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**SUB: Insurance and Risk Management (IRM)**

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**UNIT 1: Concept of Risk**

**Managing Risk or Risk Management:**

Risk management is the identification, evaluation, and prioritization of [risks](https://en.wikipedia.org/wiki/Risk) followed by coordinated and economical application of resources to minimize, monitor, and control the probability or impact of unfortunate events or to maximize the realization of opportunities.

Risks can come from various sources including uncertainty in [financial markets](https://en.wikipedia.org/wiki/Financial_market), threats from project failures (at any phase in design, development, production, or sustaining of life-cycles), legal liabilities, credit risk, accidents, [natural causes and disasters](https://en.wikipedia.org/wiki/Natural_disaster), deliberate attack from an adversary, or events of uncertain or unpredictable [root-cause](https://en.wikipedia.org/wiki/Root_cause). There are two types of events i.e. negative events can be classified as risks while positive events are classified as opportunities.

Strategies to manage threats (uncertainties with negative consequences) typically include avoiding the threat, reducing the negative effect or probability of the threat, transferring all or part of the threat to another party, and even retaining some or all of the potential or actual consequences of a particular threat. The opposite of these strategies can be used to respond to opportunities (uncertain future states with benefits).

**Features/ Characteristics/ Nature of Risk Management:**

1. Risk management is an organized process of addressing the risks.
2. Risk Management is the use of scientific techniques and procedures and basically covers pure risks.
3. Risks of various natures are first identified through source analysis and measurement.
4. Suitable techniques are adopted for analysis and monitoring of factors leading to risks.
5. Risks are transferred either completely or partly to another party through an insurance contract or any indemnification.

**Methods of Risk Management:**

For the most part, these methods consist of the following elements, performed, more or less, in the following order.

1. Identifying the threats.
2. Assessing the vulnerability of critical assets to specific threats
3. Determining the risk (i.e. the expected likelihood and consequences of specific types of attacks on specific assets)
4. Identifying ways to reduce the risks
5. Prioritizing risk reduction measures.

**Elements of risk management:**

Risk management should include the following:

1. Creating value resources expended to mitigate risk should be less than the consequence of inaction

 2. Being an integral part of organizational processes

 3. Being part of decision making process.

 4. Explicitly addressing uncertainty and assumptions

 5. Being a systematic and structured process

 6. Being based on the best available information

 7. Being adjustable.

 8. Taking human factors into account

 9. Being transparent and inclusive

 10. Being dynamic, iterative and responsive to change

 11. Being capable of continual improvement and enhancement

12. Being continually or periodically re-assessed.

**Methods/ Techniques of Handling Risks:**

1. Prevention (avoidance/mitigation/elimination) of risks: It is rightly said that prevention is better than cure. Precautionary measures should be taken to reduce the causes of risks. Risks cannot be avoided completely but can be mitigated to a great extent through a careful and systematic planning.

 Risks can be mitigated by adopting the following measures:

1. The risk of theft and shop lifting can be prevented to some extent by imparting training to employees of the organization by installing CCTV cameras, burglar alarms, safety vaults or appointing watchmen, etc.
2. Credit should be given by verifying the credit worthiness of the customer or should be given to loyal and old customers.
3. Damage and injury to property and life through fire can be prevented by constructing fire proof building.
4. **Reduction of risks:**

There are many risks which cannot be insurable and transferred. Business is dynamic and characterized by innumerable and unpredictable risks and changes. However, risks can be mitigated by the following:

1. The continuous change in trends and fashion often leads to loss of goods in stock which can be reduced by announcing stock clearance sale at heavy discount.
2. Research and customer survey should be conducted in order to find out customers likes and preferences regarding the products and services.
3. Customers always demand something new in technology and products. As such, innovation is the only key to mitigate such inherent risk.
4. Sprinklers are designed to put out a fire in firms which can mitigate the risk of damage and loss by fire. In big organizations and MNCs, Halon Fire Suppression systems are installed to reduce the risk of fire.
5. Shifting or transferring risks (Insurance cover or Outsourcing):

Certain types of risks can be transferred to a third party or another party, where the third party shoulder’s the risk of the first party against some professional fee/commission or premium. Many natural losses can be compensated by undertaking an insurance policy (Life insurance or General insurance).

 **‘Outsourcing’** is another strategy for managing risk if the outsourcing unit is an expert demonstrating higher capability to absorb risks and manage the risk. An organization may outsource its marketing and promotional activities to an advertising firm and decide to fully concentrate on its production activities.

1. Acceptance of risks (retention):

Accepting the risks means accepting the loss/damage as and when it occurs. Risk retention strategy is a flexible plan of action covering small risks when the cost of insuring against a particular risk is greater than the total loss incurred i.e.

 *Acceptance of risk=****Cost of insuring the risk > total loss/damage actually incurred***

1. Spreading of risks (budgeting):

Whether in personal life or professional life, risk cannot be mitigated completely. Different measures may be adopted to spread the risks or save from its harmful effects such as:

1. A company can diversify or go for market segmentation strategies instead of concentrated marketing. It may enter or spread its business activities in different geographical locations encompassing different villages, towns, cities, states and abroad;
2. A firm may apply for re-insurance business with other organization and also accept re-insurances from other companies;
3. By entering into pools of certain risks in case of hazardous or critical nature;
4. Many organizations keep a provision for absorbing risks. Business organizations are prone to different risks such as social, economic, legal, technological or political risks. As such, the business organizations maintain a ‘Reserve Fund’ to mitigate the heavy impact of risks in business.