**Course Code- DFIN404: INSURANCE AND RISK MANAGEMENT**

**Unit 1**

Risk: An Introduction, interpretations of the term ‘risk’, types of business and personal risks, significance of risk management function within business organizations

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**1. An Introduction**

Risk is the possibility of a loss or injury will occur. It is impossible to escape all kinds of risk in today’s world. For individuals, driving an automobile, investing in stocks or bonds, and even jogging along a country road are situations that involve some risk. For businesses, risk is a part of every individual life. In fact, the essence of business decision making is weighing the potential risks and gains involved in various courses of action. There is obviously a difference between, the risk of losing money one has invested and the risk of being hit by a car while jogging.

* + 1. ***Different concepts of Risk***

Chance of loss: The probability that an event will occur • Objective Probability vs. Subjective Probability – Objective probability concerns to the long-run relative frequency of an event based on the assumptions of an more number of observations and of no change in the underlying conditions – Subjective probability is the individual’s personal estimate of the chance of loss.

* + 1. ***Chance of Loss vs. Objective Risk***• Chance of loss is the probability that an event that causes a loss will occur. • Objective risk is the relative difference of actual loss from expected loss the chance of loss may be identical for two different groups, but objective risk may be quite changed.

**Learning objectives:**

After studying this chapter, you will be able to:

1. Acquire the knowledge about the concept of risk
2. Understand the different types of risks
3. Examine the nature and causes of risks
4. Explain the meanings of objective and subjective probabilities
5. Describe the personal estimation of the chances of loss

**1.2 Interpretations of the term ‘risk’**

***1.2.1 Definitions of Risk***

To start us off let us know what risk is. There are several meanings used by those who manage risks. There are five areas of risks are stated below:

***1.2.2. Risk is the chance of a loss***

This definition explains that one is exposed to some loss at any time in his or her life. The loss may take up place or never take place, but there is always a chance that the loss may take place at any moment of life of individuals.

***1.2.3 Risk is a possibility of a loss***

When we discuss about the possibility of something happening, we are not very sure that the event will take place, but from experience we know that the event could take place. If we have experienced a loss in the earlier, then there is a possibility that a similar losses could take place again and again.

***1.2.4 Risk is the dispersion of actual from expected results***

In organisations especially, we undertake certain business decisions and expect certain outcomes. When we do not think the expected results, there is a dispersion from the actual that is the result is different from what was expected. This dispersion is the risk and can be measured in absolute terms or using statistical tools and percentages.

***1.2.5 Risk is the Probability of any outcome different from the one Expected***

Probabilities can be measured from 0 to 1(or. 0% to 100%). We can further assign a probability of a certain event happening based on past happenings or experiences. The more the probability the higher the chance of that event occurring. Therefore the risk is measured by the probability assigned to it.

***1.2.6 Suggested definition***

As you can see, all the above definitions reflect an aspect of uncertainty. Risk is therefore defined as:

**“Risk is a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for”**

***1.2.7 Economic (cost) Significance of Risk***

The concept of the cost of risk can be accessed from both a micro level and a macro level economic perspective. The microeconomic perspective considers how individual organizations deal with risk, whereas the macroeconomic perspective considers the cost of risk to society.

***1.2.8 Microeconomic Perspective***

Every year enterprises spend hundreds of billions of money in connection with “pure risk” exposures, i.e. those that present only the possibility of loss should they occur. Some of this money is spent wisely, as part of formal management programs that analyze alternative ways to deal with a particular organization’s loss exposure. In other cases, management is less aware of alternative techniques for managing pure risk exposures. Consequently, the entity’s operational goals can be adversely impacted by less than optimal decisions. For example: -

1. Additional time is spent by managers and board of directors in managing with unanticipated losses, thus detracting the firm from strategic applications;
2. Credit ratings of the firm and firm’s costs of capital are negatively affected;
3. Cash flows, profitability, and growth are decreased due to sub-optimal pricing structures necessitated by concerns over risk;
4. Public images are furnished and customers are lost as a result of actions that offend societal regulations;
5. Insufficient allowance is made for funding post-retirement health and welfare plans;
6. Eligible persons sometimes are reluctant to serve on board of directors because of concerns about individual liability; and

Vii) Systematically desirable projects are not implemented due to lack of abilities to manage associated loss exposures.

**Self-assessment questions:**

1. Discuss the meaning of risk?
2. What are the different types of risks?
3. Identify the various reasons of risk?

**1.3 Types of business and personal risks**

***1.3.1 Types of risk***

There are different types of risks, which face employees and organizations. These include:-

1. Economic risks
2. Financial risks
3. Unexpected deaths and public injury risks
4. Employee dishonesty risks
5. Social risks
6. Physical risks
7. Personal risks

Number of examples of risks and losses that an organisation or an individual can face were pointed out in the preceding chapters. These recommend therefore that there are many types of risks.

***1.3.2 Social Risks***

Social risks are caused by people in the society. In other words it is people who cause some of the risks they (or others) face. Examples of socially caused risks are numerous, for instance, theft, vandalism and accidents. Theft of items like cars, household goods, industrial equipment and so many others amount to millions of rupees worth of prosperity loss in the country over any one period.

***1.3.3 Physical Risks***

Physical cause of losses are also numerous. Some originate from natural phenomena whereas damage others result from human error. Fire, which is a major cause of death, injury, and damage to property, is a physical cause that may result from such natural phenomena as lightning or human failure such as defective wiring. Other examples include the weather (too much rain that causes floods or too little rain that causes drought), landslides and earthquakes.

***1.3.4 Economic Risks***

Majority of the risks that face a business firms (or an individual) are of economic nature. As any basic text in economics will point out, the general level of activity in the economy fluctuates from time to time. These fluctuations are seen in depressions resulting in loss of jobs and decline in property values, expansions, booms and recessions that bring losses to certain individuals and firms.

Economic risks are such that they impact the whole society. Whereas it is possible for some of them to be dealing with by individuals or some firms; the majority of them are so large and complex that they call for unified measures by the society.

Economic risks are those risks that a business or an individual faces because of this changes in economic conditions. Such changes may be caused by droughts, floods, wars, overpopulation, inflation, and other natural calamities etc. these changes can cause businesses to close down or individuals to suffer hardships.

The basic challenge here is to reduce such risks while retaining the flexibility and dynamic growth of the system.

***1.3.5 Financial risks***

These are the risks of loss of income through investments or through destruction of property. Examples would include loss of the principal investment in bonds plus interest due to insolvency of the borrower, or loss of profits due to the destruction of a factory by fire.

***1.3.6 Death and accident risks.***

These are the risks, which can also cause loss to both the business and an individual either financially or morally. Death to a key employee or a director of an organizations can cause the business to suffer financially. Accidents on the business premises of a employee can also cause the business enormous economic losses. For an individual, the death or impairment of the breadwinner, places the dependant in difficult financial problems.

***1.3.7 Personal and public risks.***

These are risks, which face an individual or a business because of his or its actions towards the public. These include things like injury to third parties and their property, libel, nuisance, etc. again these can have far reaching economical losses to the individuals or to the business through court cases.

***1.3.8 Employee dishonesty risks***

These are to do with fidelity or trustworthiness of a person. As the owner of the organization cannot do everything by himself, be trusted. Embezzlement of cash and other dishonest practice can also lead to large economical losses to the business. It is these numerous risks that individuals and business must guard themselves against, because most of them have an implication of economical losses. Having covered the concept of risk, we can now proceed to differentiate it from other related terms.

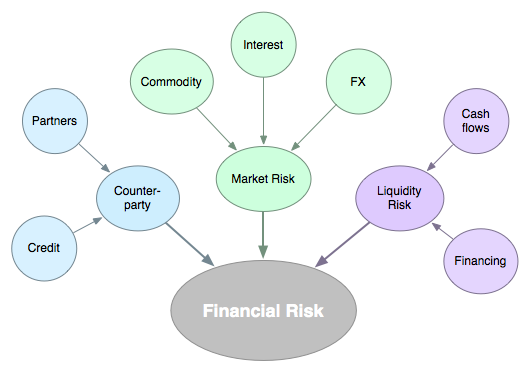


Fig: 1 Types of financial Risks

**Self-assessment questions:**

1. Explain the various types of business and personal risks?

2. Social risks are caused by people in the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

3. Majority of the risks that face a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ are of economic nature.

**1.4 Significance of risk management**

***1.4.1 Need for risk management:*** Risk management is a significant process because it empowers a business with the necessary tools so that it can adequately identify and deal with potential risks. Once a risk’s been observed, it is then easy to mitigate it. However, risk management provides a business with a basis upon which it can undertake sound decision-making.

For an organization, assessment and management of risks is the best way to prepare for eventualities that may come in the way of progress and growth. When a business estimates its plan for handling potential threats and then develops structures to address them, it improves its odds of becoming a successful entity. In addition, progressive risk management ensures risks of a high priority are dealt with as aggressively as possible. However, the management will have the necessary information that they can use to make informed decisions and ensure that the business remains profitable.

***1.4.2 Identify existing risks****:* Risk identification mainly involves brainstorming. A business collects its employees together so that they can review all the various sources of risk. The next step is to organise all the identified risks in order of priority. Because it is not possible to mitigate all existing risks, prioritization ensures that those risks that can affect a business significantly are dealing with more urgently.

***1.4.3 Assess the risks:*** In many cases, problem resolution involves identifying the issues and then finding an appropriate solution. Moreover, prior to figuring out how best to handle risks, a business should locate the cause of the risks by asking the question, “What caused such a risk and how could it influence the business?”

# *1.4.4 Develop an appropriate response*

# Once an organization entity is set on assessing likely solutions to mitigate identified risks and prevent their recurrence, it needs to ask the following questions: What measures can be taken to prevent the identified risk from recurring? Apart from that, what is the best thing to do if it does recur?

# *1.4.5 Develop preventive mechanisms for identified risks*

# Here, the ideas that were found to be useful in mitigating risks are developed into a number of tasks and then into contingency plans that can be deployed in the future. If risks occur, the plans can be put to action.

**Self-assessment questions:**

1. Describe the need for risk management?

2. How do you identify the existing risk of an organisation?

3. Explain the method of assessment of risk?

4.How do you develop preventive mechanisms for identified risks

**1.5 Functions within business organisations**

***1.5.1 Traditional approach***

Traditionally, an organization’s risk management function ensured that the pure risks of losses were managed appropriately. The risk manager was charged with the responsibility for specific risks only. Most activities involved providing adequate insurance and implementing loss-control techniques so that the firm’s employees and assets remained safe. Thus, the risk managers sought to reduce the organization’s costs of pure risks and to initiate safety and disaster management.

Typically, the traditional risk management position has reported to the corporate treasurer. Handling risks by individuals (retaining risks within the firm) and paying claims in-house requires additional personnel within the risk management function. In a small company or sole proprietorship, the owner usually performs the risk management function, establishing policy and making decisions. In fact, each of us manage own risks, whether we have studied risk management or not. Every time we lock our house or car, check the wiring system for problems, or pay an insurance premium, we are performing the same functions as a risk manager. Risk managers use agents or brokers to make smart insurance and risk management decisions.

The traditional risk manager’s role has evolved, and corporations have begun to embrace organisation risk management in which all risks are part of the process: pure, opportunity, and speculative risks. With this evolution, firms created the new post of Chief Risk Officer (CRO). The role of CROs expanded the traditional role by integrating the firm’s efficiencies, or separate risks, into a holistic approach and its framework. Risks cannot be segregated—they interact and affect one another.

In addition to insurance and loss control, risk managers or CROs use specialized tools to keep cash flow in-house. Captives are separate insurance entities under the corporate structure—mostly for the exclusive use of the firm itself. CROs oversee the increasing reliance on capital market instruments to hedge risk. They also address the entire risk map—a visual tool used to consider alternatives of the risk management tool set—in the realm of non-pure risks. For example, a cereal manufacturer, dependent upon a steady supply of grain used in manufacturing, may decide to enter into fixed-price long-term contractual arrangements with its suppliers to avoid the risk of price fluctuations. The CRO or the financial risk managers take responsibility for these trades. They also create the risk management guideline for the firm that usually includes the following:

***1.5.2 Functions of risk management in business organisations***

* Writing a mission statement for risk management in the organization
* Communicating with every unit of the organisation to promote safe behavior.
* Identifying risk management policy and procedures.
* Pinpointing all risk exposures (what “keeps employees awake at night”)
* Assessing risk management and financing alternatives as well as external conditions in the insurance markets
* Allocating the various operating costs
* Negotiating insurance terms and conditions
* Adjusting claims adjustment in self-insuring firms
* Keeping accurate records

Writing risk management manuals set up the process of identification, monitoring, assessment, evaluation, and adjustments. In larger companies, the risk manager or CRO has differing authority depends upon the policy that top management has adopted. Policy statements generally outline the dimensions of such authority. Risk managers may be authorized to make decisions in routine matters but restricted to making only recommendations in others. For example, the risk manager may suggest that the costs of employee injuries be retained rather than insured, but a final decision of such magnitude would be made by top management.

A typical risk management activity includes the steps listed above: identifying risks, assessing them, anticipating future frequency and severity of losses, mitigating risks, finding risk mitigation solutions, creating plans, conducting cost-benefits analyses, and implementing programs for loss control and insurance. For each property risk exposure, for example, the risk manager would adopt the following or similar processes:

***1.5.3* Modern *approach***

* Finding all properties that are exposed to losses (such as real property like land, buildings, and other structures; tangible property like furniture and computers; and intangible personal property like trademarks)
* Evaluating the potential reasons of loss that can affect the firms’ property, including natural disasters (such as windstorms, floods, and earthquakes); accidental causes (such as fires, explosions, and the collapse of roofs under snow); and many other causes. Evaluating property value by different methods, such as book value, market value, reproduction cost, and replacement cost.
* Evaluating the firm’s legal interest in each of the properties—whether each asset is owned or leased.
* Identifying the actual loss exposure in each property using loss histories (frequency and severity), accounting records, personal inspections, flow charts, and questionnaires.
* Calculating the frequency and severity of losses for each of the property risk exposures based on loss data.
* Estimating future losses for each property risk exposure.
* Creating a specific risk map for all property risk exposures based on forecasted frequency and severity.
* Developing risk management alternative tools (such as loss-control techniques) based upon cost-benefit analysis or insurance.
* Comparing the present existing solutions to potential solutions (traditional and nontraditional)—uses of risk maps.
* Communicating the solutions with the whole organization by creating reporting techniques, feedback, and a path for ongoing execution of the whole process.
* The process is very similar to any other business process.

***1.5.4 Risk Distinguished from Peril and Hazard***

It is not uncommon for the terms peril and hazard to be used interchangeably with each other and with risk. Moreover, to be precise, it is significant to distinguish these terms. A peril is a cause of a loss. We speak of the peril of fire, or windstorm, or hail, or theft. Each of these is the cause of the loss that occurs. A hazard, on the other hand, is a condition that may create or increase the chance of a loss arising from a given peril. It is possible for something to be both a peril and a hazard. For instance, sickness is a peril causing financial loss, but it is also a hazard that increases the chance of loss from the peril of premature death. Hazards are normally classified into three categories:

• **Physical hazards** consist of those physical properties that increase the chance of loss from the various perils. Examples of physical hazards that increase the possibility of loss from the peril of fire are the type of construction, the proper area of the property, and the occupancy of the buildings. Moral hazard relates to the increase in the probability of loss those results from dishonest tendencies in the feature of the insured person. More simply, it is the dishonest tendencies on the part of an insured that may induce that individual to attempt to defraud the insurance company. A dishonest person, in the hope of collecting from the insurance company, may intentionally cause a loss or may exaggerate the amount of a loss in an attempt to collect more than the amount to which he or she is entitled. Fraud is a significant problem for insurance companies and increases the cost of insurance.

• **Morale hazard**, not to be confused with moral hazard, acts to increase losses where insurance exists, not necessarily because of dishonesty but because of a various attitudes towards losses that will be paid by insurance. When people have purchased insurance, they may have many careless attitudes towards preventing losses or may have a different attitude toward the cost of restoring damage. Moral hazard is also reflected in the attitude of persons who are not insurers.

• **The tendency of people** to provide more expensive levels of care when costs are covered by insurance is a part of the morale hazard. Similarly, the inclination of juries to make larger awards when the loss is covered by insurance—the so-called deep-pocket syndrome—is another example of morale hazard. In short, morale hazard acts to increase both the frequency and severity of losses when such losses are covered by insurance.

• **The Legal hazard** relates to the increase in the frequency and severity of loss that arises from legal doctrines enacted by legislatures and created by the courts. Jurisdictions in which legal doctrines favor a plaintiff represent a hazard to individuals or organizations who are sued at tort. Although legal hazard is biggest in the field of legal liability, it also exists in the case of property exposures. In jurisdictions where building codes require that new buildings conform to statutory requirements, the destruction of a building that does not meet the requirements may force an owner to incur additional costs in reconstruction, thereby increasing the exposure to loss.

***1.5.5 Risk Management as a Business Function***

As mentioned earlier, risk management is a merger of the disciplines of decision theory, finance, insurance theory, and loss prevention and control specialties. Because risk management draws on these different disciplines, it is sometimes considered a subset of one of them. In majority of the colleges and other educational institutions, insurance and risk management are a part of the finance curriculum, while in other schools they are located in another department. In fact, the study of risk management is a separate and distinct discipline that draws on and integrates the knowledge from a variety of other business fields. The same ambiguity about the nature of risk management is reflected in the view of risk management within many organizations. In some organizations it is viewed as a part of finance; in others it may be considered part of the safety organizations.

In the organization, as in the academic environment, risk management is a distinct and separate functional area of business. The famous French management authority Henri Fayol, writing in 1916, divided all activities of industrial undertakings into six broad functions, including one (which Fayol called security) that is compulsory equivalent to what we now call risk management.

The six broad areas into which Fayol divided industrial undertakings were technical activities (such as production and manufacturing), commercial activities (buying and selling), financial activities (finding sources of capital and managing capital flows), accounting activities (recording and analyzing financial information), managerial activities (organizing, planning, command, coordination, and control), and security activities (protecting the property and persons of the enterprise). While the other areas as described by Fayol all developed as well-defined academic disciplines, and became divisions in the corporate design and structure headed by a vice president, “security” somehow got lost in the shuffle, and it was not until the 1950s that Fayol’s six-function division of business activities are re-distributed.

Position in the Organization in general, one should be the common finding that risk managers in one of three corporate departments, depending on the history and development of risk management in the particular firm. In other organizations, the risk manager evolved from the insurance manager, who was traditionally located in the finance division or under the comptroller. In these companies, risk management is viewed as a financial function and reports to the finance department. In companies in which the risk manager evolved from the employee benefits manager, the risk manager may be in the human resource division.

Finally, in some organisations, the risk manager will have developed from the safety and security function. Here, the risk manager will generally be located in the division that traditionally housed the safety director, usually the production division. Most risk managers have a financial orientation, reporting to a vice president–finance, treasurer, or comptroller; although there is a growing school of thought that says he or she should be in a less specialized department, reporting to an executive vice president or even to the president to illustrate the company-wide scope of risk management activities.

In Indian business sector, including small and medium size companies, needs to accelerate internal process of risk management and scale up the best policies to keep competition with the fastest growing national economy, according to experts. The experts, who participated in the Singapore Global Convention 2018 from December 5 to 7, called for more efforts to match the in-house standards and processes set by American and European corporations and stressed on the need to adopt Enterprises Risks Management (ERM).

# ERM are the methods and processes used by various companies and multinational organisations to manage risks and seize opportunities related to the achievement of their objectives. Given the opportunities in India, it need the corporate world fully internally risk protected and adopt the ERM framework. According to the experts, the improvement in business functions among the Indian companies is slow and needs to be at par with the American and European standards. The American and European companies have far stronger and stringent standards. Their internal way of working is also far more process and control driven. However, India still has a long gap to be at par with international corporate on good governance. Experts also urged family-owned businesses to make "mind-set change" from their own operating legacy. "Corporatize, reduce the risk and enhance governance, as it is very significant to develop global standards very fast. The experts said that large number of mid-and small size companies are not concentrating on managing their risk across the supply chain.

# "Some very large scale companies are doing risk management while many some others are doing it from the perspective of compliance," Sarang Mahajan, Principal, Asia Pacific at Du Pont Sustainable Solutions, said. "But we would like to see the big industrial sector leading the compliance and be couple of steps ahead of the game. They should also help their suppliers in the tier 2 and tier 3 to fulfill the compliances," he added.

# The convention was organised by the UK-based Institute of Directors' India establishment and was held in the midst of Indian professional community based in Singapore familiar with business cultures in India and South East Asia. This makes it an important platform for Indian and South East Asian businesses to adopt best global practices, explore and exploit regional business opportunities.

**Self-assessment questions:**

1. Discuss the nature and traditional approach of risk?
2. What do you mean by risk distinguished from Peril and Hazard?
   1. **Terminal questions:**
3. Write the different functions of risk management in business organizations?

2. Explain the nature of risk management as a business function?

1. Differentiate between economic risk and financial risk of an organizations?
2. What is the difference between micro and macro level of risk perspectives?
3. Discuss the need for risk management practices of an organisation?
4. How do you develop the preventive mechanism for identified risks?

**Images of Risk Management**

Fig: 1 Project Risk Management

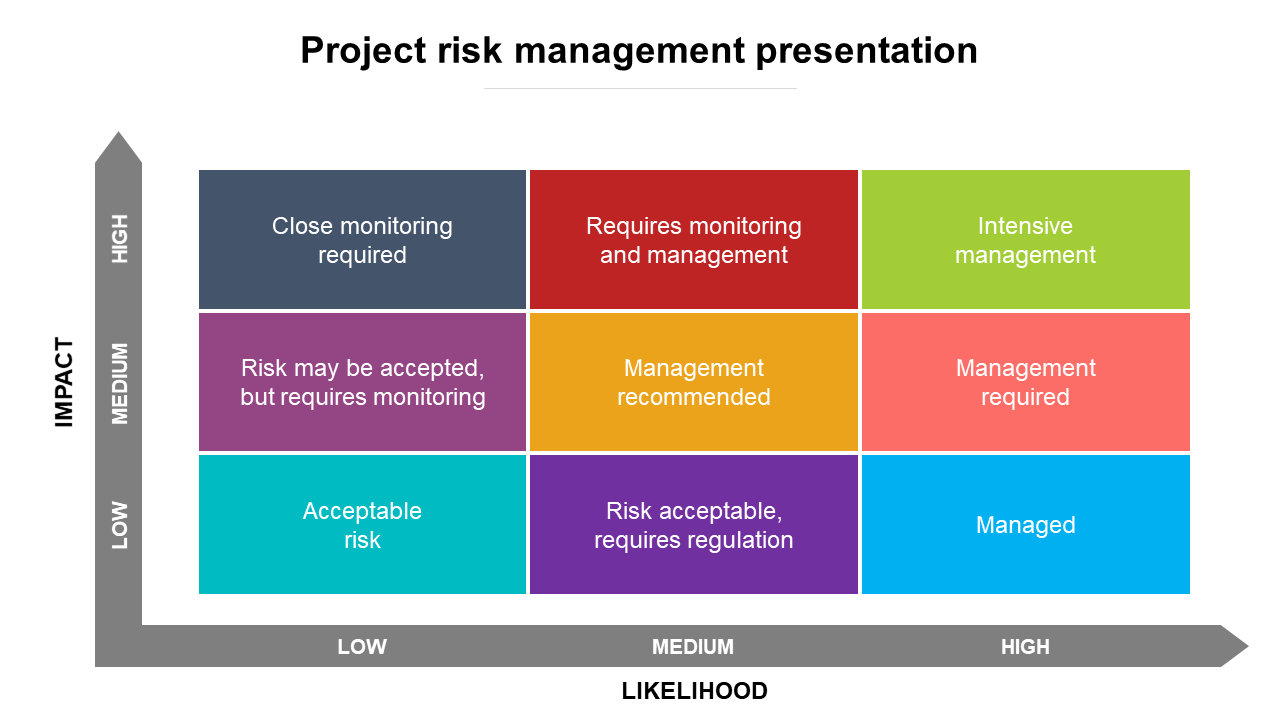
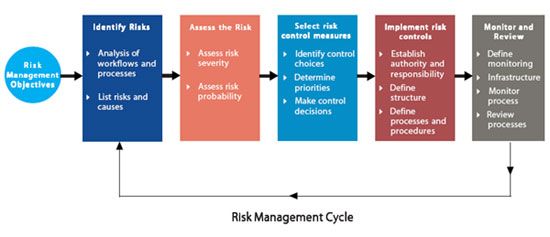


Fig: 2 Risk Management cycle



**Summary**

# Risk management is the process of [identifying, assessing and controlling uncertainties](https://whatis.techtarget.com/feature/How-to-assess-and-prioritize-insider-threat-risk)  to an organization's capital and earnings. These uncertainties, or risks, could stem from a wide range of sources, including financial uncertainty, legal liabilities, strategic management errors, accidents and natural disasters.

# [IT](https://searchdatacenter.techtarget.com/definition/IT) security threats and data-related risks, and the risk management strategies to alleviate them, are become a high priority for [digitized](https://whatis.techtarget.com/definition/digitization) organisations. As a result, a risk management strategy increasingly includes companies' operations for identifying and controlling threats to its digital properties, including proprietary corporate data, a customer's personally identifiable information (PII) and intellectual property.

# Every organisation faces the risk of unexpected, unpredicted events that can cost the company money or cause it to permanently close. Risk management permits organizations to attempt to prepare for the unexpected by minimizing risks and additiona costs before they happen.

Risk management is the procedure of analyzing exposure to risk and determining how to best manage such exposure. The risk management process undertakes a best practices approach and focuses on understanding the key risks and managing them within affordable levels.

# The significance of combining risk management with maximum safety has also been revealed. In some health care organizations, the risk management and patient safety departments are separated; they incorporate different leadership, objectives and scope. Moreover, some of the organisations are recognizing that the ability to provide safe, high-quality patient care is necessary to the protection of financial assets and, as a result, should be incorporated with risk management.

**Glossary**

**Accident:** Unpredicted or choice of event. This term is often defined in older

commercial general liability (CGL) policies.

**Agent:** An insurance professional or intermediary who sells and explains insurance

products to insured and prospective insured.

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**Broker:** Brokers are commonly licensed by an authority to place insurance on behalf of

clients with any number of companies, while others represent a single insurer. A broker

technically represents the client.

**Claims:** A liability coverage form that requires the claims be reported to the insurance

company while the policy is still in force in order for coverage to apply.

**Definitions:**  Part of every insurance policy; explain the unique meaning of the designated

words (identified in bold print or set off by quotation marks) within the context of insurance.

**Earthquake coverage:** Purchased as separate policy as more property policies do not

protect against damage by earthquake.

##### **ERM risk management: A**n organization’s activitiey to and method of enterprise risk

##### management.

**Formal management**: An organisation has a management system when they have defined,

documented, and deliberately managed their management processes.

**Financial risks:** Financial risk is the possibility of losing money on an investment or

business venture.

# Impairment: [deterioration](https://dictionary.cambridge.org/dictionary/english/deteriorate) in the [working](https://dictionary.cambridge.org/dictionary/english/function) of a [body](https://dictionary.cambridge.org/dictionary/english/body) [part](https://dictionary.cambridge.org/dictionary/english/part), [organ](https://dictionary.cambridge.org/dictionary/english/organ), or [system](https://dictionary.cambridge.org/dictionary/english/system) that can

# be [temporary](https://dictionary.cambridge.org/dictionary/english/temporary) or [permanent](https://dictionary.cambridge.org/dictionary/english/permanent) and can [result](https://dictionary.cambridge.org/dictionary/english/result) from [injury](https://dictionary.cambridge.org/dictionary/english/injury) or [disease](https://dictionary.cambridge.org/dictionary/english/disease)

# Morale hazard: Is an insurance term used to explain an insured person's attitude about

# their belongings. It represents the rise of indifference to loss because the items are

# covered.

# Vandalism: Action involving deliberate destruction of or damage to public or private

# property. "an act of mindless vandalism".

**Windstorm:** A [wind](https://www.britannica.com/science/wind) that is strong to cause at least light damage to trees and buildings and

may or may not be accompanied by [precipitation](https://www.britannica.com/science/precipitation).

**Answers**

**Self-Assessment questions:**

**Short Questions:**

1. **Discuss the nature and traditional approach of risk?**

**Ans**: Traditional risk management is a risk method which is the organised by different responsible departments. According to risk management designs, risk is controlled in each business unit, adapted to each strategic application, level of profitability, products, prices, and relationship with the other functional areas of the organisation.

However, this traditional bottom-up approach to risk management relies too heavily on communicating upward and will likely create performance .

1. **What do you mean by risk distinguished from Peril and Hazard?**

**Ans:** It is not uncommon for the terms peril and hazard to be used interchangeably with each other and with risk. Moreover, to be precise, it is significant to distinguish these terms. A peril is a cause of a loss. We speak of the peril of fire, or windstorm, or hail, or theft. Each of these is the cause of the loss that occurs. A hazard, on the other hand, is a condition that may create or increase the chance of a loss arising from a given peril. It is possible for something to be both a peril and a hazard.

**Terminal questions:**

**Essay questions**

1. **Write the different functions of risk management in business organizations?**

**Ans:** Risk management functions are:

  1. Identifying risks,

2. Assessment of risk,

3. Estimation of Future frequencty,

4. Severity of losses,

5. Mitigating risks,

6. Finding risk mitigation solutions,

7. Creating plans,

8. Conducting cost-benefits analyses,

9. Implementing programs for loss control and insurance.

1. **Explain the nature of risk management as a business function?**

**Ans:** The nature of risk management is the process of identifying, assessing and controlling threats to an organization's investment and earnings. These threats, or risks, could stem from a wide variety of sources, including financial uncertainty, legal liabilities, strategic management errors, accidents and natural calamities. When we think of high risks, we often think in terms of natural hazards such as hurricanes, earthquakes, or tornados. Perhaps man-made disasters such as the terrorist attacks etc are also risks. We have overlooked financial crises, such as the credit crisis. Moreover, these kinds of man-made risks have the potential to devastate the global market place.

1. **Differentiate between economic risk and financial risk of an organizations?**

**Ans:** The following are the major differences between business risk and financial risk:

1. The uncertainty caused to insufficient profits in the business due to which the organisation is not able to pay out expenses in time is known as Business Risk. Financial Risk is the risk originating due to the use of debt funds by the organisations.
2. Business Risk can be assessed by variations in earnings before Interest and Tax. On the other hand, Financial Risk can be measured with the help of leverage multiplier and Debt to Asset Ratio.
3. Business Risk is linked with the economic environment of business. Conversely, Financial Risk associated with the use of debt financing.
4. Business Risk cannot be reduced while Financial Risk can be avoided if the debt capital is not used at all.
5. Business Risk can be disclosed by the difference in net operating income and net cash flows. In contrast to Financial Risk, which can be exposed by the difference in the return of equity shareholders?

**4. What is the difference between micro and macro level of risk perspectives?**

# Ans: Micro Risk level of risk perspectives

# Micro level risk deliveries are local. No matter how far services travel, you receive your delivery from a local provider, meaning you run a risk of missing shipments if your local delivery service fails or is mismanaged. You can manage this risk by having a backup delivery product on call to pick up any shipments that haven’t reached your door.

# Macro Risk level of risk perspectives

# Macro level risk refers to ability to borrow money depends to some extent on the worldwide interest rate and lending environment. Because even small U.S. banks lend to foreign banks, interest rates are sensitive to world financial environments. However, if American banks are concerned about foreign defaults on loans, they may be increasingly conservative when it comes to making loans to businesses like yours. You can manage this risk by having backup plans for raising money. For example, if you can’t get a bank loan, consider selling bonds to raise capital, selling excess inventory at a discount and negotiating with vendors for extended credit.

**5. Discuss the need for risk management practices of an organization?**

**Ans:** The need for risk management refers to implementing a risk management plan and considering the various potential risks or events before they occur, an organization can save money and protect their future. This ability to understand and control risk enables organizations to be more confident in their business decisions. Risks management is a significant process because it empowers an organisation with the proper tools so that it can adequately identify and deal with potential risks.

Once a risk’s been identified, it is then easy to mitigate it. Moreover, risk management provides a business with a basis upon which it can undertake sound decision-making. For an organisation, assessment and management of risks is the best way to prepare for eventualities that may come in the way of progress and development. When a business evaluates its plan for handling potential threats and then develops structures to address them, it improves its odds of becoming a successful entity.

# In addition, progressive risk management ensures risks of a high priority are dealt with as aggressively as possible. Moreover, the management will have the necessary information that they can use to make informed decisions and ensure that the business remains profitable.

1. **How do you develop the preventive mechanism for identified risks?**

# Ans: Every business faces risks that could present threats to its success. Risk is defined as the probability of an event and its consequences. Risk management is the practice of using processes, methods and tools for managing these risks. Risk management mainly concentrates on identifying what could go wrong, estimating which risks should be dealt with and implementing strategies to deal with those risks. Organizations that have identified the risks will be better prepared and have a more cost-effective way of dealing with them. This guide sets out how to identify the risks your business may face. It also looks at how to implement an effective risk management policy and program which can increase your business' chances of success and reduce the possibility of failure.

**Preventive mechanism**

# 1. [Effective risk management practices](https://www.infoentrepreneurs.org/en/guides/manage-risk/#1)

# 2, [The nature of risk of business faces](https://www.infoentrepreneurs.org/en/guides/manage-risk/#2)

# 3. [Strategic and compliance risks](https://www.infoentrepreneurs.org/en/guides/manage-risk/#3)

# 4. [Financial and operational risks](https://www.infoentrepreneurs.org/en/guides/manage-risk/#4)

# 5. [How to evaluate risks](https://www.infoentrepreneurs.org/en/guides/manage-risk/#5)

# 6. [Use preventative measures for business continuity](https://www.infoentrepreneurs.org/en/guides/manage-risk/#6)

# 7. [Choose the right insurance to protect against losse](https://www.infoentrepreneurs.org/en/guides/manage-risk/#8)s

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