Risk Management & Insurance

Chapter Two
Risk Management

Agenda

1.1. Definitions of Risk

1.2. Risk Vs Uncertainty, and chance of loss

1.3. Risk, peril and HAZARD

1. **Physical hazards**
2. **Moral hazard**
3. **Morale Hazard/ Attitudinal Hazard**
4. **Legal Hazard**

Agenda

1.4. Classes of Risk

- 1.4.1. Financial and non- financial
- 1.4.2. Objective and subjective
- 1.4.3. Static and dynamic risk
- 1.4.4. Fundamental and particular risk
- 1.4.5. PURE and speculative risks

1.5. Types of pure risk

- 1.5.1. Personal pure risk
- 1.5.2. Property pure risk and
- 1.5.3. Liability pure risk

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Risk Management

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- 2.3.2. Measurement potential risks
- 2.3.3 Selection of due Tools of Risk Management
- 2.3.4 Administration of the Entire Program

Learning Objectives

After studying this chapter you should be able to:

1. Describe the **meaning** and **nature** for risk management.
2. Describe the **difference** b/n risk mgt and insurance mgt.
3. List and describe **pre** and **post-loss** objectives.
4. Describe the **process/steps** of risk management.
5. List the **source** of risk exposures identifications.
6. Describe the **risk financing** and **risk control**

2.1. Meaning of risk management

- *The term risk management can be defined as "A **systematic process** for **Identification** and **Evaluation** of **Pure risk** exposures exposed to an organization or individual and for the **Selection** and **Implementation** of most appropriate techniques for treating such exposures*

  - R.M is a systematic process
  - Deals with pure risks

Risk Management Vs Insurance Management

Risk management (RM)

- R.M is a broader concept & deals with **all pure** risks exposures.
- In addition to insurance, R.M uses avoidance, loss prevention, loss control, retention, non-insurance transfer, separati tool to handle risk
- R.M has a great the org'n.

Insurance Mgt.

- Deals Only those risks having **high severity** and **low frequency.**
- It is only insurance
- Has lesser impact.
- Needs a few number of

Type of Loss	*Loss Frequency*	*Loss Severity*	*Appropriate Risk Management Technique*
1	Low	Low	Retention
2	High	Low	Loss prevention and retention
3	Low	High	Insurance
4	High	High	Avoidance

2.1. Risk Management Objectives

- **Risk management has objectives before and after a loss occurs**
- **Risk management objectives serves as a:**
  - **prime source of guideline**
  - **bunch mark to evaluate the performance.**

Pre-loss objectives

1. **The objective of economy.**
2. **Reduction of anxiety.**
3. **Discharging externally imposed obligations.**

Post-loss objectives

1. **Insure Survival of the firm**
2. **Continued operation**
3. **Stabilize earning**
4. **Maintain growth**
5. **Minimize the effects on the society or stack holders.**

2.3. Steps in the Risk Management Process

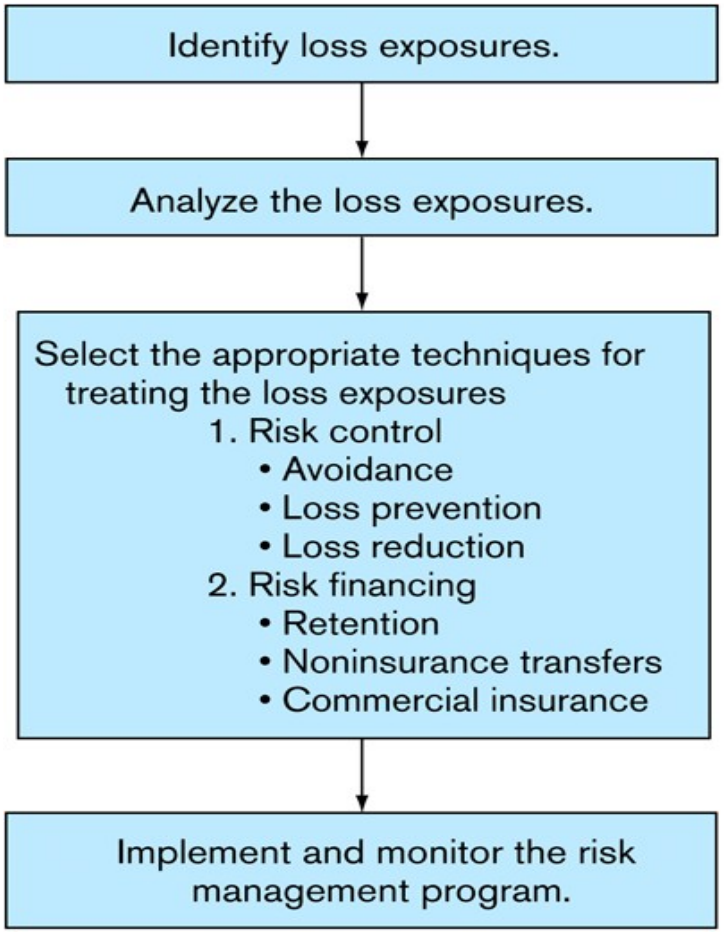
The process/ steps of risk management involves:

2.3.1. **Identify** potential losses

2.3.1. **Evaluate** potential losses

2.3.1. **Select** tool(s)

2.3.1. **Administration** of the program



2.3.1. Identification of potential risk exposures

- This is the **first and most difficult** step
- Identification is a process by which a business **systematically and continuously** identifies **property, liability and personal** risk exposures
- Both ***hidden and oblivious*** risk exposures should be identified.
- If **we fails** to identify a given risk we will not have any due opportunity to determine the best way.

2.3.1. Identification of potential risk exposures (Cont…)

Sources of Identifying Loss Exposures

- Risk Managers have **several sources of information** to identify loss exposures both hidden and obvious:

1. **Risk analysis Questionnaires**
2. **Physical observation and inspection**
3. **Analyzing production and delivery flowcharts**
4. **Analyzing Financial statements**
5. **Through Historical and departmental loss claim data**

2.3.2. Evaluation of potential risk exposures

- It is about the ***measurement*** of the impact of a given risk on the organization

- Done through Estimate of ***frequency*** and ***severity.***
  - **Loss frequency:** refers to the probable number of losses that may occur during some given time period
  - **Loss severity:** refers to the probable size of the losses that may occur

- Once loss exposures are analyzed, they can be ranked according to their relative importance

- Loss severity is more important than loss frequency:

2.3.2. Evaluation of potential risk exposures(cont…)

Ranking potential risks based on severity:

- **Critical risks**
  - Losses which may lead the firm to bankruptcy
- **Important risks**
  - Losses which may lead the firm to external assistance like borrowing
- **Negligible/ unimportant risks**
  - Losses which may have negligible financial impact on the firms financial wellbeing

3.3.2. Select the Appropriate Risk Management Technique

- It is about selecting or looking for appropriate tool (s) of risk management to treat the risk already identified and evaluated.
- **Roughly classified in two:**

1. **Risk control techniques:**
   - refers to techniques that **reduce frequency and severi**ty of losses
   - The following are the common tools of risk management tools
     1. **Avoidance**
     2. **Loss prevention**
     3. **Loss reduction**
2. **Risk financing techniques:**
   - refers to techniques that provide for the **funding of losses**
   - The following are the common tools of control tools
     4. **Retention**
     5. **Non-insurance Transfers**
     6. **Commercial Insurance**

Risk Control Methods: 1. AVOIDANCE

1. AVOIDANCE

- **Avoidance means a certain loss exposure is never acquired or an existing loss exposure is abandoned.**
- **Is done either:**
  - ***to assume a property*, person, or activity which gives rise to possible through *refusing* le loss even momentarily**
  - **or by abounding an existing exposure to loss assumed earlier and has been giving rise to a risk.**
    - **Examples:**
      - **1**
      - **2**
      - **3**
    - **Advantages and disadvantages**
      - **1**
      - **2**
      - **3**

Risk Control techniques: 2. & 3

2. LOSS PREVENTION

- It is measures that reduce the "frequency" of a particular loss

3. LOSS CONTROL /REDUCTION

- It is a measures that reduce both frequency and severity

- Examples of loss prevention measures (frequency)
  - Institution of quality-control checks
  - Regular inspection of machinery
  - Due drivers exam
  - Improvement on product design.

Examples of loss reduction measure (severity)

- Installation of an automatic fire alarm sprinkler system
- Having warehouses with inventories at different locations (**diversification**).
- Early treatment of injury
  - Etc

Tools of risk management: Retention

4. Retention

- It is the ***most commonly*** and ***frequently*** used tools of risk management
- The **source of finance** for retention is both internal and external sources

- There are of **two types** of retention.

Passive retention

1. **When we don't know the risk exposure at all**
2. **When we poorly/wrongly measure the potential risk exposure**

Active retention

- **When we properly, actively, identify and evaluate a risk exposure and decide retention as a best tools of risk management.**

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