International Journal of Computing and Corporate Research

ISSN (Online) : 2249-054X

Volume 3 Issue 4 July 2013

Manuscript ID : 2249054XV3I4072013-10

RISK MANAGEMENT AND ORGANIZATION VALUE

Dr. Ruchi Sharma

Risk management is integral part of generating sustainable value to a business . Introduction of a new product has both pure and business risk implications. In this new technology age, risk abounds. Companies take out insurance covers to protect themselves against pure risks, but very few companies have thought of managing business risk. There are three layers of risk management, viz. bottom-layer , middle-layer and top-layer risks, which have been discussed here. Risk management ensures that revenue generating capacity of the asset is not affected.

One should know the price to paid for insuring business risk and how it is going to help in generating or sustaining wealth to a business organization . Risk management contributes to business in two ways, on expense side as well as revenue side.

CEOs and CFOs on expense side should rethink as to how they manage and allocate money in terms of insurance, so as to increase the value generation for the organization and the shareholder.

INTRODUCATION

R isk is an integral component of today's business environment. Organizations of all types are now realizing that risk is no longer just a threat, but can be a powerful asser that delivers competitive advantage. Managing risk means that you are more likely than your competitors to meet business objectives, hit profitability targets and protect your reputation. Risk management implies seeking the upside while managing the downside hence CEOs of many companies have realized and recognized that managing risk is an integral part of generating sustainable value to a company . This positive interpretation of risk reflects the new understanding of the connection between well managed risk and improved performance

CONCEPT OF RISK MANAGEMENT

In its broadest sense risk management is concerned with the planning, arranging and controlling of activities and resources in order to minimize the impact of uncertain events. Risk management as a function of business management is not relatively new, however its precise boundaries are still the subject matter of debate. This is due to the fact that any loss, whether it is due to operation of pure risk or business risk, will have same financial implication of a product has both pure and business risk implications.

In this new technology age, risks abound. They are inherent in the environment, embedded in process and hidden in the information used to make decisions. The most of the risk management, which seeks to achieve financial stability through conscious decision on risk retention and risk transfer, was concentrated on managing pure risk. Pure risk management primarily

Involves physical/financial protection of all fixed and current assets against accidental losses, anticipating hazards which gives rise to a loss and taking preventive measures across a areas of assets, liabilities and their operations. This was essentially done through active assessment, review and decision to retain or transfer risks to professional risks carriers like insurance companies.

Companies routinely take out property and casualty insurance covers to protect themselves against the pure risks like damage caused by fire, theft, storm, etc. But, few companies have thought of managing business risk by way of risk transfer. Business risk management establishes, calibrates and realigns the relationship between risk, growth and return. Business risks like failed product launches, and regulatory changes, which can be managed by way of transferring them to professional third party risk carriers . Currently only few business risks are covered, like loss of profit, product, public and professional liability. Many organizations regard these business risks as the inevitable, uninsurable perils of entrepreneurialism.

LAYERS OF RISK AND RISK MANAAEMENT APPROACH

In most organizations internal insurance department rarely serves a risk management function instead, it is chiefly seen as an administrative office for buying and renewing insurance policies. With the liberalization and entry of new private players, these will be noticeable shift in the function of insurance department of the organization and CFO's and insurance management will try to establish linkages between risk, transfer and financing.

Most customers in current environment tend to choose insurance companies on the basic of their capital strength or ability to absorb risk, regardless of the layer of risk they are trying to insure, assuming service to be constant . Price, the other important differential, does not exist in current regulated environment as insurance regulatory and development authority (IRDA) through Tariff Advisory Committee (TAC) regulates most of the product pricing. The risk(whether pure or business risk)can be classified into three layers as stated below:

1.Bottom-Layer Risks are those where the frequency of occurrence is expected to be high and the severity of claims low, Such as auto fleet insurance, marine/transit insurance.

2. Middle-Layer Risks are those where the frequency and severity claims are expected to be moderate. Fire, liability, and engineering coverage typically fall into this category.

3. Top-Layer Risks are those with low expected frequency but catastrophic severity, such as product liability.

In case of bottom –layer risks ,corporate can adopt a strategy of self-insurance by sitting up self-retention limit as claims are so frequent that it would effectively mean exchange of rupee for rupee. Losses beyond retention limit will be insured with insurance companies, while losses within retention limit can be financed by company's cash flow. This will help in reducing the overall cost of risk cover as the administrative costs of running a self insurance program are usually much lower than those loaded in to regular insurance premiums. In addition, Self-insurance increases premiums. In addition , Self-insurance increases the sensitivity of line managers to risk management issues, since any losses at his level will cut into his budgets.

In case of middle layer risk, where cost of risk can be predicated only over a five to ten year horizon corporate would do well to transfer the risk to professional carriers who have the ability to structure the coverage and are reputed for paying claim on time . though price of the cover would be important consideration, In current regulated environment this is of little relevance.

Thirdly , In case of top layer risk , which is hard to measure and predict, corporate should choose insurance carriers on the basis of their capital strength or ability to absorb risk. Typical exposures include product and environmental liability, catastrophic property damage, and business interruption exposure.

PHYSICAL RISK MANAGEMENT

The main objective of physical risk management is to ensure that revenue generating of the asset is not affected or even if it is affected, the same is restored with minimum or no impact on the cash flow of the company. The first step is to identify those assets of the company that are susceptible to various perils and have significant impact on balance sheet of the company or revenue generating capacity of the company. For the purpose of identification it would be good to have a balance sheet perspective. After identification, next step would be to see whether it can be prevented or reduced through scientific techniques like segregation of units, substitution of raw material, installation of physical protective devises and necessary education and training to the staff. In spite of all the beat all the risk can neither be prevented nor reduced in its entirety. Thus, for the risk which still remain, organization will have either to retain and manage them or alternatively transfer through suitable means like professional risk carriers or natural calamity bonds.

BUSINESS RISK INSURANCE-CONCEPT AND APPLICABILITY

Business risk insurance can be made used to preserve or even increase business value in terms of return on equity by protecting the cash flow, reducing the amount of capital tied up in the business, or improving their financial terms. Business risk insurance can be viewed as financial terms. Business risk insurance can be viewed as new and efficient sources of capital. Cases abound of the drastic impact business risk insured can be viewed as new and efficient source of capital. cases abound of the drastic impact business risk can have on value of business . For example, Philip Morris was forced to slash the price of Marlboro cigarettes for four months to win back market share from cheaper private-label rivals. Other case is of Barings, the British merchants bank, that collapsed because of massive unauthorized trading.

Just like in any other risk transfer mechanism, one would like to know what is the price to be paid for insuring business risk. Business risks, unlike common property & causality risk, can't be priced based on common actuarial techniques. This is because they are unique to the company and hard to access statistically and difficult to spread.

Business risk insurance programme is customized product for each corporate. This kind insurance programme would cover mix of following features:

- Risk distribution over several years,

- Innovative risk evaluation techniques,
- Risk portfolio management, and
- Securitization.

The above two will also facilitate improved financing term from various banks .

However, not all the business risks can be insured, mainly for two reasons. Firstly, it may not be cost effective way of managing the risk. Secondly, corporate performance and shareholder value will always be determined primarily by how well a company conducts its core business. There is no standard formula to identify any transfer the insurable business risk. It involves thorough analysis and assessment of business risk that have significant bearing on balance sheet/profit and loss account of the company. the decision to transfer the risk so identified will be based on following factors:

1. Whether risk is caused by internal factor or external actor
2. Whether risk is manageable or not.
3. Whether it is extraordinary nature or recurrent.
4. Whether the risk is core competency of the organization otherwise.

____

RISK MANAGEMENT AND ITS CONTIBUTION OT AN ORGNIZATION

Risk management contributes to an organization mainly in two ways. On expense side, the proper choice of risk management techniques, such as loss prevention, self insurance and risk transfer to the firm and obtain cash to replace the losses can be equated to cost of raw material, labor and other production cost. Just as cutting the cost of raw materials adds to profit the organization, reducing the costs of accidental losses also adds to profit.

On the revenue side, the organization would be able to take on more risk as some additional capital would be released. This will help in generating additional revenue.

CONCLUSION

As stated earlier in the article, most of the organization are happy for insurance manager to handle their normal insurance needs. CEOs and CFOs of the company may not take decision on marine or fire insurance. However in case of business insurance more is at stake as the potential impact on shareholder value is significant s. CEOs nag CFOs should rethink how they manage and allocate money in terms insurance so as to increase the value generation for the organization . The challenges for them lies in drawing a line between risks that should be transferred to professional risk carriers or to retain with them.