatory actions, it is better to fully consider what they mean rather than quickly respond to a momentary emergency. And then I think there is also, and this is difficult for anyone who implements these things, there is a need to after a while to step back and say what have I wrought, what does this really do and is it as intended. Because for example, we all know that it is important to control how many people or which people come into the United States.

Dr. CHRISTENSEN. Right.

Mr. CZINKOTA. But it may seem that on occasion some of these controls have been too harsh and as a result there may be a lot of people who should be coming, let us say from a business perspective they come to inspect goods, to buy merchandise, but they cannot come or they will not come because it is too onerous for them.

Dr. CHRISTENSEN. Yes.

Mr. CZINKOTA. Now these things one ought to take second looks at that rather than sticking slaveriously to this is what it is going to be and think about could there be a trusted travelers program, trusted business person's program.

So, yes, that should take place.

Mr. KNIGHT. I agree with Professor Czinkota about the notion of untended consequences. Of course, any proposed legislation should undergo cost benefit analysis, thorough cost benefit analysis to ascertain what will be the costs and the benefits. And we, obviously, want the benefits to greatly exceed the costs, especially as far as burdens on the economy and on the business sector are concerned.

But I would also say that I want to reemphasize the importance of recovery from disasters.

Dr. CHRISTENSEN. Absolutely.

Mr. KNIGHT. And we need to interject emergencies as much as possible, but it is hard to intradict a Hurricane Katrina and it is hard to stop it out there in the ocean. And so we need to emphasize facilitate in this country an infrastructure whereby, especially small businesses, resource constrained small businesses can recovery as quickly as possible from disasters in order to ensure the integrity of our economy in general.

Dr. CHRISTENSEN. Well, I wish—could I just ask one short question, please.

Chairman MANZULLO. Sure.

Dr. CHRISTENSEN. Mr. Scanlon, there is some discussion about the role of the Government versus the role of the business. In your experience in Project Impact do you think that it can work just with the provision of the technical assistance to the businesses? It would not really cost the Government a lot to institute that program again.

Mr. SCANLON. Yes. I do not think there needs to be, you know, a tremendous amount of federal funding. You know, with $25 million we got—we started Project Impact with, I think, $2 million with seven communities. And in places like Seattle they got a million dollars eventually and I think they raised from the private sector $8 million. So there was a return on that and it spoke to Congressman Akin's question of how to encourage your own employees where people like Washington Mutual or Fannie Mae joined with us in Seattle to have a loan program for businesses who are involved in Project Impact that they would get below market loans to do seismic retrofitting.

So, you know, it is just to be a coordinator, if you will, or to start the process. And in many areas they just took it and ran from there. I do not think that there needs to be even grants. I think, perhaps, as Dr. Livingstone spoke about having the software, perhaps, or other things that could be done by the SBA or others. But I do not think that there needs to be grants or those sort of things. It is more just providing the impetus and bringing the partnership together with the public and private sectors.

Dr. CHRISTENSEN. Thank you.

Thank you, Mr. Chairman.

Chairman MANZULLO. Congressman Sodrel?

Mr. SODREL. Thank you, Mr. Chairman.

I got here a little late so I did not get in all the testimony. But when I listened to the discussion about how we get information to small businesses, it seems to me there are two ways of doing that. One is provide it on the website, let them come to you. But have we considered going through trade associations? Because the challenges faced by each of these businesses is in some respects similar, but in other respects it is completely different.

You know, it occurs to me we have a National Restaurant Association, American Bus Association, you know an association that represents practically every segment of small business. And that might be a way to push information down instead of wait for somebody to ask for. If we had some system of contacting those various trade associations and making recommendations for individual industries and asking them at their national conventions or seminars, you know, to add that to the list of things that you want to talk about when you get people from your industry together.

Any comments on that? I mean, has anybody tried that or do you think that would be helpful?

Mr. CZINKOTA. Sir, I could not agree more with your comments. First of all, in terms of resource constraints, to reach out to multipliers who then touch many other people is, of course, one of the essences of public/private sector collaboration. Because the public sector can perhaps put together or acquire the software, but then the distribution itself is what the private sector can be of great help.

But it is also I think one of perspective. Right now, at least, I find whether I talk to my students, whether I talk with firms, that the terrorism issue is sort of a sideline or the disruption issue is sort of well it happens to others, hopefully. That's sort of the generic reaction.

And what I find absolutely amazing. Here, everybody sits and watches these reality TV shows and we have "Boston Legal" and we have these crime shows and so on. What makes the economy really go is what companies do, what businesses do with their international stuff. And to my line I'm waiting everyday to see a new program where we have, I call it as my acronym is IMDC, international marketing in D.C. That's important for society and we should bring that closer to people as part of their regular thinking, as part of their regular appreciation of what makes the world go around in terms of investments and activities.

Mr. LIVINGSTONE. And if I could add to that, after the 1993 attack on the World Trade Center, which was unsuccessful at dropping the towers but was carried out also by Muslim fundamentalists at the time, the International Parking Congress, just to name one organization then devoted seminars at its annual meeting to basically dealing with the issue of security of underground parking areas. I think that this is where, Mr. Chairman, as you were talking about insurance companies as well, this is where we need to get the partnership with the insurance companies to make it in their interest to do it. And, similarly, with the terrorism insurance requirements that we have today. All of these things that we can encourage business to do, what is in its in own self-interest in some cases. And I think many of the trade organizations are the way to go about some of this information dissemination.

Mr. KNIGHT. If I could add a little bit more. I absolutely agree that I think the first response should be at the local level. Local entities understand their own needs best. You know, in thinking of terms of trade associations, Chambers of Commerce, the local Red Cross branches, local agencies, local firms, life insurance companies.

But I would add that I think that there probably is a coordinating role for the Federal Government in disseminating information and getting these different entities to work together on the same sheet of music in dealing with crises. And most crises do tend to have a major local component to them. And so it certainly makes sense to push a lot of the responsibility for dealing with, especially the aftermath of crises, and also the preparation of crises down to the local level. And it's also more cost effective, frankly, to do it that way.

Thank you.

Mr. SODREL. Just to add on it. There is an organization of associations, I think it is the American Society of Association Executives or something where kind of the umbrella organization.

The other thing that occurs to me, if you could encourage these folks to have some mutual assistance agreements to try to get small business back up and running. I mean, if the American Restaurant Association, for example, would be willing to help another member in another community or if communities were paired up or sister communities or something, you know, where they could bring some assets to bare to try to get the small business back up and running, a self help if you will. But at least organized or suggested from the outside.

Thank you, Mr. Chairman.

Ms. BORDALLO. Thank you, Mr. Chairman.

I have a question for Dr. Knight. You suggested I think in your testimony that the Federal Government should take a more active role in educating small business owners about emergency planning. Now, what kinds of training programs would you suggest be run and which federal entity do you think should be responsible for such a program?

Mr. KNIGHT. Well, first of all, I could point to the example of, for instance, the International Trade Administration of the Department of Commerce has done an excellent job of training programs for SMEs that are interested in international business and exporting and so forth. And, in fact, I used to work in the private sector years ago in an SME as the export manager of a company and I participated in some of those programs. And the ITA offered programs at major cities at relatively accessible cities throughout the nation in a very coordinated effort. And I thought it was very good. And it was also very cost effective, I felt.

And I feel that there could be a similar role for the Department of Commerce and/or one of its agencies, possibly Homeland Security although probably Commerce is more qualified in this area to develop similar programs of training of business continuity planning, of checking for security weaknesses in company's value chains of analysis of security issues and preparedness issues, dealing with emergencies as they're occurring, dealing with the aftermath of emergencies. There is all kinds of training programs that are possible, and they exist already out there in the private sector. And perhaps there could be some sort of private/public coordination, partnership, in developing a little more systematic approach with the Federal Government having a little more of a coordinating role through the Department of Commerce in developing these programs, marketing these programs, frankly. You know, aggressively letting SMEs throughout the nation know that these programs are available. And perhaps even incentivizing companies. I do not know what it would be through tax incentives or something of that nature to go and participate in these kinds of programs.

Because I think as others have said either, we need to develop in this country a culture of preparedness, a culture of preparedness. And, frankly, I think of the example of Israel, for example, of a country that has developed this tremendous culture of preparedness and they have, obviously, a lot more experience with various crises than we do. But I think that if we had this kind of culture or mentality of preparedness in the nation, encouraged through a more systematic educational effort, in part coordinated through the Federal Government, I think we would be in a much better position to recover from crises.

Ms. BORDALLO. I guess we always think it is going to happen to the other person.

Mr. Scanlon, do you feel, too, the Department of Commerce would be the most ideal department?

Mr. SCANLON. Well, I think that you may want to look at it may be a combination of agencies. But I think much like the respective or the recommendation at looking at having an emergency support function for business, that they should be tied with whoever is doing the training and helping with preparedness. Much as we oppose separating preparedness from response from FEMA and DHS,

I would oppose it for businesses. Whoever is helping them prepare should be interlocked with them in helping them respond.

Ms. BORDALLO. Yes. Any other comments?

Mr. CZINKOTA. Well, perhaps. Let me just add what is terrible important and our research has shown that is it is not just sufficient to provide information. We have to understanding doing so what is that firms need.

So, for example, a manager who is totally unprepared, totally uninformed, you give that person some checklists, some ideas to raise the concern; that's great. But you do the same thing for a manager who is looking for true implementation. How do I get my firm ready and then all he gets is a pamphlet with some general ideas, that's a waste of effort. And that actually results in the trust in the communication or information going down. So, ah, this is just another Government wasted effort.

So what that means it is not just from a Government perspective to provide information,but to understand processes and to provide the right information to the right people so to truly help them forward. So it shouldn't just be an agency which says here is a brochure.

Ms. BORDALLO. But I think that is a way we have to start. Because if you are going to go into all the different needs, you know, then it becomes very complicated. I think we have to start out with a basis and take it from there. Then there are other needs. I agree with you. Everybody needs different information to prepare. Is that not what you are saying?

Mr. CZINKOTA. Well, different level of information.

Ms. BORDALLO. Yes.

Mr. CZINKOTA. I mean, obviously there's specificity of the information always will come down to the individual company. But in terms of how in depth do I go makes a real difference. And, of course, the issue is also if I just reactively sit there and wait for them to come to me and pick up a brochure.

We have such wonderful technology today. For example, some agencies are still conducting any training by doing sort of the city tour and then on this date you can come to this place and participate in training. What happened to webcasts? We have great technology available to reach out and let people do things at their own terms. And especially business owners. They do not necessarily have time this Thursday from 8:00 to 10:00. They should be able to do this at their time, and we have the technology for it.

Ms. BORDALLO. But there are still many small businesses in our country I feel that really do not have the technology available in their little businesses and some of them are not knowledgeable on how to use it. So we have to keep that in mind, too.

I am just thinking, you know, the more complicated you get in Government, the more the program will fall apart later on down the road. So to start with a basis if the Department of Commerce is the Department, then maybe that is the way to go. I mean we have to think it over, you know. I just wanted an idea from you. So thank you very much.

Thank you.

Chairman MANZULLO. I have a comment here. Mr. Scanlon, going over your bio. I saw that you were in the Banking Committee Conference on the National Flood Insurance Reform Act.

Mr. SCANLON. I was, indeed.

Chairman MANZULLO. It is a good thing Mr. Akin had not read that in your bio.

This has been a very interesting hearing. We have had the delight of not having to respond to bells because of voting. What I see here is four people that have incredible backgrounds in the private sector. In fact, Dr. Livingstone, you could probably be advisor to the next James Bond movie, maybe you are. Maybe you are James Bond. But, I mean, hostage recovery. I might have my 19 year old sophomore who is looking for an interesting life to sit down and talk to you. Maybe you could give him about 27 different lives with the roles and the hats that you played.

And, Dr. Knight, working with an export facility. When are you going back to Tallahassee?

Mr. KNIGHT. Well, I am supposed to go back tomorrow. I am teaching on Thursday.

Chairman MANZULLO. Well, okay, because I wonder if you could stick around after the hearing. I am going to Japan the first week of January to check out some new manufacturing processes. I spend about 75 percent of my time working on manufacturing issues. I notice that you speak fluent Japanese and French.

Dr. Czinkota also a tremendous academic background and work in the private sector.

I think that if there is one conclusion that I can glean from four outstanding witnesses is the fact that the threshold level of the need to prepare for most businesses is almost nonexistent. Even with the repeated distress signals from the President and the Governor and Governor Bush now down in Florida for people to evacuate or to go to higher ground, it just does not seem to set in. I do not know how do you start with people that just refuse to listen and think that it is not going to happen to them? Is there any answer to that?

Dr. Livingstone, what you said about the company having enough sense to have a fire drill. That does not cost any money. Sure, you are down a little bit, but you know people take a break anyway. But in terms of the practicality that saved, how many lives in that? How many people worked in that company?

Mr. LIVINGSTONE. I think over 500.

Chairman MANZULLO. Yes. And not one life was lost.

Mr. LIVINGSTONE. Correct.

Chairman MANZULLO. In all of that? Somewhere along the line people have to accept the fact that they are responsible for their own fate, not that they have to determine it. That is why you have government, at times. But I do not know how you go about teaching people that it is absolutely necessary. But we finally have, I guess it's a go bag or an escape bag my wife put in one of our three vans. But how do I know that van is going to be there? How do I know that my daughter is not going to have the van with the escape bag in it at school?

Mr. LIVINGSTONE. Well, I think that the answer to this is really that people have been seeing on television is a pretty good incentive to take some basic steps.

Chairman MANZULLO. But did it help the people in Florida? They saw what happened to people in Katrina.

Mr. LIVINGSTONE. Well, let us hope that they are beginning to get the message. You know, I have worked with the states for over 20 years in teaching emergency preparedness and training first responders and so on. I think we have made, and thanks I think particularly under the leadership of James Lee Witt, I think FEMA made tremendous progress in reaching out, involving communities in all of the disaster preparedness areas. We have got a long way to go. And not to cast dispersions, but I think we have to have the right kind of professionals there. And if we can just talk about it for a second. This is an agency has been for both parties, a political dumping ground for many years. I think Mr. Witt was the first person, and I am a member of the other party but I roundly commended his performance there. And I think we have to look to have the right kind of professionals that can show leadership and go around the country and do the kinds of things that are going to inspire businesses and people and get out of just the professional areas, but start speaking to the major business groups, start working with the insurance companies, start working with people and saying look, you got to take preparedness. And I think that is also a job of the SBA. As I said, more proactive effort than simply reactive effort.

And, you know, if we look at what we were 25 years ago, we have made substantial progress. And there are some states that just do a terrific job in some of these areas. Unfortunately, it is not always the states that have the most disasters. So I think that is where we need real improvement.

Chairman MANZULLO. Well, again, thank you for your testimony.

This hearing is adjourned.

[Whereupon, at 3:27 p.m., the Committee was adjourned.]

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
109th Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

Promoting Private Sector Emergency Preparedness
Room 2360 of the Rayburn House Office Building
November 1, 2005 at 2:00 PM

Opening Statement of Chairman Donald A. Manzullo

Good afternoon, and welcome to this hearing on an important and unique topic. In the United States today, businesses face considerable challenges on several fronts. These include burgeoning health care costs, high tax and regulatory burdens, and rising energy prices, to name a few. These obstacles are expected by those entering the current market place, and through ingenuity and persistence, they must be dealt with and overcome by all involved.

Today however, this Committee will focus on market challenges of a more unexpected variety. The direct and indirect effects that result from both natural and man-made disasters, including terrorism, can be economically devastating. As small businesses become part of national and international supply chains, even distant disasters can have very harmful consequences.

The human costs that result from such events are immeasurable. And every government agency and institution of civil society must vigorously play their part in responding to individual needs that arise in the wake of such events. As America continues to pursue more effective means of public and private sector responses to emergencies, it is also important to bring to light how these emergencies affect the livelihoods of businesses.

The significance of emergency preparedness for businesses was just emphasized yesterday by the Secretary of Homeland Security, Michael Chertoff, as he called on businesses to invest in preparing their companies and employees for emergencies such as terrorism and hurricanes. The Ready Business campaign, which was initiated last year by DHS, is comprised of public service announcements aimed at educating small and medium sized businesses in emergency preparedness. This campaign was reiterated yesterday because the Administration recognizes the wide-ranging disparity between what is required presently of businesses for sufficient emergency preparedness and what is actually being done.

The primary purpose of this hearing is to get a sense of the level of threat posed by potential emergencies to the business community. What are the current private sector responses to these emergent threats in contrast to the suggestions of experts in emergency preparedness? What preparedness measures can small businesses take, despite limited resource availability for such preparation? Finally, what can Congress do, however limited in scope, to encourage

and facilitate more robust emergency preparedness by private sector firms in this country? For example, in the past, Congress passed a loan program to help small businesses deal with Y2K concerns. This year, the SBA proposes to increase the size of disaster mitigation loans.

This Committee, the Administration, members of academia, and many in the business community realize how important this issue is, and I hope this hearing will provide clearer understanding of what businesses should prepare for, how they should implement this preparation, and suggestions for Congress on encouraging this type of activity in the private sector.

I now yield to the ranking Member, Rep. Velazquez of New York, for her opening statement.

STATEMENT
of the
Honorable Nydia M. Velazquez, Ranking Member
House Committee on Small Business
The Hearing on "Promoting Private Sector Emergency Preparedness"
November 1, 2005

Thank you, Mr. Chairman.

Throughout our nation's history we have endured numerous natural and man-made disasters – from the earthquakes in California, to the terrorist attacks of 9/11, to the recent hurricanes that plagued the Gulf Coast. It is clear that this country is not a stranger to the devastation that can be brought on by catastrophes.

However, one thing has been made very apparent – the need for emergency preparedness and an immediate response are by far the most critical elements in any economic recovery following a disaster.

What our nation recently witnessed – and is still witnessing – after Hurricane Katrina, has shown us that the federal government and the Bush administration have a long way to go before this response reaches an adequate level. We can sit here today and talk about what needs to be done to ensure sound preparedness for small businesses in the future. However, we need to learn from what is currently taking place right in the Gulf Coast region.

There are thousands of businesses that are operating with only one third of their usual staffs, and are pulling from their own savings to cover administrative costs and replace equipment. It is only a matter of days and weeks for some business owners before they are going to run out of money – and before they are forced to shut down their business altogether or move forward regardless.

In order to mitigate these effects in the future for small businesses, it is vital that these entrepreneurs have the ability to access disaster assistance and relief immediately following the disaster. Sadly, this has not been an easy feat for the thousands of small firms in the Gulf Coast region who continue to wait for assistance.

As of just last week – eight weeks after Hurricane Katrina hit – only 193 business loans had been approved. It doesn't look like SBA's record is getting much better either – a month after Hurricane Rita had touched down, only 1 business loan had been approved. This is clearly unacceptable – and in no way illustrates an adequate response. In order for businesses to fully recover and rebuild – they need to know they can access disaster assistance immediately, not months later.

Given all of these factors, and the lack of assistance that is reaching the Gulf Coast small businesses, it appears as if has been a growing trend – the administration has been unable to provide immediate assistance to the majority of the Gulf Coast's small firms.

The fact of the matter is that many administrations have endured disasters – and never before has the response for small businesses been so poor. There are steps to be taken beforehand to effectively lessen the impact but the most recent disaster in the Gulf Coast region should be a reminder to all of us that when a disaster of such magnitude strikes – it is up to the federal government to help pick up the pieces afterwards and provide the immediate assistance these small businesses need.

In testimony today we will hear about a program established by FEMA that helped achieve these two vital initiatives – preparedness and an immediate response. Unfortunately, the administration did away with the program in 2001.

In order to provide effective guidance in emergency preparedness for small businesses, this nation's entrepreneurs must know they can rely on the administration – and the federal government – to come through with adequate assistance after the disaster hits.

I look forward to hearing the testimony of today's witnesses.

Thank you.

INTERNATIONAL MARKETING AND TERRORISM PREPAREDNESS

Testimony of
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Before the
CONGRESS OF THE UNITED STATES
House of Representatives
109TH Congress
Committee on Small Business
Washington, D.C.
November 1, 2005

INTERNATIONAL MARKETING AND TERRORISM PREPAREDNESS

Mr. Chairman, members of the Committee: It is a great honor to be invited to testify before you today on the important topic of terrorism and international marketing. Firms in the United States and around the globe have been exposed to the vicissitudes of terrorism which, more often than not, aims to disrupt the flow of supply and demand and to destroy our way of life. With a group of colleagues in the U.S. and abroad * , I have therefore undertaken research over the past years to investigate the effect of terrorism on companies and to find the possible steps which might help these companies better prepare for terrorist incidents. Just like our research team, our research approach is global, in full recognition that terrorism is a threat to everyone and requires vigilance and preparation by all of us. Nonetheless I will focus today specifically on steps that can be undertaken by the United States Congress in order to encourage and improve the preparedness of firms to cope with disruptions caused by terrorism.

Our past research has consisted of in-depth interviews with managers of both multinational corporations as well as small and medium sized firms, in the United States and abroad, followed up by the administration of a survey questionnaire. In conducting the survey, I have been supported by two major trade associations: The American Management Association, which has been providing management development and educational services to individuals and firms worldwide since 1923; and the American Marketing Association, which, with its more than 38,000 members worldwide has been, for over six decades, the leading source for information, knowledge sharing and development in the marketing profession.

(*) Of particular note are the ongoing collaborative research activities of Professor Gary Knight, Florida State University, Professor Gabriele Suder of Ceram Sophia Antipolis in France, Professors John Steen and Peter Liesch of the University of Queensland in Australia, and Shahed Amanullah of Georgetown University.

DEFINING THE ISSUES AND CONCERNS

We define international terrorism as "the systematic threat or use of violence across national borders to attain a political goal or communicate a political message through fear, coercion or intimidation of non-combatant persons or the general public." Terrorism is a human imposed disaster which purposefully aims at maximum random destruction and which is planned to systematically circumvent preventive measures. The potential targets for terrorism are far too numerous to be consistently protected. Even small terrorist groups with minimal resources have the ability to achieve major effects. Typically, the cost-effectiveness equation is in favor of the terrorist and against the target. The cost of protecting ourselves and averting terrorist acts is many billions of dollars, while the terrorists' costs are in the millions or less.

Terrorists direct their attacks against business far more than any other target. In addition, the need for businesses to remain easily accessible to the outside and to conduct transactions with many persons with whom no prior interaction had taken place, introduces a level of vulnerability which is not typically encountered by government offices or individuals. Terrorists intend to affect supply and demand in order to precipitate deleterious effects on existing economic systems. There are two key types of effects which take place: direct and indirect. The direct effects of terrorism comprise the immediate business consequences as experienced by individual firms. For example, some firms located in the World Trade Center lost most of their employees and operations. While the harm is clearly tragic for individually affected people and firms, from a societal perspective the direct effects of terrorism tend to be smaller than the indirect effects. The latter accumulate and often become recognizable only over time and include long term changes such as a decline in buyer demand; shifts or interruptions in value and supply chains; new policies, regulations and laws which have intended and unintended effects; as well as changes in international relations and perceptions that affect trade and investment. These indirect effects pose the greatest potential threat to the activities of firms. For example, interruptions in the supply of needed inputs to one industry can lead to shortages of parts and components which serve as crucial input for other economic sectors. Policy measures intended to increase security may lessen the efficiency of global transportation and logistical systems. The unintended consequences of such actions may

increase market imperfections and raise business costs further, and may alter the environment in ways more harmful to business interests than the terrorist events that provoked them.

From a global perspective, these effects are present for many firms, even those who see themselves as quite remote from any location affected by terrorism. Today's climate of global commerce involves extensive interaction with countless distributors and customers. Producers and marketers rely on suppliers and suppliers' suppliers to obtain goods and components. Such extensive networks increase the exposure of firms to events that take place at a far distance. Even firms perceived as having little international involvement may depend on the receipt of imported goods and are therefore subject to shortages or delays of inputs and the disruption of company operations.

An important consideration is the fact that individual assessment of vulnerability to an occurrence changes based on our information, experience and perception of the event. Over time these impressions shift, which can result in faulty managerial decisions. For example, during the days following a terrorist event or right after a natural disaster such as the flooding of New Orleans by hurricane Katrina, there is typically the feeling of "but for the grace of God, it could have been me." However, over time, this feeling is likely to give way to a perception of "this was an aberration and cannot happen to me." While such a shift is instrumental to restore human confidence and encourage the resumption of "normal" activities, it may also lead to a wide spread underestimation of the likelihood of future exposures to new risks and terrorism. For many firms concern about possible damage from terrorism has assumed a back seat. Ignorance and apathy may lead to managers resting comfortably on the belief that any future attack will not affect their firm or lead to personal repercussions.

It is also important to understand that in today's business climate of global competition and rapid response, firms no longer have the luxury of just aiming for "survival" in case of a terror attack. Much rather firms need to be flexible in order to be able to withstand shocks. They must offer assured continuity to their suppliers, their clients, their employees and other stakeholders in order to inspire confidence in the relationship. Flexible firms will recover more quickly and can more readily sustain performance in the aftermath of terrorism's direct and indirect

consequences. Firms need to develop continuity plans need to deal with crises. Such plans may, for example, facilitate a shift of production to different regions of the world in the wake of unanticipated disruptive events. Particularly for firms that engage in massive outsourcing, the reliance on a single or even limited number of suppliers, or on suppliers concentrated in a limited range of locations, is very risky. Renewed and ongoing business relationships need to be a principal goal of any firm following a terrorist attack. Quite apart from the importance of such an achievement for the viability of the firm, business continuity is also a major step in denying terrorists their achievements.

Particular attention needs to be paid to the marketing function within corporations when it comes to a response to terrorism. Even though all corporate areas are likely to be affected by sudden shifts triggered by terrorist activity, the marketing field, which constitutes the key corporate liaison with the world outside of the firm, is likely to be under most pressure. When properly prepared, marketers can be the most capable in delivering corporate responses to such an event. Key reasons are that the field of marketing deals most closely with consumers and markets, in direct linkage to the activities of supply and demand, which terrorists aim to destroy. This proximity makes marketers the first responders to business disruption. Within industry, marketers deal with imports and exports, as well as distribution and logistics. Marketers tend to have the clearest understanding of the mutual corporate dependence so critical for effective planning. For example, when determining the need for specific emergency inputs, marketers will not only look for the source of such inputs. They will also be able to analyze the existing relationships and networks and devise incentives to ensure that the supplier will actually provide goods and services to the firm. Dry runs and simulations can then be used by marketers to develop expectations about long-term effects and to see whether the system works as planned. Without such considerations, a plan for input contingency is akin to identifying the location of gas stations as the principal remedy for a fuel shortage, without keeping in mind that the station needs to be re-supplied itself, be open, and be willing to provide the gasoline needed to the car pulling into the station.

On the supply side, marketers deal with communication with customers and suppliers, devise campaigns to present information, provide direction and alter any misperceptions. Marketers

are the experts who implement steps to address imbalances and create new incentives by changing corporate pricing, packaging or sizing. Goods or services whose price is strongly affected by changing information flows and perceptions of risk are highly susceptible to the indirect consequences of terrorism. Insurance coverage is an example. Actual or perceived terrorist threats tend to create upward pressure on the pricing of particularly vulnerable offerings. Prices may also experience a certain "stickiness", that is, under conditions of inability to predict the occurrence of terrorism or its indirect effects, once raised, prices may not be decreased. Conversely, firms in certain industries may feel pressure to lower prices in order to induce reluctant buyers to maintain or increase their buying activities. Through their actions, marketers can reverse an emerging softness in demand, rally joint responses and avoid the occurrence of unintended consequences. With their understanding of the long term repercussions of terrorism, marketers can also be instrumental in formulating alternative corporate strategies – say the design of a shift from an investment based foreign market expansion to an export based one.

The continuing efforts of marketers to understand cultural issues are also highly useful for devising terminology and persuasive encouragement. Studies tell us that there are major cultural differences between and even within nations. International marketing, through its linkages via goods, services, ideas and communications, can achieve important assimilations of value systems. Marketers know that culture and values are learned, not genetically implanted. As life's experiences grow more international and more similar, so do values. Therefore, every time international marketing forges a new linkage in thinking and provides for new exchanges of goods or services, new progress is made in shaping a greater global commonality in values. It may well be that international marketing's ability to align global values and the subsequent greater ease of countries, companies and individuals to build bridges between themselves, may eventually become the field's greatest gift to the world.

THE GENERAL BENEFIT OF PREPAREDNESS

Even though the focus today is on corporate preparedness for the impact of terrorism, it is important to consider that in most instances, corporate preparedness per se is of key importance

to any firm. As the vagaries of the 2005 hurricane season have shown us up close, natural disasters can have a major impact. But even relatively small and local events can cause major dislocations for firms. For a corporation to simply assume that it never will be exposed to disruptions and substantial sudden shifts in supply or demand is a high risk strategy. Suppliers can go out of business or have their facilities burn to the ground. Employees may be struck by illness or a labor dispute may ground shipments. Rumors about product quality may dissuade loyal customers from buying. If managers intend to safeguard the investment of shareholders and assure the viability of their firm, it is of utmost importance to prepare contingency plans and operational alternatives which respond to a sudden shock or dislocation. Firms which have not devoted efforts and resources to systematically prepare an ability to respond flexibly to changes will risk falling drastically behind their competitors who have engaged in such thinking and planning. We therefore believe that corporate preparation for the repercussions of terrorism is likely to be of general value to society and of use to the operations of the firm. Preparation reduces the risk, surprise and punch of the system shock exerted by sudden change.

SOME BACKGROUND ON OUR DATA

There has been some public discussion of what the current response by managers and corporations to terrorism should be. There has also been much speculation as to how firms perceive different dimensions of guarding against terrorism and how these perceptions might be interpreted and affected. However, there has been preciously little insight based on specific and systematic research with corporations and their managers. The danger of relying primarily on anecdotal information consists of coming up with unnecessary or non-functional solutions and assistance measures. To get the facts right, we conducted research with corporations to determine the actual thinking of managers with regards to terrorism. The plan was also to find out more details and specific corporate actions already undertaken to thwart terrorism and the steps taken to prepare for the effects of inimical activities. Based on the facts, we can then attempt to develop and recommend supportive and effective policy actions.

The information and thoughts presented here today are based on a systematic data collection effort. In-depth interviews have been conducted with 37 corporate executives of internationally

active companies. Subsequently, we conducted a survey of firms, both from the United States and abroad. There were 1,488 visitors to our research web site. With 642 actual participants in the questionnaire, we can report a response rate of 43 percent. Of all the respondents, 41 percent are manufacturers, and 59 percent service firms. The company headquarters are mainly in the United States (83 percent) with the rest in Europe (10 percent) and elsewhere. The managers of 27 percent of firms indicated that their company was national or regional, while 73 percent saw their firm's orientation to be international or global. The annual sales of about half of responding firms were less than $100 million, while the other half reported sales above that level. Regarding international business experience, seven percent of companies were about to enter the international market, one third had been active for up to 10 years, while more than 60 percent had been internationalists for more than 10 years. Fifty-five percent of firms made up to 20 percent of their sales internationally, while for 45 percent international sales had a larger share .

SELECTED RESEARCH RESULTS

We asked firms about their key concerns in international business. Three major issues emerged: Increases in energy cost, volatility of exchange rates and terrorism. Measured on a relative scale, energy rated a 10; exchange rates rated 8.5 and terrorism 5.4. We then inquired about corporate responses to terrorism and found that many firms were opposed to spending funds on terrorism preparation. The vast majority of respondents felt that there had not been a specific terrorism threat against their business, even though many more believed that their firm might be directly affected by a terrorist attack in the next 10 years. Corporate supply chain cost had risen since the 9/11 attacks but prices had declined.

Throughout the responses, we were struck by the bi-modal responses of managers. Typically, just as many firms were telling us that they were actively taking steps to prepare for terrorism as those who were indifferent. To some extent this reaction appeared to be a function of varying perceptions of responsibility. Headquarters of firms often told us that they believed terrorism preparation to be an issue for the on site managers at the local level. Subsidiaries, in turn, often believed that the problem was one for headquarters to respond to. We also found

that non-U.S. firms often believed terrorism to be an American problem – about which they, as foreigners, did not have to worry. But most important was the clearly emerging bifurcation of corporate orientations: Many firms were telling us that they were taking action to prepare for terrorism. But many also were reporting that they did not believe this issue to warrant much effort. In essence, consistent with a report issued by the Council on Foreign Relations, many firms are still unprepared for the impact of terrorism.

In part, one can attribute this to the "how soon they forget" phenomenon, the tendency to put the past behind and to look forward to a new, more optimistic environment. There was also the powerful effect of insufficient economic rewards. Firms, particularly the larger ones, reported to have spent on average about $ 147,000 on terrorism preparedness and hired about five new employees to deal with the issue. Yet, many corporations were telling us that they did not believe their shareholders would reward investments into terrorism preparations. Also, any such activity would not help in differentiating the firm from the competition – a good reason not to undertake it. Unless shareholders and other stakeholders encourage and appreciate investments aimed at terrorism preparedness, managers may remain unwilling to devote major funding to such efforts.

A MODEL OF CORPORATE PREPAREDNESS FOR TERRORISM

Figure here

We propose a model which captures the different levels of corporate readiness for international terrorism. This model, which is shown in the figure, indicates the interrelationship among conditions, activities and people, and identifies leverage points which policy makers can use to initiate improvement and change. The model might also be of assistance in evaluating policy approaches to emergency preparedness in general.

Our model starts with the trigger of either terrorist threats or incidents. The consequences are both direct and indirect effects. The direct effects are most keenly felt by those closest to the terrorist activity, while the indirect effect are more likely to cause a severe domino effect over

time. These effects in turn trigger the actions of responders who can be either internal or external to the firm and are typically managers or government officials. These responders interact with and affect directly the information, experience and perception of society and the firm. This linkage is reinforced by media which have the capability to immediately transmit and magnify deleterious news. The consequence is the creation of friction that can reduce the transactional freedom of international business, be it through new regulations, more inspections, or a greater hesitation to become involved in international ventures. Such friction becomes particularly notable when it comes to linkages with stakeholders or the movement of goods, services and people.

Within the firm, the prevailing information, perception, and experience of managers is constrained or assisted by the availability of resources and a corporate willingness to employ them. The result is various levels of preparation for coping with sudden dislocations. We find a sequence of steps or stages of preparation. Managers typically start out totally unprepared for the effects of terrorism on their firms – such contingencies are simply not on the radar screen. At this stage, there is no history or willingness on the part of the firm to undertake any kind of investment or preparatory action. Over time and with sufficient input, managers change their attitude as they become aware of the issue, but are still not ready to take on any activity. The next level represents management which is concerned about terrorism. There begins a search for further input for action. Typically firms prepare by finding or developing checklists and conducting audits as to the preparedness status. As a further step, managers start to plan responses to terrorism, initially at a tactical, eventually at a strategic level, based on the information gathered earlier. Here interaction begins to take place with various stakeholders of the firm, ranging from employees to suppliers, banks, and legislators. Finally, management devotes important efforts to the implementation of preparedness steps in case the firm encounters dislocations triggered by terrorism.

One can easily fathom that at each level of preparedness managers have different needs and concerns. Meeting these is important if one is to move the participants up to a higher plane of preparation. Our research has shown that any outside assistance which delivers insufficient, overwhelming or inappropriate help to firms will be seen as inappropriate and wasteful of both

external and internal resources. A lack of trust in such help will then result in a downward spiral of its acceptance and perceived usefulness.

Depending on their level of preparation, managers and their firms are able to influence the movement inward and outward (including the shelter) of goods, services and people. They can source from or supply multiple partners; they can bring in customers to evaluate products and buy them; hire bright new employees at home or from abroad. To do so effectively, firms need ongoing communication to maintain contact within the company, with suppliers and with the market.

Management also needs to communicate with additional stakeholders in the business process who may be affected by terrorism as well. For example, banks are exposed to a rising regulatory burden in international commerce which drives up fixed costs. The need to create or expand entire departments to deal with compliance issues will influence a bank's willingness to go after new business that requires additional oversight and reporting. Managers will also need to consider the ramifications of their actions. There is the issue of their moral responsibility to protect employees by relocating staff, ensuring that they have employment and that they get paid when the ATMs are down. Access to data will be crucial to continue contact with and service to customers. The benefits of such contingency preparation became quite evident to me at Georgetown University in the recent devastations by hurricane Katrina, when affected students and faculty members from New Orleans were able to find continuity in our classrooms.

There are also the shareholders who may or may not be supportive of preparation for terrorism events and legislators abroad who may engage in negative reciprocity and impede travel through high entrance fees or fingerprinting. All these components will shape the eventual viability of a corporation and determine its ability to engage in further demand centered activity. It is important to appreciate the long-term significance of corporate readiness for international terrorism. Unless firms achieve a minimum level of readiness to ensure their survival and prosperity, they may be the proverbial dead duck in the hunt: Once hit by shotgun pellets they may still be flying but they are destined to crash and perish.

LEGISLATIVE STEPS TO ENCOURAGE CORPORATE READINESS

Our model indicates key leverage points for possible public policy action. On a general level one could plan for actions which might modify any sequence of events. For example, we know that there is much value to great deliberation before taking legislative action in order to avoid the unintended consequences which could accompany hastily taken decisions. Legislative preparation will therefore be more advantageous than an overly rapid but unexamined response to a current emergency. One could recommend studies to analyze and subsequently guide the indirect repercussions of terrorism. Similarly, one could focus on the long-term unintended consequences of events and search for ways to reduce them. It might also be helpful to have increased insights into the magnification effects which media reports have on the perceived intensity of terrorist actions.

Today, however, the plan is to focus on managers and firms, and to identify how Congressional action can improve their preparedness for international terrorism. There are three particular areas to highlight for such intervention: Information, resources and movement.

1. Information

Knowledge is power indeed, and more information will be instrumental in preparing firms. In recognition of this fact, various government efforts provide information to firms. For example, FEMA, the Federal Emergency Management Agency, has produced emergency guides for business and industry. The Small Business Administration (SBA) has prepared a disaster planning toolkit. The Department of Homeland Security (DHS) is offering, in collaboration with the General Services Administration (GSA) and the Office of Personnel Management (OPM), courses in emergency management training. All these efforts are important and worthwhile. To increase their impact several considerations are in order. First off, information is typically provided primarily to those entities which seek it and which have the energy and resources to take advantage of the knowledge provided. We know from past efforts how easily such an approach neglects large portions of one's intended target group. It is insufficient to rely

only on traditional outreach efforts by government agencies or on the proactive search for information on part of individuals and firms.

Our research shows that firms at the uninterested stage are not likely to actively engage in information search for knowledge which they don't think they will need. Also, firms which do not feel threatened by terrorism are, over time, likely to treat the entire issue with benign neglect rather than with concern. The number of these firms is likely to grow rather than shrink. Even managers who are aware of the need to prepare for terrorism often do not know where to turn for more information, or assume that some other corporate division has the lead. Therefore it is imperative to make information dissemination a concentrated effort, with the objective to reach out far beyond current levels.

Such outreach needs to benefit from close collaboration between government and the private sector and should make use of new approaches to the public. Government offices need to systematically touch multipliers who can carry the message onwards. For example, terrorism preparation insights should be provided where taxes are paid or licenses issued. There needs to be an increased development of short seminars and the integration of preparedness materials into university courses, community college training and high school curricula. Publishers and textbooks authors should be helped to integrate terrorism response aspects into their materials. The collection and dissemination of success stories and near misses can be instrumental here. We make sure that our children know how to check for dangerous traffic – why shouldn't they be more informed about terrorism and have a sense of planning embedded? Their preparedness may eventually lead to a national competitive advantage! Information sharing between the public and the private sector should close knowledge gaps crucial for terrorism preparedness. Often the private sector knows more than the public sector does. For example, public agencies know very little about the 85 percent of physical infrastructure in the US that is owned by the private sector – yet such knowledge may be very important to the design of preparedness efforts.

Technology can help to communicate more effectively and to reach new groups. For example, web-based training media allow users to digest materials at their own pace rather than

according to the schedule of an office or trainer. Also, just as there are many late night shows hawking the latest weight reduction breakthroughs, there should be co-opted media time to communicate terrorism preparation activities. It may not be too far-fetched to think of video games and a televised soap opera dealing with concern about and preparedness for terrorism. After all, the impact of terrorism is global and its threat could not be more real than the activities of any reality show.

There is also the issue of information specificity and efficiency. If firms are inundated with materials which they cannot use, their level of trust in the provider of the information and their review of the materials will decrease drastically. Therefore it is important to ensure that the information provided is targeted to the individuals and firms that receive it. To do so, a stage specific information effort is required. For example, a manager who is uninterested in terrorism preparedness will need to receive very different information than one who is already concerned but searching for a checklist. Information needs change even more for a manager who is preparing for a strategic planning task and needs interactive help to develop firm specific scenarios. The more precisely the information provided matches the current needs of its recipients the more useful it will be perceived. This means that information components need to be specific, actionable and differentiated. They can range from an exhortative pamphlet with key bullet points to the development of a terrorism risk index for corporate evaluation of an international expansion strategy.

The availability of information must be seamless between agencies. We know that different agencies have different constituencies and therefore a variation in focus. Nonetheless, internal organizational reasons should not lead to limitations in information flow. From a customer perspective, the flow of information should be easy and direct. This means that even though the SBA produces some materials on terrorism preparedness and the GSA and DHS produces others, the curious customer will never need to know that fact as long as all three parties do their utmost to keep the customer informed. Firms should only see and remember a one-stop-shop in learning how to prepare, respond and recover from a disaster.

2. Resources

Preparing and planning requires the dedication of resources. We have found that many firms are either not willing or unable to commit such resources, and their shareholders are not supportive of spending on terrorism related tasks. If more firms are to engage in preparedness activities, they need a resource incentive to do so. Support can either ease compliance with governmental rules, help the firm plan and prepare for the repercussions of terrorism, or enhance the firms' global competitive position. For example, the cost of database management in order to determine whether one's customers and contacts are on the prohibited persons list can be several thousand dollars a year. The expense of conducting a basic vulnerability and security assessment can easily run into the tens of thousands, with big firms spending upwards of a quarter million dollars on an in-depth plan. Restructuring one's strategy by, for example, ensuring multiple global suppliers or designing flexibility into ones production schedule, can have very high changeover costs.

These activities can be encouraged by providing either special funding or other fiscal measures. In order to encourage firms to prepare and plan, particularly the smaller ones need help. Of course one would not expect the public sector to carry all such expenses – but the enlightened self-interest of firms should be encouraged by such support. Though public support will not deliver to firms the Rolls Royce of plans, it would bring them closer to the KIA. Tax credits in the range of $ 3,500 – $ 5,000 could go a long way to help small firms with a template based plan, which includes a risk assessment, a needs specification and an evaluation of direct and indirect problems. Public support of research on cumulative long-term change factors could help provide a vision for many managers. Having such a plan would encourage the firm to get involved in the implementation of business alternatives. Therefore a subsidization of planning can move the firm and its managers along the preparatory stages in our model. Such public support is also likely to hearten other stakeholders. For example, shareholders may become more willing to prod their firms to plan for terrorism triggered contingencies. Similarly, a reduction of compliance expenses incurred due to onerous requirements imposed upon the financial sector may encourage more banks to offer international business support services.

3. Movements

International marketers have to move **goods and services.** Although a great portion of international transactions can today be conducted via e-mail or on the web, products still need to get to where the customers are. Companies require that movement and storage of products takes place with the fewest impediments.

Security measures have introduced greater friction into international marketing. We know that increased inspections of containers used in international shipping, new security programs to protect ports, and various other new protective policies are decreasing the efficiency and effectiveness of international shipping and logistics. In consequence, the costs of value chain and supply chain activities have increased substantially. Our survey respondents tell us that due to greater transportation delays their international shipments now take an average of three days longer to arrive. Time is crucial when it comes to international competitiveness, merchandise shelf life, product quality and payment receipt. The new delays are evaluated to be the equivalent of a 2.4 percent tariff rate on goods, which is as large as the current overall level of protective tariffs imposed by Japan.

The process of movement has also become more expensive due to the greater need to supervise movement activities in order to avoid pernicious inimical intervention. Such scrutiny applies to both imports and exports. International business threats do not consist solely of inward smuggling of, say, a dirty nuclear bomb. U.S. exporters also need to be able to track their merchandise as it is leaving the country in order to prevent terrorists from contaminating their shipments with the goal of destroying foreign markets together with the reputations of U.S. firms. If preparedness leads to additional storage requirements, say due to higher inventory safety stocks, firms will encounter an increase in inventory carrying costs and sometimes even inventory taxes.

Policy makers can address these cost increases. In order to plan for problems, firms must first have a good understanding of what they can reasonably expect their environment and their government(s) to provide. Such understanding requires ongoing, repeated and broad based

advance planning exercises and collaboration between the public and the private sector. This way firms do not just wait passively for outside rescue but can be ready to take remedial steps themselves. A better understanding of available transport alternatives may make all the difference in the world. If firms need to make investments into maintaining such alternatives, public support for them should be considered. At the same time, it is important to gain early recognition of problem areas where existing rules could present obstacles to creative responses. Advance provisions need to be made for exemptions or waivers from these rules in times of response to terrorism. We need an improved understanding of the cost of delays so that new security systems can intelligently consider trade-offs. Encouragement of radio frequency identification (RFID) technology could help provide tracking devices for both imports and exports. Also, if new contingency planning leads to higher storage requirements, policy makers might help ensure that such preparatory measures do not result in outside cost increases for the firm. The inventory tax, still in use in many location, should be abandoned in order to encourage firms to stock up.

Movement also concerns **people.** On an individual level firms can safeguard such movement by working on the physical protection of managers abroad. Training, equipment and guards may help reduce the likelihood of executive kidnappings, while insurance may reduce the corporate financial exposure.

But the new friction resulting from policy actions has also led to major inhibitions of people flows. For example, new rules have dissuaded a large number of international travelers from coming to the US. Tighter restrictions on the international flow of students and faculty have caused major problems in the education sector. Some universities have lost important pillars of instruction, research assistance and funding by not being able to attract higher international enrollments. The emergence of newly competing teaching and training facilities abroad which do not have to suffer from onerous visa restrictions deprives U.S. institutions of income and growth. New rules now require private schools to send their international teaching staff home after six or even three years, leading to key institutional difficulties in building a faculty of excellence and making a longer term career investment by individuals virtually impossible. Visa delays or refusals also lead routinely to the inability of business visitors to come and

attend trade shows, visit factories, or make purchases. For example the International Manufacturing Technology Show in Chicago, which you, Mr. Chairman attended last year, lost almost one third of its invited Chinese customers due to visa difficulties. In consequence, there is a loss of competitiveness, a loss of jobs, a reduced flow of orders, and less tax income.

The visa process can be improved. Though we are granting a favor to people by permitting their entry into the US, they also support us by wanting to come here. More resources need to be made available for the processing of visas. Delay benchmarks need to be established and improved upon. Options such as the development of a trusted travelers program need to be explored in greater detail. Trusted shippers and, perhaps, trusted payers should benefit from reduced bureaucratic interference. Paperwork should contain as few complications as possible so that small businesses can afford to be players. Naturally, when a specially bestowed trust is violated, some high profile punishment should be in the offing.

Improvements are also necessary to ensure the ongoing flow of **communication**. We have seen how first responders do not have sufficient communications ability, how different systems are non-compatible, and how there is a crowding out syndrome in emergency conditions. We also know that there is a substantial untapped capability of technology, such as satellite communication, which can be instrumental not just for the authorities but also for businesses. Unless a firm is able to stay in touch with its stakeholders in order to communicate, for example, to its employees where and how to proceed for operational continuity, the likelihood of corporate survival is in great jeopardy.

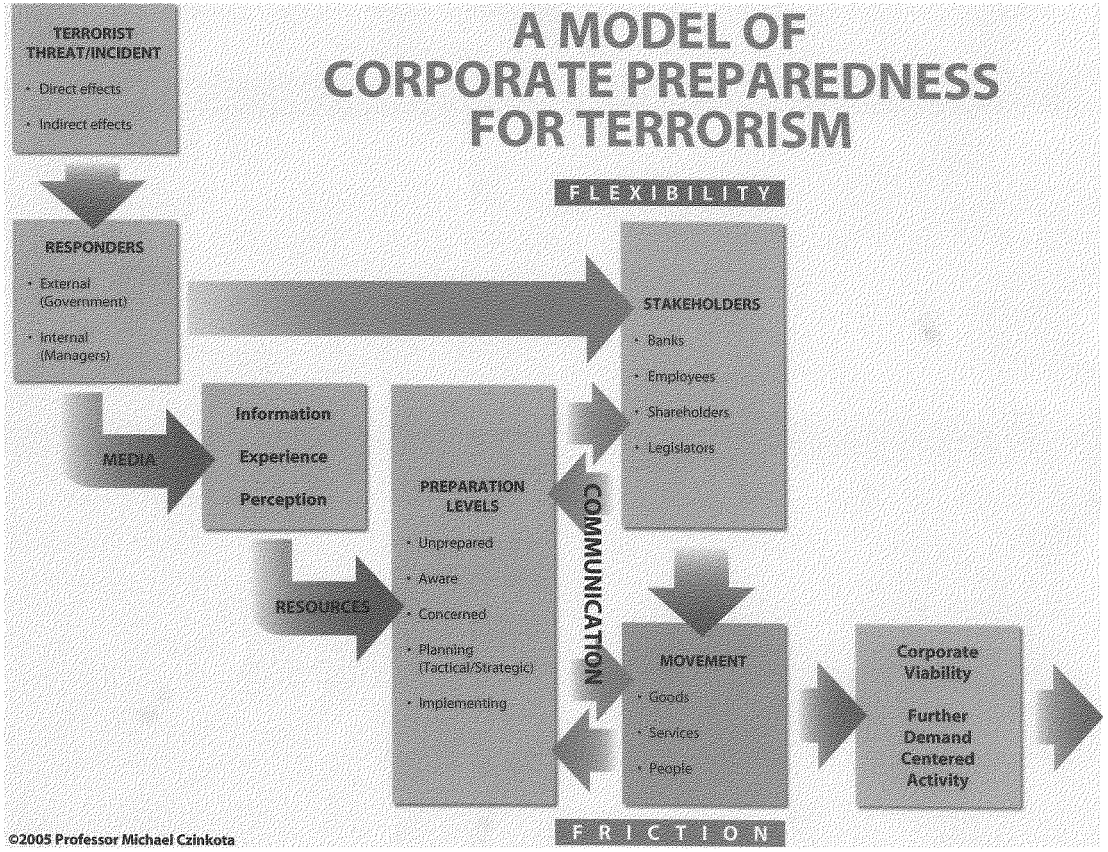
Congressional action can address the communication infrastructure. Special tax treatment can support research and development in the communications sector and investment by firms into communications security. The national pre-positioning of individual communication devices ready for distribution could be considered.

Some brief comments to the issue of cost. Some of the remedies proposed here require more planning rather than funding, such as agency coordination, personnel cross training and materials exchanges. In many instances more public private sector interaction may not require

new money. I have seen at STAT-USA in the Commerce Department how good collaboration by itself can lead to excellent progress. Yet, there will also be cost associated with achieving increased preparedness. Just like with inoculations, the benefit of early prevention is high when compared to its cost. The speedier and more capable response which prepared firms can deliver when faced with disaster will be of benefit to the public purse. If public order and processes fall apart, the government will have to set things right at great expense. Firms which stay in business, retain their employees and serve their customers can make a great difference to societal continuity. Therefore, assistance provided today for the planning of such response would appear to be a justified investment. As the old saying goes – you can either pay now or pay later.

Mr. Chairman, members of the Committee, the key purpose of my testimony was to provide structure to the many complex interactions which are needed to ensure corporate readiness for international terrorism. By understanding the links and processes involved, it becomes easier to see where policy levers can be used to systematically increase preparedness levels. There are many alternatives for future action by Congress and, naturally, tradeoffs and resource assessments will play an important role in determining what steps to take. However we do know that action is needed if we are to ensure the continued competitiveness and viability of our corporations. Standing still will only leave our firms in a position of great vulnerability.

Thank you for your attention and I will be pleased to answer any questions you may have.


A MODEL OF
CORPORATE PREPAREDNESS
FOR TERRORISM
TERRORIST THREAT/INCIDENT
• Direct effects
• Indirect effects
RESPONDERS
• External (Government)
• Internal (Managers)
MEDIA
Information
Experience
Perception
RESOURCES
PREPARATION LEVELS
• Unprepared
• Aware
• Concerned
• Planning (Tactical/Strategic)
• Implementing
COMMUNICATION
FLEXIBILITY
STAKEHOLDERS
• Banks
• Employees
• Shareholders
• Legislators
MOVEMENT
• Goods
• Services
• People
FRICTION
Corporate Viability
Further Demand Centered Activity
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TERRORISM AND OTHER THREATS TO SMALL BUSINESS

Testimony of

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United States Congress: Committee on Small Business

November 1, 2005

Terrorism can be defined as the systematic threat or use of violence, often across national borders, to attain a political goal or communicate a political message through fear, coercion, or intimidation of non-combatant persons or the general public. Terrorism holds important implications for business, and international business in particular. Terrorists direct their attacks against businesses far more than any other target. The most common type of event is bombing, followed by armed attack, kidnapping, arson, and vandalism. Most victims are randomly-targeted civilians.

The great majority of businesses are unprepared to meet such risks and decision-makers remain relatively complacent. In our discussions with practitioners and academicians, and based on the results of our large-scale empirical studies, we conclude that relatively few firms have devised substantive plans or restructured operations to deal with terrorism. Top managers as numerous U.S. firms have advised us that they have no specific plans to safeguard against this threat.

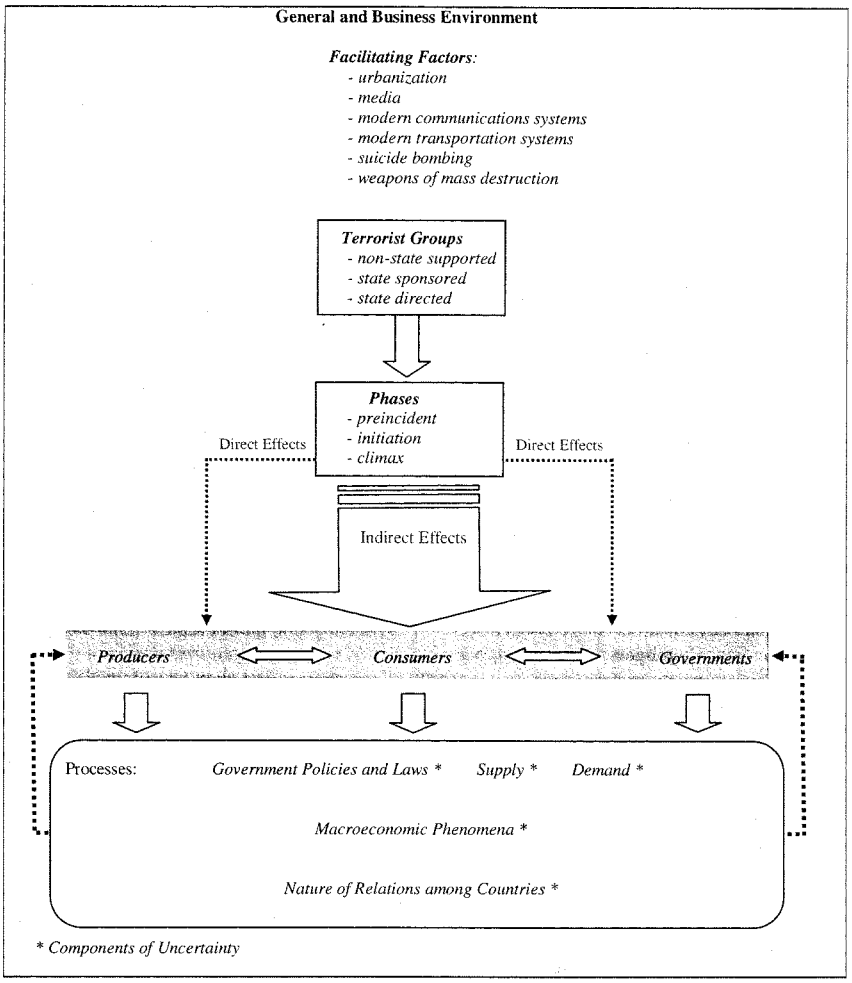
BACKGROUND ON TERRORISM

Actors and other key constructs in terrorism research are summarized in the conceptual framework in Figure 1. The figure highlights the major actors in terrorism. *Terrorists* target *firms* who employ managers who devise approaches to deal with terrorism. *Consumers* reflect all buyers of goods and services whose purchasing behavior may be affected by terrorism. State, national, and supranational *governments*, as well as other public and semi-public entities (e.g., port authorities, trade associations, the United Nations), may respond to terrorism in various ways. Overall, firms, consumers, and governments are influenced by, and will usually respond to, the actions of terrorists.

There are several distinct phases to a terrorist attack. In the *preincident* phase, the intelligence needed to plan the event is gathered by a cell charged with this task. This information is communicated to the command cell for target selection and a plan of attack is developed and rehearsed. In the *initiation* phase, after a target has been chosen and an attack plan has been devised, the tactical cell is activated. The members of the tactical cell may travel to the target using different routes, coming together only at the last minute. The *climax* phase is when the attack takes place, the bomb goes off, the victim is assassinated, or the hostage event is concluded. At this point the terrorists either escape or are captured or killed.

FIGURE 1

A General Model of Terrorism and International Business



Terrorism's Facilitating Factors
Several key factors have affected the way terrorists can operate today. Among them, *urbanization* and the resultant concentration of people, government offices, businesses, and industrial facilities, facilitate the efforts of terrorists. Cities bunch people into confined spaces, usually providing them with fewer means of escape, while terrorists can find more places to hide and plan their violent activities.

The *media* also has seemingly increased the payoff from terrorism, with rapid, widespread global reporting bringing to the world the fear and ever-present possibility of a local attack. The global reach of a message is now more easily achieved, since television and other instant communications allow people worldwide to learn about a terrorist incident within minutes of its occurrence. Competition among media outlets also encourages the broadcast of information that again facilitates diffusion of terrorist messages, sometimes inciting support that might not otherwise have eventuated. By putting terrorism on a global stage, the media also may provide the means to inspire and instruct other terrorist groups, leading to further or escalating terrorism.

Today, terrorist group members communicate with each other with great efficiency, using *modern communications systems*, such as international telephony and the Internet. They allow terrorists to plan and activate attacks with unprecedented efficiency and maximum impact. Alternatively, terrorists may circumvent detection by using primitive communications, such as runners or motorcycle couriers. Many communications between terrorists remain impervious to detection.

Modern transportation systems provide the means for terrorists, in a timely manner, to arrive at, and depart from, the sites of attacks. Sophisticated transportation also facilitates the often unaccompanied movement and delivery of weapons and other supplies used in terrorist attacks.

Today, various new techniques and technologies are available to terrorists. *Suicide bombing* is a relatively new trend that has increased the stakes of terrorist attacks. Perhaps most worrisome is *weapons of mass destruction* (WMDs), including nuclear, biological, and chemical weapons that hold the potential to kill thousands of people in a single event. Today, terrorists can use WMDs and suicide bombing to wield higher levels of derivative influence than ever before.

Terrorism's Direct and Indirect Effects
Terrorism poses both direct and indirect threats to the operations of the firm. *Direct effects* comprise the immediate business consequences of terrorism, as experienced by individual firms. For example, the bond-trading company Cantor Fitzgerald was destroyed and lost 658 of its 960 employees in the 9/11/01 attacks ("9/11"). While the harm is clearly tragic for individually affected people and firms, in terms of the U.S. and world economy, the direct effects of even the 9/11 attack were relatively small.

In terms of the impact on business, *indirect effects* are the most important outcome of terrorism. These include declines in consumer demand; unpredictable shifts or interruptions in value and supply chains; new policies, regulations and laws; as well as harmful macroeconomic phenomena and deteriorating international relations that affect trade. It is these indirect effects that pose the greatest potential threat to the activities of countless firms. *Declines in consumer demand* result from the fear and panic that that ensue following terrorist acts. Unable to predict future events, consumers may delay or discontinue purchases. Industrial demand is derived from retail consumer demand. A widespread psychological response of individuals, therefore, may trigger a decline in demand for industrial goods. Fear may also impact the behavior and reactions of managers. Firms experience reduced revenues from falling consumer demand and may attempt to recoup decreasing sales by reducing prices or via

increased advertising and other communications activities, all of which engender reduced revenues or unplanned expenses.

Unpredictable shifts or interruptions in the supply of needed inputs, resources, and services is another indirect effect of terrorism. They hold the potential to induce serious problems for the firm's value-chain operations and other activities. For multinational firms, interruptions may result from delays in the supply chain as increased security measures and other factors lessen the efficiency of global transportation and logistical systems. Short-term shortages of input raw materials, parts, and components may occur if, as a result of attacks, certain externally-obtained resources are delayed or become unavailable. Shortages are also associated with higher costs of input goods, which can contribute to higher prices for consumers.

Policies, regulations, and laws are enacted by governments in response to terrorist events. While intended to improve security conditions, such actions may have unintended consequences of hindering efficient business operations. They can increase business costs and alter the business environment in ways more harmful than the terrorist events that provoked them. Government actions make the terrorist intent come true by transmitting effects far beyond the industries and regions that were the original targets of terrorist acts. Public remedies may not reduce risks by a degree commensurate with the severity of the original terrorist events.

For example, provisions of the Patriot Act dissuades international travelers from visiting the U.S. Increased inspections of containers used in international shipping, new security programs to protect ports, and other new policies decrease the efficiency and effectiveness of international shipping and logistics. Policies generated by governments and by firms themselves in response to the threat of terrorism substantially increase friction in international business, as well as the costs of value-chain and supply-chain activities.

Macroeconomic phenomena, such as (real or perceived) declines in per-capita income, purchasing power, or stock market values, are exacerbated by terrorism. Such trends affect the extent of consumer uncertainty about the state of national economies. In the long run terrorism can induce declines in international trade, with associated consequences for GDP, tax revenues, and living standards.

Similarity of Terrorism to Other Emergencies

With respect to indirect effects, terrorism is similar to other emergencies that confront firms and the nation. Natural disasters include earthquakes, fires, hurricanes, and floods. Other disasters include war, civil unrest, epidemics (such as might occur via the Avian flu), supply shocks in key resources (as occurred in the 1973 Arab oil embargo), and macroeconomic crises (such as the 1930s depression). These emergencies can give rise to the indirect effects of terrorism summarized above: declines in consumer demand; shifts or interruptions in supply chains; new policies, regulations and laws; harmful macroeconomic phenomena; and deteriorating international relations that affect trade. Therefore, the ideas presented in this testimony can apply equally to the other types of emergencies that firms and the nation may face.

THE SMALL AND MEDIUM ENTERPRISE (SME)

SMEs are companies with 500 or fewer employees and comprise between 90 and 95 percent of all firms in the U.S. They are often young firms, established within the previous 20 years. While most operate strictly within individual countries, they are increasingly active in international commerce. Not only do SMEs provide the vast majority of jobs in the U.S., they are often the major source of

innovation, upgrading current industries and opening frontiers in new industries. SMEs are often more adaptable and have quicker response times when it comes to implementing new ideas and technologies. Their contribution to the nation's economy is virtually incalculable.

The globalization of markets and advances in various technologies are allowing more and more SMEs to participate in international business. They represent the fastest growing segment of international firms. They account for about one-third of exports from Asia and about a quarter of exports from developed countries in the rest of the world, including the U.S. In selected countries such as Italy, South Korea, and China, SMEs contribute more than 50 percent of total national exports.

Vulnerability of the SME

International business is a potentially expensive undertaking, and requires the firm to deal in foreign languages, cultures, and unusual ways of doing business. Compared to doing business in the familiar home market, international business is complex and challenging. It is within this environment that many SMEs operate today. However, compared to large firms, SMEs face a big challenge: given their size, youth, and inexperience, *SMEs lack substantial financial and human resources*. Management may be short-handed or lack superior business skills. Their smaller size and lower level of resources makes SMEs vulnerable. Compared to large multinational corporations, the complexities of doing international business are very challenging to SMEs.

They often operate on slim profit margins, across a narrower base of revenue streams. They often lack the capital to cushion against the harmful consequences of emergencies. SMEs are less equipped than large firms to defend against the challenges of the business environment. Accordingly, while the domestic contribution of SMEs is huge, and their international role is substantial and growing, *SMEs are the most vulnerable to indirect effects of terrorism and other emergencies.*

But relatively little is known about the effects of emergencies on SMEs. Despite their current and projected impact, there has been little research that attempts to explain how SMEs perform in the uncertain environment of indirect effects posed by terrorism and other emergencies. There has been almost no empirical research that examines the specific approaches the SMEs follow to cope in such environments.

THE STUDY

To address the knowledge gap noted above, we conducted a substantive survey-based study to explore the link between SMEs, terrorism, and other emergencies. Initially we conducted interviews with managers at firms throughout the U.S. and overseas. This was done to uncover key issues and relationships in preparation for conducting a large-scale survey. Subsequently, in the summer of 2005, we conducted an online survey of U.S. firms. The purpose of the survey was to isolate processes in domestic and international business that are vulnerable to terrorism and other emergencies, and to understand what types of responses firms are making to these challenges. The case studies and survey were conducted to provide input for the formulation of national policy regarding these important issues.

Results were received from 219 randomly selected SMEs from around the U.S. Thirty percent of respondents are manufacturing firms and the remainder are in the services sector. This reflects the U.S. economy, which is 80 percent services. Some aspects of manufacturing firms are more vulnerable to terrorism and other emergencies, because of the need to deal in potentially long supply chains, transportation systems, and other business activities characteristic of dealing in tangible

products. The services and manufacturing firms are compared below. In addition, we collected data from 423 large firms (those with greater than 500 employees), and results for the SMEs are compared to these firms as well.

In the sample of SMEs, 58 percent had between 100 and 499 *employees,* 29 percent had 20 to 99 employees, and the remainder had fewer than 20 employees. In terms of *annual revenues*, 65 percent had revenues of $2.5 million to $100 million, 20 percent had less than $2.5 million, and the remainder had greater than $100 million. Sixty three percent of the respondents had been in business for over 20 years, 20 percent for 11 to 20 years, and the remainder for less than 11 years. Regarding *international* operations, 71 percent got up to 20 percent of their total sales from international sources, 19 percent got up to between 20 and 39 percent of their sales internationally, and the remainder got over 39 percent of their sales from abroad. In other words, most of the SMEs are only moderately international in their business dealings.

Exporting was by far the most popular form of international entry (59 percent of firms), and about a third of the firms shipped their international offerings by *sea*, while a smaller proportion (21 percent) shipped by *air*. Very few of the SMEs engaged in foreign direct investment. About one-third of respondents cited *Europe* as their most important international business location, and another third cited *North America* (Canada and Mexico); 20 percent cited *Asia*. Very few of these firms (less than 4 percent) cited other locations (e.g., South America, Russia and former USSR, Middle East, Africa) as their most important international targets. Very few of the firms (20 percent or less) did business with countries prone to terrorism, such as Colombia, Indonesia, Israel, and Yemen.

Major Results

Nearly all respondents (88 percent) said their businesses had not been *directly* threatened by terrorism. We asked the SMEs if they had been affected by *indirect* effects of terrorism. The most important effects, experienced by about one-quarter of all firms was *increased insurance costs*. The second greatest effect (18 percent of respondents) was a tendency to *place greater importance on the integrity of international business partners*. The third most cited effect (16 percent) was *more delays in international business activities*. This was followed by *less trust in international business* (15 percent of respondents). Five to seven percent of firms reported experiencing the following: unpredictable shifts or interruptions in supply chains, decreases in consumer demand, deteriorating international trade relations.

While nearly 50 percent of firms were concerned about the effects of terrorism or threats of terrorism, only a quarter had prepared a terrorism contingency plan. Only about one-third said they were prepared to deal with the effects or threats of terrorism. Only 8 percent said they were considering moving critical operations or branching out into less sensitive areas due to terrorism. Less than 20 percent stated that they included terrorism as a factor in selecting or designing supply chains and distribution channels, or in developing and revising marketing strategy. Only 18 percent said anti-terrorism expenditures were seriously considered in their firm. Only 12 percent said shareholders reward corporate efforts to prepare for terrorist threats. On the other hand, two-thirds of respondents were concerned about the effects of rising oil prices.

In terms of international shipping of input and finished goods, since the attacks of 9/11, about 50 percent of respondents felt they had experienced *no significant delays*. Nearly one-third had experienced international shipping delays of one to six days. Eighteen percent had experienced international shipping delays of over one week. Fifty four percent said their supply chain costs had

gone up since the attacks of 9/11, but only a quarter had raised their prices in response to terrorism risks.

We also asked about the corporate response to terrorism. Forty three percent of the SMEs replied they had *not responded at all*; They did not revise company operations or devise any strategies at all to deal with the threat of terrorism. Of those firms that did respond, almost half (27 percent of the total sample) had done so largely on their own, with little prodding by government mandate. One-third of the responders (19 percent of the total sample) replied that nearly *all* of their response was due to government mandate. About one-quarter of all respondents had spent over $50,000 in new technology and systems upgrades to comply with post-9/11 federal antiterrorism mandates. Only eight percent had spent more than $200,000 for such upgrades. Fully 77 percent of the respondents had not pursued such upgrades, or had spent less than $50,000 on them. Only 7 percent of respondents had joined the federal government's Customs-Trade Partnership Against Terrorism (C-TPAT). Few SMEs felt that government policies had interfered with their normal operations. Only 21 percent stated that government policies towards terrorism had substantially slowed their international business operations. Only 16 percent stated that their international growth had been curtailed by governmental antiterrorism policies

Comparing SMEs to Large Firms

To better understand the SMEs, we compared their results to results of a sample of 423 large firms (greater than 500 employees) that were administered the same survey. On average, the small firms were slightly less experienced in international business and derived a substantially smaller proportion of their revenues from international sales. The small firms were much more likely than large firms to be exporters, while the large firms were much more likely to internationalize via foreign direct investment. A much larger proportion of the small firms were importers, as opposed the large firms which had much more developed and outward international operations.

In terms of responsiveness, on average SMEs were less prepared than large firms. They were less concerned about terrorism, and less prepared to deal with its effects. The SMEs were also less prepared for raw material disruptions, natural disasters, rising oil prices, political instability, corruption, and fluctuating exchange rates. The lack of responsiveness might arise because SMEs are somewhat less experienced and less involved in international business than larger firms. The SMEs reported they had experienced substantially fewer specific terrorism threats and were less likely to feel they would be directly affected by a terrorist attack in the coming 10 years. They reported that shareholders would be less likely to reward corporate efforts to prepare for terrorist threats.

Overall, compared to the large firms, SMEs are less serious about making expenditures to deal with the threat of terrorism. Far fewer SMEs had prepared a terrorism contingency plan. Fewer SMEs indicated they had included terrorism is a factor in devising marketing strategy, or designing supply chains and distribution channels abroad. Fewer had increased their safety stock of international supplies. Fewer believed that firms should carry terrorism insurance. Fewer can identify and track antiterrorism expenditures in their accounting systems. SMEs have spent far less money on new technology and systems, and they have hired far fewer new staff, to comply with post-9/11 federal antiterrorism mandates. Overall, compared to large firms, SMEs have been much less responsive to dealing with the threat of terrorism and other potential disasters.

In thinking about these results, one should bear in mind that SMEs are, by definition, smaller firms. Compared to large firms, they are less involved in international business. For example, far fewer SMEs do business in terrorism prone countries (e.g., Columbia, Indonesia, Afghanistan) or in the

Middle East. Moreover, compared to large firms, a significantly larger proportion of SMEs in the study are in the services sector (e.g., professional services, educational services, finance, insurance). Smaller services firms with fewer international involvements appear to be less concerned about, or to prepare for, terrorism and other potential emergencies. Managers at these firms appear to view themselves as less affected by these threats. Yet this perception is flawed: Given their small size and limited resources, SMEs are likely to be *more* vulnerable to especially the *indirect* effects of terrorism and other emergencies.

Comparing Manufacturing SMEs to Services SMEs

The service sector comprises 80 percent of the U.S. economy. Correspondingly, about 70 percent of respondents to our study on 219 SMEs are in the services sector, with the remainder in the manufacturing sector. Because there are substantial differences in the characteristics between services firms and manufacturers, it is useful to compare these two groups of firms.

As might be expected, manufacturing SMEs were far more involved in exporting and importing then the services firms. By contrast, far more of the services firms were engaged in foreign direct investment, licensing, and franchising, in terms of their overseas operations. The manufacturers were substantially more concerned than the services firms about access to raw materials and labor instability. The manufacturers were also significantly more concerned about rising oil prices. Manufacturers were more likely than services firms to report that their supply-chain costs had risen since the attacks of 9/11. Compared to services firms, far more manufacturers reported that their international shipping time frames were longer since 9/11.

On the other hand, compared to manufacturers, the services firms in our sample were more concerned about the effects of terrorism and had taken more steps to prepare for it. Overall, they felt more vulnerable to terrorist attack. Shareholders at services firms were more likely to reward corporate efforts to prepare for terrorist threats. Relatively more services firms had taken steps to prepare a terrorism contingency plan. These firms had spent more money on new technology and systems upgrades to comply with post-9/11 federal antiterrorism mandates. They were more likely to have considered moving critical operations in response to 9/11. They felt more positive about the steps that government bodies had taken in determining national security and terrorism responses.

Additional Findings

Among the 219 SMEs surveyed in our study, the following additional findings emerged.

- The longer a firm had been engaged in international business the more likely it was to prepare for terrorism.
- The more involved the firm in international business, the more concerned was management about terrorism, and to have taken steps to deal with it.
- Importers and others engaged in extensive international sourcing were relatively more concerned about access to raw materials, fluctuating exchange rates, and the potential effects of natural disasters. They reported their supply-chain costs and prices had gone up since 9/11, and that government policies towards terrorism had substantially slowed their international operations. Importers put greater emphasis on the importance of integrity in their international partners. They were more concerned about deteriorating international relations. Importers were much more likely to have joined the Customs Trade Partnership Against Terrorism (C-TPAT).
- Companies that experienced terrorism threats and expressed concerns about terrorism, were also more likely to have spent money on dealing with terrorism, to have shareholders support in

preparing for terrorism, and to have prepared terrorism contingency plans and made other preparations. There appears to be a segment of SMEs that are more vulnerable to, or feel more threatened about, the risk of terrorism. These firms tend to be in the services sector.

- Among firms that believed government policies towards terrorism had substantially hampered their international business operations and international growth, the following characteristics applied. These firms:
    - were often engaged in importing or licensing;
    - were more concerned about access to raw materials and rising oil prices;
    - had experienced decreases in consumer demand and unexpected interruptions in supply-chains due to terrorism;
    - were *not* particularly concerned about the effects of terrorism, but had taken steps on their own to prepare for terrorism, including spending money on new technology and systems upgrades.

KEY CONCLUSIONS

In summary, respondents to the survey of 219 international SMEs were largely exporters that had experienced rising insurance costs, rising supply-chain costs, delays in international business activities, and put greater importance on the integrity of international business partners. The majority have responded little to terrorism, or not at all, and there is relatively little stakeholder support for such responses. Most have been little affected, or not at all, by government-sponsored antiterrorism policies. A large proportion believes firms should carry terrorism insurance. They tend to be much more concerned about rising oil prices than terrorism or other possible emergencies.

Most respondents operate in the services sectors, and these firms have relatively more overseas operations (as compared to manufacturing firms). Services firms were somewhat more concerned about terrorism and had taken some steps to prepare to deal with it. Compared to manufacturers, stakeholders at services firms were more likely to reward corporate efforts to prepare for terrorism.

Older, more internationally involved firms were more concerned about terrorism and more likely to prepare for it. Compared to large firms, smaller firms do less international business, and are less internationally experienced. SMEs are relatively less prepared to deal with terrorism, natural disasters, and other threats. SMEs generally don't tend to perceive terrorism as much of a threat to them. SMEs are less likely, as compared to large firms, to enjoy stakeholder support to prepare for terrorist threats. Relatively few SMEs had prepared a terrorism contingency plan, or devised antiterrorism strategies.

Smaller firms in general saw themselves as not prepared, while larger ones reported clearly higher levels of preparation. Smaller firms were also much less likely to take out terrorism insurance. The SMEs were much less likely than larger firms to undertake shifts in their corporate strategy due to terrorism. A difference in resources was also reported when it came to personnel and technology investments for terrorism prevention. Smaller firms had spent on average $ 40,200 and hired 1.5 employees to respond to terrorism concerns. Larger firms in turn had an average investment of $ 140,000 and had hired almost four new employees to deal with terrorism. This underscores the resource constraints faced by the SMEs.

CONSIDERATIONS FOR POLICY DEVELOPMENT

Results suggest that SMEs are largely indifferent about and unprepared for terrorism and other major threats. This culture of indifference is somewhat understandable – the only major event in recent memory was the 9/11 attack, which occurred more than four years ago. (It should be noted that nearly all responses to our survey arrived *before* the Hurricane Katrina disaster or from firms unaffected by Katrina.) Yet terrorism can impact the nation is very substantive ways, particularly in terms of its indirect effects. When combined with other emergencies (e.g., hurricanes, floods, epidemics, supply shocks, macroeconomic crises), *the consequences for U.S. small businesses could be huge.*

A key challenge is that firms, especially SMEs, have both *limited resources* and *competing priorities.* Managers are disinclined to plan for contingencies that (1) *may* occur at some distant future time (e.g., not *this* quarter); (2) involve high levels of uncertainty and are therefore difficult to measure and plan for; (3) shareholders and stakeholders view as relatively unimportant. A key challenge for policymakers, therefore, is to stimulate managers at resource-constrained SMEs to invest time and money in dealing with the threat or possible effects of terrorism and other emergencies.

Fear may be our greatest enemy. The *panic and psychological impact of disasters can be more harmful to the nation's interests than the disasters themselves.* For instance, the 9/11 attacks triggered a decline in construction of high-rise buildings and other vulnerable structures. While an influenza pandemic, such as the Avian flu, might kill far less than one percent of the U.S. population (i.e., the chances of dying are very small), the ensuing panic, psychological harm, and tendency of people to stay home and retrench, could have much more devastating effects. A key function of government is to rapidly restore public confidence in the economy and business systems. It is critical to restore confidence and maintain order as early as possible following catastrophic events. The federal government should take steps to ensure that businesses continue "business as usual" as quickly as possible in the wake of an event.

SPECIFIC POLICY IDEAS

- ***Position terrorism together with other emergencies.*** The indirect effects of terrorism are very similar to those of hurricanes, floods, epidemics and other disasters. All these events have the potential to engender declines in consumer demand, supply chain interruptions, harmful macroeconomic phenomena, and so forth. Collectively these events and their effects are more salient to the public than any one event. From the standpoint of capturing the attention of SME management and other interested parties, it is useful, therefore, to group these events together and address them at a collective level. It is more cost-effective to develop programs and policies that deal with various emergencies in aggregate. Regardless of their immediate source, disasters *will* occur. Hurricanes cannot be averted, supply lines are often controlled by others, and even the best intelligence and interdiction efforts cannot stop some terrorist acts. Because their impact is similar, it is more effective to deal more in terms of their effects, especially their indirect effects, rather than individually.

- ***Strengthen the partnership between the private and public sectors.*** There are certain things that government does especially well, and others that the private sector does especially well. The federal government is strong at intelligence gathering, national defense, and coordinating certain types of recovery efforts. The private sector is a potential fighting force of doctors, scientists, managers, and venture capitalists. Companies are spending hundreds of billions of dollars on homeland security – insurance, workplace security, logistics, and information technology – much more than the federal

government's announced Homeland Security budget. A strong public-private partnership helps each side compensate for the weaknesses of the other. Examples include the Pentagon's directed funding to private-sector ventures that address new strategic and tactical needs for dealing with disasters. The CIA established Q-Tel, Inc., a private nonprofit organization that provides capital to private firms to develop information technology deemed critical to the intelligence community. But much more needs to be done. The private-public partnership needs strengthening and further development.

- ***Provide educational programs for SMEs.*** At present, the Department of Commerce offers educational programs in general business and international trading opportunities. FEMA offers substantial training to prepare emergency workers to deal with disasters, as well as an "Emergency Management Guide for Business and Industry." Homeland Security is attuned to emergency avoidance and security. However, very little training is now provided to SMEs on the *business* dimensions of disaster avoidance and recovery. Workshops, seminars, and other educational programs might be offered to SMEs by Commerce or its agencies. They should cover topics such as disaster avoidance, analysis of weak links in value chains and corrective steps, security planning, scenario and contingency planning, disaster insurance, best practices for crisis management, emergency response, and business recovery. Various private firms offer programs in these areas. However, they are often expensive or otherwise inaccessible to SMEs.

Government has a role to provide widespread training on emergency planning, responses, and recovery. SMEs need to become more aware of the *indirect* effects of terrorism and other disasters. Business continuity preparation and planning are critical for a growing number of firms. SMEs need to learn how to ensure their own safety and survival. The more rapidly SMEs recover from emergencies and the more of these firms that survive, the stronger the U.S. economy will be and the faster it will recover. The Department of Commerce or its agencies need to devise a systematic program of educational programs, directed particularly at vulnerable SMEs, that is widely advertised, cost-effective, and proven for disaster response and recovery. The program need not be costly, and SMEs should contribute to their own tuition. Incentives might be required to encourage firms to participate. These could include tax incentives or similar inducements. The program should be offered in various cities, to maximize its accessibility by the largest number of SMEs.

- ***Expand disaster recovery loans and loan guarantee programs.*** Perhaps the largest problem that companies face following an emergency is *recovery*. As Katrina demonstrated, capital for rebuilding and restarting is in short supply. The firm may be out of business for weeks or months, with no revenue during this time. The problem can be addressed via low-interest loans and loan guarantees. The Small Business Administration already provides such loans, but the program needs to be marketed better and expanded. The DOC-sponsored educational programs noted above can advise SMEs about these loan programs and their importance in disaster recovery. The need for government-sponsored loans emerges because while SMEs may need capital to jump-start their businesses following a disaster, many such firms may be unable to obtain or to afford loans from conventional sources. Moreover, private banks may lack the ability to service all SMEs affected by a large-scale disaster. A good model for this is the *Export-Import Bank of the United States*, a government agency that provides direct loans or loan guarantees to exporters or importers for risky international sales that require financing. The Bank also provides insurance to cover non-payment by foreign customers.

- ***Provide better intelligence support.*** Better intelligence should be made available to the private sector, to assist them in preparing for, and dealing with the aftermath of, emergencies. The Department of Homeland Security has a website that provides such information to the private sector. The should be enhanced. It should become a major resource that businesses can consult to obtain

current information on the state of any emergency, or threatened emergency, that may pose consequences for the firm. The news media currently play the major role in providing information to the public about emergent events. However, media are not always reliable and inclined to sensationalize news stories or focus on negative, anecdotal information. Thus, the federal government has a role to play in ensuring that the public obtains news and information which are factual and genuinely helpful about possible threats or evolving situations.

- ***Strengthen the information and communications infrastructure***. Technology is helping clear many of the obstacles once faced by firms in their business dealings. Recently developed technologies facilitate intelligence collection and business continuity. For example, highly developed back-office systems and emergency response plans helped many firms recover very quickly following the 9/11 attacks in New York. On the other hand, recovery efforts were substantially delayed following Katrina because of massive communications breakdowns. State-of-the-art information and communications systems enable firms to maximize their productivity and manage crises with maximal efficiency at reduced costs. For SMEs, the Internet and e-mail hold special promise because of their efficiency and cost effectiveness for information dissemination and exchange. Information and communications technologies provide many of the answers to the problems that terrorism and other disasters pose. They can be applied to (1) detect or prevent disasters; (2) maximize the efficiency with which firms can prepare for, and deal with, disasters; and (3) help minimize the costs of preparedness and post-event recovery.

In terms of the public-private partnership, several positive trends have emerged in recent years. For instance, the Technical Support Working Group at the Pentagon coordinates and funds numerous private sector R&D initiatives aimed at enhancing homeland security. The federal government must take stronger efforts along these lines. Steps should be taken to improve and institutionalize the information and communications infrastructure to help ensure a dynamic business environment capable of withstanding interruptions and turbulence caused by disasters. The public sector, in its partnership with the private sector, must encourage R&D and innovative behaviors that lead to the development of leading-edge technologies that ensure early detection of, and rapid recovery from, catastrophic events.

- ***Encourage more economic resiliency and dynamism***. The flexibility and dynamism of the U.S. economy encourages continuous innovation and entrepreneurship. It also allows firms to recover more rapidly from disasters. Flexibility, dynamism, and resiliency result in large part because businesses enjoy relatively free trade and are largely unencumbered by government intervention, regulations, and bureaucracy. This type of business environment must be encouraged and continued. Government should encourage a strong, vibrant economy and business environment. It should support *an economy and business systems that are strongly resilient to, and capable of recovering quickly from, terrorism and similar events*. Most solutions to dealing with threats will come from the private sector. Thus, government should facilitate the flexibility, dynamism, and innovativeness of private firms. It should minimize the regulatory burden and intervention that often engenders harmful unintended consequences. Desirable policy initiatives in this regard are given in Table 1.

- ***Encourage free trade and economic development worldwide***. As it has done for over 50 years (in part via the General Agreement on Tariffs and Trade, the World Trade Organization, and the U.S. Trade Representative), the United States must continue to encourage and stimulate free trade and economic development around the world. Free trade is the most effective means for alleviating poverty in developing countries. Poor countries, with high unemployment rates, are fertile ground for

the recruitment of future terrorists. Their economic health and national stability depend to a large extent on economic development that is stimulated by international trade. For example, Pakistan, a strategically important ally in the war on terror, employs over half of its industrial work force in textiles and apparel manufacturing. The continued openness of the U.S. market will help maintain Pakistan's stability and rising living standards. In general, the less poverty worldwide, the lower the likelihood of terrorism. Empirical evidence for the success of free trade and for the tendency of protectionism to impede progress on economic indicators can be seen in the contrast between various countries. In the years following World War II, Germany, Japan, Singapore, and South Korea adopted policies based on export-oriented industrialization. By contrast, China, India, Russia, and several eastern European countries adopted anti-trade policies, shutting themselves off from the world. History reveals that the free-trading group of countries performed much better in terms of economic growth and living standards.

Firms that believe themselves to be immune from the effects described above are asking for trouble. Proactive efforts to deal with terrorism and other disasters are needed. Such efforts have become more salient in recent years. The indirect effects of disasters hold the potential for massive harm to the interests of the nation and the world. Panicked efforts to deal with suddenly unfolding events are less likely to sustain SME performance in the absence of preparation. But we cannot expect those without resources to battle disasters on their own. Rather, it has to be those who possess the wherewithal, the imagination and the drive to lead the charge and make our lives safer and better.

TABLE 1

Intervention to Enhance National Resilience for Dealing with Disasters

The federal government can take various steps in order to enhance the ability of the nation's managers and firms to deal with terrorism and other national disasters. The more sound the economy and the more competitive the nation's industries are, the more resilient it will be for dealing with the aftermath of disasters. Programs should aim to strengthen the natural forces of the nation's economy by reducing the burdens and disincentives that are imposed by bureaucratic and regulatory intervention in the private sector. Key policy approaches include the following.

- Emphasize development of a ***high quality educational system***. This helps ensure citizens acquire the skills and flexibility needed to adapt and perform well in turbulent business environments.
- Encourage private sector ***investment in R&D*** on behalf of innovatory processes that create and maintain high-value-adding industries, such as robotics, microelectronics, biotechnology, software, and telecommunications. This can be accomplished by creating enterprise zones, reducing the tax burden on corporations, and providing tax credits for R&D outlays. Such industries provide higher levels of wealth, and generate technologies that can be used to combat terrorism and other emergencies.
- ***Avoid protectionism***, which tends to weaken national industries in the long run. Imposing tariffs and non-tariff trade barriers eventually impedes national economic development. The U.S. must continue to encourage free and fair trade worldwide, as a means of alleviating poverty, which is a major factor in the emergence of terrorism.
- ***Encourage savings and investment***. When citizens save their money, the resulting capital is used to fund public and private investment in infrastructure, innovation, productive assets, and skills development. This results in capital needed to prepare for and deal with national emergencies. The tax code can be structured to include incentives that encourage saving.
- Emphasize ***sound monetary and fiscal policies***. Emphasize monetary policies that maintain the value of the national currency at an optimal level for international trade and investment, and to help maintain a stable trading environment. A stable world economy contributes to lowering levels of terrorism and economic turbulence.
- ***Avoid deficit spending*** in the federal budget, as this reduces available capital and the ability of the country to invest for the long term, and to employ in preparing for, dealing with the aftermath of, disasters.
- ***Avoid excessive business regulation***. The regulatory burden imposed by well-meaning authorities interferes with market forces and reduces the real options for dealing with emergencies. Excessive regulation has actually *reduced* the ability of the U.S. to deal with a potential flu epidemic, by increasing the costs of R&D and by reducing the potential profitability of producing vaccines.

PROMOTING PRIVATE SECTOR EMERGENCY PREPAREDNESS

Testimony by Neil C. Livingstone, Ph.D.

before the Committee on Small Business

November 1, 2005

Washington, D.C.

Good morning and thank you for the opportunity to testify before the Committee today. I am Neil C. Livingstone, CEO of GlobalOptions Inc., an international risk management and business solutions company headquartered here in the nation's capital. I have authored nine books on terrorism and national security, as well as several hundred articles appearing in the nation's major newspapers and publications. I hold an A.B. from the College of William and Mary, three Masters Degrees, and a doctorate from the Fletcher School of Law and Diplomacy.

I have been working in the emergency management and business continuity area for more than two decades and previously served as an adjunct faculty member at the National Emergency Training Center in Emmetsburg, Maryland.

It is estimated that as many as 14,000 businesses were displaced by the 9/11 attacks in New York City.[1] Some of these businesses were located as far away as New Jersey and Connecticut.

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[1]Jennifer Friedin,"One Year Later: Small Businesses Still Recovering From 9-11 Attacks," Associated Press, 2002.

In the first forty-five days after the attacks, 3,400 businesses in the vicinity of the World Trade Center were inaccessible to customers, costing an estimated $800 million in lost sales. A total of 707 small businesses were inside or in the immediate vicinity of the World Trade Center complex.[2]

The figures are Hurricane Andrew equally stark. Some 8,000 businesses were seriously impacted by the hurricane. Of this amount just under 5,000 were small businesses, of which 90 percent were destroyed.

Every small businessman or businesswoman in America fears being a victim of a major disaster, be it a natural disaster like a flood, fire, hurricane, power blackout, tornado, or earthquake, or, more recently, a terrorist attack. This is because they don't have the capacity to recover like major businesses, which often have large corporate reserves and borrowing power, an international, national--or at least regional--footprint (permitting the shifting of resources and responsibilities), a diversified workforce, and far-flung markets and suppliers. The average small business employing fewer than one hundred workers, by contrast, generally has fewer than three locations (usually in the same area), a highly localized marketplace, and little in the way of capital reserves and credit lines. Thus, a major disaster can spell the end for a small business that is heavily damaged or destroyed. Its customers and workforce may drift away, and it may be difficult or impossible

[2]New York City Council.

to find adequate financial resources to restock its shelves or replace equipment and technology, even for companies with normal insurance coverage (since most businesses are underinsured). Indeed, after Hurricane Andrew two-thirds of all businesses, nearly all small businesses, that remained closed for more than three days never reopened their doors again.

This is why it is so important for small businesses to take necessary and appropriate steps to protect themselves and their employees in the event of a major disaster. To its credit, the federal government has made considerable progress in this regard. For the most part, however, this assistance takes the form of emergency management advice and recommendations.

The Department of Homeland Security maintains an excellent website (www.ready.gov) for private enterprises to prepare for terrorist attacks and other emergencies which contains checklists, brochures, sample plans, cost breakdowns, and other information.

The Federal Emergency Management Administration (FEMA) also offers information to the private sector, most notably their publication Emergency Management Guide for Business and Industry: A Step-by-Step Approach for Companies of All Sizes. While comprehensive, it is over a decade old and very much needs to be updated, particularly in light of new terrorist threats like nuclear, chemical and biological attacks. FEMA also has launched a "Risk Management Series" of publications that can be helpful, such as the recent report entitled, Reference Manual to Mitigate

Potential Terrorist Attacks Against Buildings.

While similar information designed for small businesses operating abroad is scarce, the State Department's Overseas Security Advisory Council makes available a number of publications, including Security Guidelines for American Enterprises Abroad and Emergency Planning Guidelines for American Businesses Abroad.

Small Businesses: On Their Own?

The Small Business Administration (SBA) offers various loan options for qualified companies impacted by disasters, but its efforts are largely focused on recovery rather than prevention and avoidance. The SBA's website, under the heading "Get Ready/Be Prepared," offers advice on preparing for disasters, but much of the information is rather general and too often obvious. "The best time to respond to a disaster is before it happens,"[3] notes the website, which goes on to suggest that small business owners may want to "identify the hazards you may face."[4] Some of the advice is absolutely gratuitous such as: "Guard against the loss of your customer base by diversifying your product lines, sales locations, or target customers."[5] While a laudable goal, there are often compelling reasons why small businesses cannot do such things,

[3]Small Business Administration website, "Get Ready - Be Prepared," p. 1.

[4]Ibid.

[5]Ibid.

including lack of capital and strong competition in other markets.

There have been several proposals to provide tax credits to businesses in order to implement anti-terrorism measures, most notably H.R. 3562. While such legislation has not yet been enacted into law, anything that can be done to incentivize small business to better prepare for disasters and emergencies should be encouraged. If, as the old saying goes, an ounce of prevention is worth a pound of cure, then surely every dollar prudently invested by small businesses in disaster preparations and avoidance will save many times that amount in future tax revenues, insurance reimbursements, and unneeded government recovery subsidies and payments. Thus, the SBA should be encouraged to take a much more aggressive and proactive role in preparing small businesses to adopt and implement appropriate crisis management/business continuity plans, along with steps not only to reduce their vulnerabilities but to recover more rapidly from cataclysmic events like 9/11 and Hurricane Rita.

Preparing for Disasters

But today I would like to focus the balance of my remarks on some of the specific actions that can help small businesses protect themselves, their employees, their shareholders (where applicable), and their investments. Every business, no matter how large, should perform some kind of risk assessment and, predicated on that,

develop a crisis management/business continuity plan. As a start I would refer those interested to the Department of Homeland Security "www.ready.gov" website for more information.

I have seen figures suggesting that thirty-eight percent of all small businesses have some kind of crisis management/business continuity (CM/BC) plan, but my personal experience suggests the figure is far lower. Perhaps the greatest oversight by businesses, large and small, once they have a CM/BC plan is that they put it on a shelf and really don't exercise and update it on a regular basis. All CM/BC plans should be living documents, constantly updated and changed as experience and circumstances warrant.

Templates for CM/BC plans are available on a number of websites, but all good plans ultimately depend on security and risk assessments which have traditionally been performed by professionals, often at considerable cost. A number of software tools for conducting security and risk assessments exist, with easy-to-follow checklists and recommendations, but all are fairly expensive and most have a large business bias. If the SBA bore the cost and made such software, tailored to small business, available on line, it would greatly facilitate the ability of individual firms to identify potential risks and hazards, and to measure and assess their own security standards and emergency preparations.

While many disasters, like terrorist attacks and earthquakes, cannot be anticipated with any certainty, other disasters like hurricanes can. I was amazed by how few companies in Florida and

on the Gulf Coast redeployed their vital assets, like vehicles and equipment, to other, more protected, locations. This was true of critical public assets as well. The flooded school busses in New Orleans, which could have been used to evacuate people to safer locations, were perhaps the most obvious example of the failure to plan by the city government, but such incompetence was not limited to New Orleans. CNN broadcast an interview with a frustrated sheriff on the Mississippi coast who complained that he didn't have any police vehicles left because they had all been destroyed by the storm surge. He was standing in front of his destroyed police station with the ocean clearly visible in the background. One would have thought--given his proximity to the ocean--that he would have pulled back his key resources, perhaps twenty or even fifty miles inland, so they would have had a greater probability of surviving the approaching hurricane. By the same token, small businesses, in advance of a problem, should scout backup sites where they can operate, or at least protect key assets, in the event of a major disaster. This could be as simple as a motel and a set of storage lockers in another community. Federal property and facilities could also be made available during emergencies, as long as all liability issues are waived by participating businesses, for the offsite repositioning of vehicles and storage of valuable corporate assets.

One of the major problems after 9/11 was the need to account for all employees of the various firms affected by the attacks, to

determine who was dead and who was alive. With the destruction of the towers, survivors were scattered throughout city, some in hospitals, others having walked to even the outer boroughs where they found shelter with friends and relatives. Prior to the attacks, a law firm in one of the towers kept track of its employees, like many other companies, on an in-and-out board in the reception area. Employees typically moved a bead on the board to the appropriate position indicating whether they were in the office or not. Every one of those attendance boards was destroyed when Towers One and Two collapsed and it took days, and in some cases weeks, for companies to learn the fate of all of their employees.

To address this problem, several access control companies, which often have excess bandwidth, have instituted systems where employees of a firm are all issued cardkeys permitting them to enter the building and their respective office suites. As they pass through various portals, their presence is automatically noted and the information passed to an offsite computer. In the event of an emergency or evacuation, it is an easy matter to ascertain the whereabouts of virtually every employee.

Backup copies of all critical business data should also be stored offsite, such as insurance policies, incorporation papers and bylaws, and customer and vendor records. We are working with another small business which has three offices--in New York, Chicago, and Los Angeles--to ensure that if one office is affected by some kind of calamity that the other offices can pick up the

load and even provide temporary working space to key executives from the stricken area. This involves configuring their data storage systems so that all corporate records are accessible to all three offices and an offsite location, instead of each office keeping its own records.

Communications are another major problem. After 9/11, many landlines and most cell phones didn't work in New York and Washington. We recommend to our clients, especially if they are in disaster-prone areas, that they purchase at least a limited number of satellite phones to ensure that they will have uninterrupted communication with their clients, vendors, and other locations in the event of an emergency. Satellite phones are no longer prohibitively expensive and should be deductible as a business expense.

One of the major problems arising after many disasters or even as a result of severe thunderstorms, which can occur almost anyplace, is the interruption of power. Our complex modern world is absolutely dependent on electricity; little runs without it. Virtually every emergency planning guide recommends that businesses acquire generators, despite the risks inherent in storing fuel at a residence of workplace. While a generator will provide some relief, many key functions will generally depend on the restoration of service by public utilities. In the wake of the most recent hurricane to strike Florida, ATM machines, gas pumps, and traffic lights were still not working days after the storm cut a path of

destruction across the state. Thus, small business owners need to anticipate the absence of such basic services and plan accordingly. I know of nothing that substitutes for a bundle of cash in the aftermath of a disaster. Credit, it seems, is in short supply after disasters and cash talks.

A colleague of mine, a former Navy SEAL, was able to amass more than $250,000 in cash after Hurricane Andrew struck Florida more than a decade ago. When he reached south Florida, he proceeded to buy every generator he could find, rent motel rooms for company employees who had lost their homes, acquire new space to set up temporary workstations, and even provide personal loans to employees in need. He later reflected that the only thing they were missing was paper, since "all the paper in south Florida was wet." They were able to locate a box of yellow post-it notes and all of their loan agreements and other corporate transactions were transcribed in tiny, crimped writing on the post-it notes until they could get their laptops up and running and find dry paper for their faxes and other business equipment.

Survival Kits

In the final analysis, disaster planning and preparation begins and ends with individual employees and their families. To this end, every business, small and large alike, should have survival kits, with a first aid component, at every location, and

it should encourage every employee to have a similar, though less extensive, kits at home and in the car. For the composition of each kit see Appendix One.

Conclusion

While private enterprise does have a natural incentive to protect its assets and employees, small businesses often lack the time and resources to do so. The government can help small businesses, where the problem is most acute, by providing appropriate incentives to prepare for emergencies. Tax credits are a good method but may, depending on their scope, place unacceptable stresses on the federal budget. A more immediate and less expensive solution is to provide more informational tools to small business, in the form of software for conducting risk and security assessments. The government, moreover, is a great repository of informational resources that can assist small business in making better preparations for emergencies and security decisions. I urge that this becomes a top priority for this Committee and the Small Business Administration.

At the same time, the government should refrain from setting obligatory emergency preparedness and security standards for small businesses, which are already overburdened by government regulations and red tape.

Again, thank you for the opportunity to testify today and for your attention.

APPENDIX ONE

Survival Kits

Go Bag

Contents:

- Small backpack for storage
- Sterile bandages
- Antiseptic Pads
- Aspirin or mild pain reliever
- Potassium Iodide
- Small flashlight with extra batteries
- Water (small bottle)
- Dust Masks / Face Masks (n95)
- Disposable poncho (fallout protection)
- Whistle
- Handheld Radio (for secondary communications)
- Prescription Medication, 3 day supply
- Extra eye glasses for children
- Cash - small bills

Car Kit - Basic

- Small backpack for storage
- First Aid Kit (see detailed list)
- Large flashlight with extra batteries
- Water (8 small bottles)
- Dust Masks / Face Masks (n95)

- Disposable poncho (fallout protection
- Handheld Radio (for secondary communications)
- Snack Bars

Car Kit - Crisis (to augment Car Kit - Basic)

- Large duffle bag for storage
- NOAA Weather Radio with extra batteries
- Candles with matches
- Large Plastic bags (for trash or contaminated clothing/items)
- Water (2 gallons recommended)
- Utility Knife
- Handheld compass
- 1 day emergency food supply "Meals-Ready-to-Eat (MRE)
- Chemical Protective Suit and Mask (first priority location)
- Duct Tape, Plastic Sheeting, Towels
- Utility Gloves
- Household chlorine bleach (for decontamination)
- Toilet Paper
- Blankets (Space & Cloth)
- Case - small bills
- Extra Eye Glasses
- Family Documentation (see detailed list)
- Complete change of clothes per person (long-sleeve, long-pants)

- **Toiletries**
- **Prescription drugs (3 week supply)** Medication you take every day such as insulin, heart medicine and asthma inhalers should be included. You should periodically rotate medicines to account for expiration dates.

First Aid Kit (A component of House, Office and Car kits.) Each of the three First Aid Kits contains the items listed below under **Contents**. A list of items that are recommended but not provided in the First Aid Kit are listed under **Recommended Items.** The First Aid Kit is intended for injuries that are not life threatening and do not require immediate medical attention.

Contents:

- **Sterile adhesive bandages in assorted sizes**
- **Assorted sizes of safety pins**
- **Cleansing agent/soap**
- **Latex gloves (2 pairs)**
- **Sunscreen**
- **Sterile gauze pads in assorted sizes**
- **Non-prescription drugs (provided):**
  - **Anti-diarrhea medication**
  - **Antacid (for stomach upset)**
  - **Laxative**
  - **Painkillers (Tylenol, Ibuprofen, generic aspirin)**
- **Sterile roller bandages**
- **Ace (type) stretch bandage**
- **Scissors**
- **Medicine dropper**
- **First Aid booklet**

- Tweezers
- Antiseptic Wash
- Thermometer
- Tube of petroleum jelly or other lubricant
- Potassium Iodide
- Syrup of Ipecac (to induce vomiting - if advised by the Poison Control Center)
- Activated charcoal (use if advised by the Poison Control Center)
- **Prescription drugs (3 week supply)** Medication you take every day such as insulin, heart medicine and asthma inhalers should be included. You should periodically rotate medicines to account for expiration dates.

Home Kit

Contents:

- Large plastic containers for storage
- First Aid Kit (see detailed list)
- Large flashlight with extra batteries
- Flashlight/Lantern Combo with extra batteries
- NOAA Weather Radio with extra batteries
- Candles with matches
- Large Plastic bags (for trash or contaminated clothing / items)
- Blankets (Space & Cloth
- Water (preferably 3 gallon per person per day)

- **Utility Knife**
- **3 day emergency food supply "Meals-Ready-to-Eat" (MRE)**
- **Dust Masks / Face Masks (Type n95)**
- **Duct Tape, Plastic Sheeting, Towels**
- **Large Bucket with lid & Toilet Paper (potential toilet)**
- **Disinfectant Wipes**
- **Household chlorine bleach (for decontamination)**
- **Utility Gloves**
- **Extra Car Keys**
- **Cash - small bills**
- **Complete change of clothes per person (long-sleeve, long-pants)**
- **Toiletries**
- **Extra Eye Glasses**
- **Family Documentation (see detailed list)**
- **Prescription drugs (3 week supply)** Medication you take every day such as insulin, heart medicine and asthma inhalers should be included. You should periodically rotate medicines to account for expiration dates.

<u>Office Kit</u>

Contents:

- **Large plastic containers for storage**
- **First Aid Kit (see detailed list)**
- **Large flashlight with extra batteries**
- **NOAA Weather Radio with extra batteries**

- **Large Plastic bags (for trash or contaminated clothing/items)**
- **Water**
- **Blanket**
- **Utility Knife**
- **Handheld compass**
- **4 MRE's (1 meal for the entire family)**
- **Dust Masks / Face Masks (n95)**
- **Chemical Protective Suit and Mask (secondary location for storage)**
- **Duct Tape, Plastic Sheeting, Towels**
- **Large Bucket with lid & Toilet Paper (potential toilet)**
- **Whistles**
- **Extra Car Keys**
- **Cash - small bills**
- **Complete change of clothes per person (long-sleeve, long-pants)**
- **Toiletries**
- **Extra Eye Glasses**
- **Family Documentation (see detailed list)**
- **Handheld Radio (for secondary communications)**
- **Prescription drugs (3 week supply)** Medication you take every day such as insulin, heart medicine and asthma inhalers should be included. You should periodically rotate medicines to account for expiration dates.

Embargoed until, 2:00 pm November 1, 2005

Statement of Barry W. Scanlon, Partner, James Lee Witt Associates
and
Former Director of the Office of Corporate Affairs, Federal Emergency Management Agency (FEMA)
Before the Small Business Committee
United States House of Representatives

November 1, 2005
(as prepared for delivery)

Chairman Manzullo and distinguished members of the committee, thank you for inviting me to participate in this hearing today. I appreciate the opportunity to come before you today to share my thoughts on private sector emergency preparedness, which come from my experiences serving as the Director of Corporate Affairs at the Federal Emergency Management Agency (FEMA) and as a Partner of James Lee Witt Associates, a public safety and crisis management company founded by Former FEMA Director James Lee Witt.

In my testimony, I would like to convey to you some of the ideas and lessons learned through my personal experience at the Federal Emergency Management Agency and from the experience of Mr. Witt and many of my colleagues in responding to over 340 federal disasters during his eight years of services as the agency's director. Most recently, in the wake of Hurricane Katrina, Witt Associates has been hired by the State of Louisiana to assist and advise the State on all aspects of the disaster recovery.

Through many of the projects undertaken by James Lee Witt Associates since 2001, we have served as a bridge between the public and the private sectors and have come to understand how each side view the other. Whether working with our partner firms and the diverse local government stakeholders involved in a local public awareness and education campaign, engaging and advising business interests such as the members of the Illinois Terrorism Task Force, or collaborating with and training the universities involved in a state-wide university preparedness initiative, our firm has supported private-public partnership development by helping the various stakeholders achieve their specific preparedness goals. Additionally, we have worked with a number of public utilities to evaluate and improve preparedness levels, response capabilities, and community outreach and public communications programs.

Each of these experiences has underscored the real gap that exists between the public and the private sector surrounding emergency preparedness issues, but also the real potential for collaboration on all levels of government.

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In this testimony, I would like to share some background information about past business preparedness initiatives; discuss a number of current relevant efforts; and then propose a number of recommendations for moving forward.

I. Background/Past Preparedness Initiatives

The impetus for the Office of Corporate Affairs, established by then-Director Witt came from the experience of implementing the Project Impact Initiative. *Project Impact: Building Disaster Resistant Communities* was a public-private partnership initiative whose goal was to motivate communities to take responsibility for their own preparedness.

I had personally seen the devastation of disasters, having traveled around the country as a Disaster Assistance Employee for several years. Former Director Witt asked me to help start the program by working closely with the seven pilot communities, chosen in part for because of their disaster vulnerability and geographic and socio-economic diversity.

Project Impact represented the first time that Congress ever appropriated money for mitigation that was not tied to the recovery from a recent disaster. Grantee communities formed groups of stakeholders which were charged with assessing the community's risks and prioritize their mitigation strategies. These stakeholders groups then implemented mitigation projects that they had decided upon. In order to build upon their success, we encouraged program participants to communicate their successes to other communities through the media and at annual summit meetings.

We learned very quickly that the business community was a very valuable stakeholder in this process. As we have all learned from the experience of catastrophic events such as Hurricane Katrina and September 11th, disasters devastate lives. They also can have incalculable costs to the economy.

Therefore, the business community became a valuable participant in our project as we sought to tailor our message of preparedness and mitigation to small business owners, to medium sized firms, and to large firms who own a large portion of the nation's critical infrastructure.

We also found that business became a key partner in our project as well. Business leaders understood the importance of preparedness and they supported the project through donations of time, money, and resources. For many communities, the federal funding they received was only seed money which was matched by in-kind and other donations from local and national business partners.

II. Current Efforts

As the government now focuses anew on the mission to protect and prepare the homeland, many people have recognized the need to engage the private sector in a meaningful way. Private sector initiatives such as Business Executives for National Security and the Institute for Business and Home Safety as well as public sector

initiatives such as the Department of Homeland Security's Private Sector Office are steps in the right direction.

Additionally, the Great Lakes Partnership, a public-private partnership initiative involving business and civic leaders in the greater Chicago area, is one example of many ad-hoc local initiatives which are attempting to tackle the issue of private sector preparedness. Another Chicago initiative, ChicagoFIRST, brings together business leaders specifically from the financial sector with emergency management stakeholders. Through this effort Chicago's financial sector has already been able to achieve a number of its goals including:

- securing a seat at Chicago's Emergency Operation Center (EOC)
- developing and communicating standard evacuation and shelter-in-place procedures to protect financial services industry personnel in a disaster; and
- creating passes for essential personnel to safely gain access and use business facilities should access to the Chicago Loop be restricted following a disaster.

While much of ChicagoFIRST's planning work was done with a major terrorist or natural disaster scenario in mind, LaSalle Bank saw the benefits of the program in a non-terrorist emergency situation. During the response and recovery following the massive high-rise fire at LaSalle's Chicago headquarters last December, essential personnel gained access to the building to access essential databases and other company resources.

III. Recommendations

Although there are many ways that the federal government can engage the private sector, what is lacking is the set of concrete steps forward to cement this partnership. Federal government leadership is needed to build upon and support local successes and to provide a national strategy.

I have four recommendations to ensure a successful federal effort.

1. Organize any preparedness effort around all-hazard preparedness.

Since September 11th and the creation of the Department of Homeland Security, the government has shifted its focus on preparedness from an all-hazards approach to one that focuses heavily on terrorism preparedness, a shift which I believe may have contributed to some of the government's failures in recent months. I urge the government that in any new programs created to address private sector preparedness that all efforts take on the all-hazards approach.

Businesses are more likely to face an emergency which causes a minor business interruption such as a loss of power or severe weather than they are likely to be impacted by a terrorist attack. It is therefore much easier to convince businesses of the utility and bottom-line benefits of preparedness if they are forced to consider all of the possible hazards they may face.

The all-hazards approach is useful not only in helping motivate businesses to participate, but it also ensures that their planning and protective measures prepare them for the right risks.

(In addition, Mr. Chairman, I have included for your consideration the testimony of my partner, James Lee Witt, who appeared before the Subcommittee on National Security, Emerging Threats and International Relations and the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs in March, 2004. He testified on what we believe is a very important issue: re-establishing FEMA as an independent agency that reports solely to the President of the United States. Re-establishing FEMA as an independent agency will help to ensure that the United State Government is prepared for all-hazards as well.)

2. Fund a federal public-private preparedness initiative which addresses the reasons why businesses don't prepare for emergencies and makes the business case for preparedness.

Congress should once again create a federally fund a preparedness initiative which gives grants to local stakeholders. Particular attention should be paid to small business. As recent events have underscored, individuals from the lowest socio-economic classes suffer the greatest from catastrophic events. Likewise, small businesses have access to the least amount of resources and suffer most. A study commissioned during my time at FEMA found that over one third of businesses that are forced to close during a disaster never re-open.

A report from the Congressional Budget Office from December 2004[1] looked at the role of the private sector in homeland security. Among many interesting observations, the report puts forward a framework for understanding why the private sector does not voluntarily pay for emergency preparedness. The main idea is that there is a gap between the real costs of disasters to society when business is impacted and the costs to individual businesses to be prepared. The problems resulting from these unequal costs are compounded by the fact that the possibility of a "moral hazard" exists. That is, another reason businesses don't prepare adequately is that they believe that the government will reimburse them for major losses in the wake of a catastrophic event.

The CBO report details three potentially policy remedies to close theses gaps and resolve the moral hazard problem. They include "internalizing the costs of security" (or in our case preparedness) through regulations to affect business behavior for example, through taxes or incentives; "socializing the costs of security" or, in other words spreading the costs throughout society by funding programs through the government; or "providing better information for making security [or preparedness] decisions."

Interesting, though we didn't think about it in those terms at the time, the Project Impact initiative was based on the second and third of the possible approaches. We used federal

[1] The Congress of the United States. Congressional Budget Office. *Homeland Security for the Private Sector.* December 2004. www.cbo.gov/showdoc.cfm?index=6042&sequence=0&from=0#anchor

dollars as seed money to start the project, and we incorporated a public outreach and education component to the program by promoting preparedness and the reasons why it made sense. We also did what we could to quantify the costs of disasters and to justify why investing in preparedness was worthwhile in cost savings. In our outreach efforts, we relied on case studies of where preparedness had worked.

There have been several more recent efforts at making the business case for preparedness. For example, the Council on Competitiveness' Competitiveness and Security Initiative[2] has formed a steering committee to look at many of the relevant issues. The federal government would be well-served to fund research in to this area as the results will likely be an important motivator for businesses and help to close the information gap.

Incidentally, while discussing federal funding, it is worthwhile to note past experience shows that small investments in targeted projects such as research or public-private partnership initiatives such as Project Impact can have disproportionately large impacts. With $25 million, we were able to launch an initiative that involved more than 250 communities and over 2,500 businesses. There are a number of existing federally funded programs today that could incorporate the private sector at a marginal cost. For example, in the last year the federal government spent millions of tax dollars funding state and local emergency preparedness exercises. But how many of those exercises involved members of the private sector? They could easily be included at a minimal cost.

3. Create an Emergency Support Function for economic recovery.
On the recovery side, we can better prepare by better organizing our recovery. We need to incorporate business recovery as one of the key components of the government's disaster recovery services.

To organize the federal government's emergency response, its activities are grouped in to categories called Emergency Support Functions or ESFs. Each ESF is the responsibility of a federal agency. For example, transportation, defined as providing civilian and military transport, is the responsibility of the Department of Transportation. Public works and engineering, the restoring of essential public services and facilities, is the responsibility of the U.S. Army Corps of Engineers, Department of Defense. Firefighting is the responsibility of the U.S. Forest Service, Department of Agriculture. The remaining ESFs include: information and planning (Federal Emergency Management Agency), mass care (American Red Cross), resource support (General Services Administration), health and medical services (U.S. Public Health Service, Department of Health and Human Services), urban search and rescue (FEMA), hazardous materials (Environmental Protection Agency), food (Food and Nutrition Service, Department of Agriculture), and energy (Department of Energy).

The obvious area that is not addressed among these ESFs is economic recovery. There should be an ESF on the federal level for business recovery. A number of jurisdictions on the local level have already incorporated an ESF, #18 for Business and Industry—for example, Chatam County, Georgia and Collier County, Florida.

[2] http://www.compete.org/cs/

As we have seen through Hurricanes Katrina and Rita, coordination among the federal government agencies proved a difficult task. As we look forward to improving our capacity to respond effectively, economic and business recovery should be an integral part of the recovery process. Dedicating an ESF to economic and business recovery, and giving the private sector official representation would help expedite programs relevant to economic recovery. In a major presidentially declared disaster, each ESF has a representative which participates in daily status update meetings, and reports on progress relevant to its area and upcoming needs. Giving business leaders a seat at the table would no doubt ensure that private sector needs were understood and addressed more quickly and efficiently.

4. Improve and strengthen the Small Business Administration's disaster loan programs

I know that you heard in last month's testimony about the importance of the Small Business Administration's loan program to small businesses after disasters. I completely concur that this program is vital to small business in that it provides essential liquidity to help them avoid having to shut-down in the wake of a major business interruption. In my experience, the SBA was a valuable partner to FEMA in providing post-disaster assistance to both businesses and individuals.

The recent catastrophic disaster has underscored that this program should be strengthened and improved in any way possible. I know that a number of specific recommendations were made in last month's hearing regarding SBA loans. I want to emphasize the importance of strengthening these programs. Just as we immediately dispatch responders to provide food, water, and clothing, we should also immediately dispatch loan officers, insurance adjusters, etc. to areas affected by disaster. Shortening the recovery time process for business by even a few days can make a measurable difference on a disaster's economic impacts.

In the immediate aftermath of a disaster, the focus on people's essential needs, health, and safety is well-placed. However, in the medium and long term, economic recovery has obvious ties to social recovery. The SBA loan program bridges a gap for small business, but its implementation would be greatly facilitated by officially including it as part of the government's emergency response functions.

Thank you again, Mr. Chairman, for inviting me to speak. I would be happy to answer any questions that you or the other distinguished members of the committee might like to ask.

end

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Embargoed until 1:00 p.m., March 24, 2004

Statement of James Lee Witt, President, James Lee Witt Associates
and
Former Director of the Federal Emergency Management Agency (FEMA)
Before the Subcommittee on
National Security, Emerging Threats and International Relations and the Subcommittee on Energy Policy, Natural Resources and Regulatory Affairs

March 24, 2004

(as prepared for delivery)

Chairmen Ose and Shays, and members of the committees, thank you for inviting me to participate in this hearing today.

I appreciate the opportunity to come before you today to share my thoughts which come from 25 years in emergency management at the local, state and federal levels.

First let me say that I am extremely concerned that the ability of our nation to prepare for and respond to disasters has been sharply eroded.

I would urge that as you look at the consolidation of offices and other areas of concern at DHS, you analyze them for their effect on the local, state and federal partnership for an all-hazard approach to emergency and consequence management – which have been harmed by DHS actions to date.

During my tenure at FEMA, the staff and resources in our regional offices enabled our agency to maintain strong relationships with our state and local partners and the other federal response plan agencies in these cities. These relationships were critical for effective communication and coordination before, during, and after a disaster. The relationships built over the years facilitated our ability to pre-position staff and resources in advance of hurricane or flood disasters and helped expedite efforts in catastrophic disasters like the Northridge earthquake.

Through on-going training and exercise and the administration of our performance partnership agreements with the states in their areas, our regional staff were able to truly know the state and local capabilities – both strengths and weakness – so that our FEMA team could hit the ground running during a disaster. The relationships that were built over the years - during disaster and non-disaster experiences - allowed the regions, and the entire agency, to accurately identify the needs of the states and local governments, first responders, and disaster victims.

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I think you should carefully scrutinize any actions that would further harm these important partnerships.

I feel very strongly that these people on the front lines of the defense of our homeland, must have input into the policies of DHS – especially in the discussion of regional and field offices.

Everyone agrees that creating DHS has been and continues to be a monumental and very difficult task. While many elements are providing essential security for our nation, I and many others in the emergency management community here and across the country are deeply concerned about the direction FEMA and the all-hazard mission are headed.

I hear from emergency managers, local and state leaders, and first responders nearly every day that the FEMA they knew and worked well with has now disappeared.

In fact one state emergency manager told me "it is like a stake has been driven into the heart of emergency management."

They are suffering the impact of dealing with a behemoth federal department, rather than the small but agile independent agency that coordinates federal response effectively and efficiently and understands the needs of its local and state partners.

They are concerned that the successful partnership that was built and honed over many years between local, state and federal partners and their ability to communicate, coordinate, train, prepare and respond has been going down hill.

And they are at a loss as to how to work with the federal government now and fear for their communities should a catastrophic disaster occur.

So what is it that is causing this concern?

First, many critical programs have been cut or dramatically altered.

The cuts in Emergency Management could result in more than half of the country's 4,000-plus emergency managers losing their jobs.

Their poor communication with the press endangers the ability to get out critical information to the public during a disaster.

Lack of information on grants makes it impossible to know if the money is being spent in the best way possible

By cutting funding to medical teams they are diminishing our nation's ability to properly care for victims

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Moving fire grants against wishes of the stakeholders.

Cuts to the Emergency Management Institute and National Fire Administration classes greatly reduce our preparedness

And there are many others.

Second, FEMA, has lost its important status as an independent agency. Instead it has been buried beneath a massive bureaucracy whose main and seemingly only focus is fighting terrorism and while that is absolutely critical, it should not be at the expense of preparing for and responding to natural disasters. While the likelihood of another terrorist attack on our land may be inevitable, it is an absolute certainty that our country will experience more natural disasters and there is no question that some will be catastrophic. It is not a matter of "if" it is a matter of when and where.

Third, the FEMA director has lost cabinet status and with it the access and the close relationship with the president and cabinet affairs. I assure you that we could not have been as responsive and effective during disasters as we were during my tenure as FEMA director had there been layers of federal bureaucracy between myself and the white house. Just one degree of separation is too much, when time is of the essence and devastating events are unfolding rapidly.

I firmly believe that FEMA should be re-established as an independent agency, reporting directly to the president - but allowing for the secretary of homeland security to task FEMA to coordinate the federal response and perform its historical duty of consequence management following a terrorist or any other kind of disastrous event.

What gives me hope about the future is that this committee and other like-minded leaders in congress are trying to help DHS sort through the many issues on their plate, to connect with their customers in state and local government, and to align themselves with a regional and field office structure that serves their customers well and allows them to efficiently achieve the important goal of a safer homeland.

Thank you again for the opportunity to appear before you and I would be glad to answer any questions that you may have for me.

end