

# Response to Environment Food and Rural Affairs Committee inquiry into the government's approach to flood risk

## Summary

This response addresses two of the points given in the terms of reference with a particular focus on Small and Medium Sized Enterprises (SMEs). This response is drawn from the knowledge gained from a research on the 2016 floods. Despite it is not about the recent floods, the evidence that underpins this response<sup>1</sup> provides valuable lessons, analysis and new evidence that can inform how to move forward the approach of the Government towards SMEs flood risk management. It offers insights from 319 businesses, 39 semi-structured interviews with insurers, national and local government officials, academics, charities and organisations that support flooding efforts and/or support SMEs. The findings provide new evidence of the challenges that SMEs have around insurance, as well as the strategies that SMEs employ to manage flooding and the opportunities that can be made available to them to increase their resilience. The results have been informing key actors and we have a new research project<sup>2</sup> to continue pushing the knowledge frontiers of this matter, but there is an urgent need to prioritise the development of a flood protection policy framework to encourage the resilience of SMEs so they are prepared not only for the next flood, but also for future climate change, and other risks.

## About the author

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## Response to selected questions posed by the inquiry

Given the challenge posed by climate change, what should be the Government's aims and priorities in national flood risk policy, and what level of investment will be required in future in order to achieve this?

SMEs are the backbone of the economy and the Government should prioritise the development of a flood protection policy framework to increase the resilience of SMEs, so they are prepared not only for the next flood, but also for future climate change. The

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<sup>1</sup> [Sakai, P. \(2020\)](#) Should Flood Re be extended to SMEs? Leeds, June. Centre for Climate Change Economics and Policy, and the Sustainability Research Institute, School of Earth and Environment, University of Leeds.  
[Sakai, P. \(2020\)](#) Submission to Call for Evidence to the House of Commons Environment Food and Rural Affairs Select Committee inquiry into the government's approach to flood risk of inland flooding in England. Leeds, July. Centre for Climate Change Economics and Policy, and the Sustainability Research Institute, School of Earth and Environment, University of Leeds.

<sup>2</sup> <https://icasp.org.uk/projects/bridging-the-knowledge-gap-to-boost-sme-resilience/>

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evidence that is presented here is clear in that there is a need to change the approach on how we assess the impact of flooding on SMEs, as there are many hidden factors that mislead the real impacts. The evidence shows how the smaller the business, the bigger the economic losses, and shows that examining the losses relative to turnover and number of employees can better reflect the real size of the impacts of flooding on SMEs. For example, for businesses with 0-4 employees, the economic costs represented 423% more of what they earn in one month. This means that a particular SME would need to have had savings of 4 months of its average income to make up for the economic impact of one flood event. The average economic costs are £46,500. If that money was invested to build the resilience of that SME prior the flood event, then no loss would have been incurred and the local economy could have recovered in a better manner. The Government should facilitate capacity building processes so SMEs are able to protect themselves. The government should also have a more coherent message and, instead of providing grants to recover, which might create a moral hazard, money should be made available to build resilience prior a flood event. The economic costs of flooding on SMEs are significant and they exert ripple negative effects in the communities at flood risk and beyond. Flood impacts on SMEs could trigger a downward-spiral effect that can erode the character and vibrancy of towns and the wellbeing of their inhabitants. Resilient towns need resilient homes and resilient SMEs. The Government should enable mechanisms to overcome the barriers of flood protection of SMEs. For instance, there is a genuine need to ensure the affordability and accessibility of insurance in flood risk areas. The evidence offers valuable analysis and insights that can inform the development of this framework, and the various findings contribute to advance the discussion.

How can housing and other development be made more resilient to flooding, and what role can be played by measures such as insurance, sustainable drainage and planning policy?

Insurance can play a big role in building resilience on SMEs' premises. However, the Government should intervene, as there is a market failure in terms of imperfect information that insurers have on the economic costs of flooding on SMEs. This is preventing flood protection of SMEs. There is a lack of understanding on the economic costs of SMEs and the risks they represent to the insurance industry. This uncertainty is translated into the price. Despite efforts made to work with SMEs by the industry, there are still questions regarding the affordability of the industry innovations, particularly for the smallest SMEs, for instance, for SMEs with 0-4 employees, the average costs of insurance would equal their average monthly sales. Insurance could be a driver for self-protection if it is tied to the take-up of resilient measures, and this is reflected in the price or conditions of insurance. SMEs not only would appreciate being recognised for their self-protection, but would also be encouraged to adopt property resilience measures. Nonetheless, this demands a better understanding of the economic costs of flooding on SMEs, as well as of the effectiveness of resilience measures that can be put

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in place, and the implementation of related standards and accreditation schemes. The research underpinning this enquiry explores the question, 'Should Flood Re be extended to SMEs?', and it details the major barriers and the benefits of that. Creating a new Flood Re scheme that enables and prepares SMEs for a future of affordable insurance, where the government and the UK insurance industry join efforts to support and incentivise community resilience might not be the answer to all SMEs, if the political will and the industry appetite are not there. Explorations should be made to include at least some type of SMEs, such as home-based businesses, the smallest SMEs and landlords. As the evidence shows, home-based businesses need extra support as they experience double impacts when flooded, e.g. a Bed & Breakfast might not be able to accommodate guests so it will have a negative economic consequence on the livelihood of the owner, while also the owner might be left without a place to live. Schemes such as Flood Re could be explored to include this type of firm so they are incentivised to implement property resilience measures, and it is protected in the future. Explorations should be made regarding if the number of employees and the turnover could serve as a proxy to determine affordability of insurance (like Council tax bands are for households) as this evidence showed the importance of looking at the relative size of the firm. In terms of businesses that rent their premises also have double economic impacts if the premises are flooded. There is an economic repercussion to the SME that rents, in addition to an impact to the landlord's income (e.g. cover repairs, deal with unpaid rents, ending contracts early), that without considering the impact to the town if the business is closed. The Government should require that there is clarity in tenancy agreements between landlords and SMEs regarding flood risk management responsibilities. And, landlords should be encouraged to take up insurance linked with investments in property resilience measures.

### **Key messages and recommendations**

A unified flood risk management framework for SMEs is urgently needed. This evidence offers valuable analysis and insights that can inform the development of this framework, and the various findings contribute to advance the discussion. Encouraging the creation of resilient SMEs is a worthy effort as the economic impacts they experience have ripple effects across local and regional economies. Moreover, wetter future winters that are expected with climate change, and black swans such as Covid-19 give us the opportunity to re-think the urgent need to increase the resilience of this vital actor of the socio-economic system, which not only drives employment and growth, but also constitutes an essential fabric of our communities.

Economic costs of flooding on SMEs are significant to towns and cities. The negative consequences on SMEs exert ripple effects in their communities, thus SMEs should protect themselves, and their protection should be of interest to the wider community, local and national Government.

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Size and turnover should be taken into account when assessing the economic losses of flooding on SMEs and insurance affordability to better understand the extent of the issue.

There is a genuine need to offer better and affordable insurance products to SMEs in flood-risk areas. But, there is imperfect information that insurers have on the economic costs of flooding on SMEs, and the effectiveness of property flood protection. More needs to be done to fill-in the gap in the understanding the economic costs of SMEs and the effectiveness of property flood protection to offer affordable and suitable insurance products in flood-risk areas.

A new joint partnership of the Government and the insurance industry should be established for towns at flood risk. Insurance could be a driver of self-protection and a driver to unlock investments if it is tied to the take-up of resilient measures and reflected on the price. The Government should seize the opportunity to establish a new joint partnership with the insurance industry focused on SMEs in towns at flood risk, home-based businesses, the micro businesses and landlords should be prioritised.