

Diagram 5: Considerations before opting for insurance.



#### 1. Considerations before opting for Insurance

When deciding whether to insure or not, one needs to weigh the cost of transferring the risk against the cost of bearing the loss, that may arise, oneself. The cost of transferring the risk is the insurance premium - it is given by two factors mentioned in the previous paragraph. The best situations for insurance would be where the probability is very low but the loss impact could be very high. In such instances, the cost of transferring the risk through its insurance (the premium) would be much lower while the cost of bearing it on oneself would be very high.

- a) **Don't risk a lot for a little:** A reasonable relationship must be there between the cost of transferring the risk and the value derived
- b) **Don't risk more than you can afford to lose:** If the loss that can arise as a result of an event is so large that it can lead to a situation that is near bankruptcy, retention of the risk would not appear to be realistic and appropriate
- c) **Consider the likely outcomes of the risk carefully:** It is best to insure those assets for which the probability of occurrence (frequency) of a loss is low but the possible severity (impact), is high.

#### E. Role of insurance in society

Insurance companies play an important role in a country's economic development. They are contributing in a significant sense to ensuring that the wealth of the country is protected and preserved. Some of their contributions are given below.

- a) Their investments benefit the society at large. An insurance company's strength lies in the fact that huge amounts are collected and pooled together in the form of premiums.
- b) These funds are collected and held for the benefit of the policyholders. Insurance companies are required to keep this aspect in mind and make all their decisions in dealing with these funds so as to be in ways that benefit the community. This applies also to its investments. That is why successful insurance companies would not be found investing in speculative ventures i.e. stocks and shares.
- c) The system of insurance provides numerous direct and indirect benefits to the individual, his family, to industry and commerce and to the community and the nation as a whole. The insured - both individuals and enterprises - are directly benefitted because they are protected from the consequences of the loss that may be caused by an accident or fortuitous event. Insurance, thus, in a sense protects the capital in industry and releases the capital for further expansion and development of business and industry.