ACTA SCIENTIARUM POLONORUM Oeconomia 7 (3) 2008, 41–49

# TARGETING BUSINESS RISK AND INSURANCE ATTRIBUTES

Štefan Majtán, Daniela Rybárová
The University of Economics in Bratislava

**Abstract.** There is growing awareness of organizations as to their ability to continue, whatever the severity of business interruption. The practical application of the targeting business risk is of particular relevance for this ability. One, which finds itself in a state of perpetual crisis, is failing to manage risks properly. Failure to manage risks is characterized by inability to decide what to do, when to do it, and whether enough has been done. Understanding business risk requires three criteria: a through understanding of the business process, an active imaginations and tools to generate ideas about possible effects of risks and a framework or risk model and a common language to discuss risk.

**Key words:** Risk Assessment, Risk Control, Source of Risks, Insurance

## INTRODUCTION

Many uninsured losses related directly to the performance of people in a crisis and their inability to understand the signals that failure is happening or events are not being. When reports are not specifically called to the attention of leadership, they are lost in the bureaucratic background noise. When confronted by catastrophe, managers have tendency from the outset to take refuge in familiar references and actions, they become preoccupied with routine and familiar tasks. Managers often spend so much time dealing with the significant risks in the present that they find it difficult to deal with risk in a longer time horizon. Day to day procedures may by the most inappropriate, as faced with crisis. Many disasters are caused by organizations that fail to prevent a crisis from getting worse and only react when things have deteriorated to the point of disaster. Crisis prevention is more effective than disaster recovery. Increasingly investors are requiring

Corresponding author – Adres do korespondencji: Štefan Majtan, The University of Economics in Bratislava, The Faculty of Business Management, Head of Department of Enterprise Economy, e-mail: majtan@dec.euba.sk; Daniela Rybárová, University of Economics in Bratislava, The Faculty of Business Management, Department of Enterprise Economy,
e-mail: rybarova@dec.euba.sk

auditing contingency arrangements, making sing-offs and further investment conditional on a fully documented plan.

## TARGETING BUSINESS RISK

Risk management as targeting business risk is focused on two main factors:
- To ensure the continuation of an organization through whatever challenging scenario it may face.
- To identify and reduce the risks which threaten the business operations in context business objectives.

Table 1. Stages of Risk Management
Tabela 1. Etapy zarządzania ryzykiem

| | | |
|---|---|---|
| Risk Identification | Risk Analysis | Prioritize Risks |
| | ***Risk Assessment*** | |
| Mitigate Risks | Plan for Emergencies | Measure and control |
| | ***Risk Control*** | |
| | **RISK MANAGEMENT** | |

Source: Authors' study.
Źródło: Opracowanie własne.

Risk Assessment can take place at any time. However, Risk Control cannot be effective without a previous Risk Assessment. Similarly, most people tend to think that having performed a risk assessment; they have done all that is needed. Far they spend a great deal of effort on Risk Assessment and then ignore Risk Control completely.

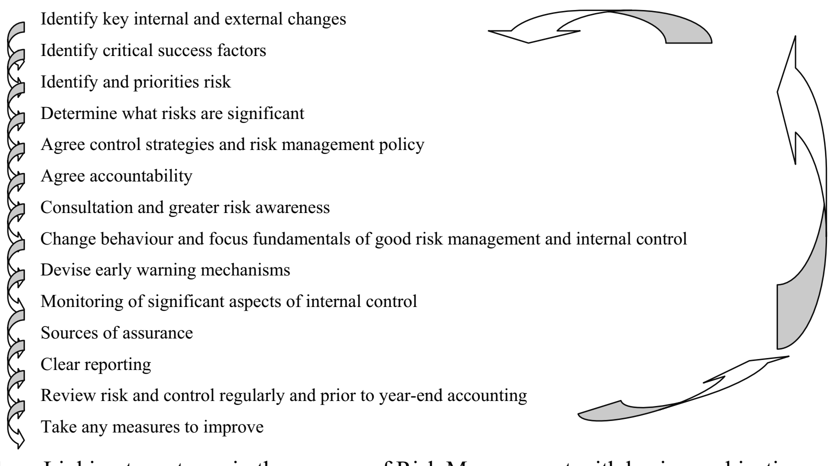


Fig. 1. Linking two stages in the process of Risk Management with business objectives
Rys. 1. Połączenie dwóch etapów procesu zarządzania ryzykiem z celami działalności gospodarczej
Source: Authors' study.
Źródło: Opracowanie własne.

**Identification risk and source of risks**

- Increasing Size and Complexity of communication within organizations.
- Increasing complexity of I.T. based systems and the movement to e-commerce, whilst still using dated business practices, firewalls and protection from global hacking and viruses.
- Continual changes in customer requirement and increased competitiveness of the market, due to e-commerce and the increasing globalization of the market, customers and competitors.
- Changes in product lines, entry into new markets or changes in regulatory requirements.
- Introduction new strategies, processes and standards without regard to potential skill shortages in key areas.
- Rapidity in change must be matched by the speed of changes in information security and risk management strategies and controls.
- Major changes in the regulatory control requirements and compliance. The board must ensure that it adheres to these regulations.
- Companies must be aware and in control of risks that could cause a major financial embarrassment such as forward contracts, currency hedging.
- Decisions made are often made on a unsystematic or unanalyzed basis, in consequence a there may not be a true understanding of the risks involved or there may be wide variations depending on a technological vision.
- Responsibility for critical areas are often given to external organizations with little control over how the risks will by managed or how the external supplier will react. In some cases the external service supplier will have open access to the IT systems with little or no controls applied.

Table 2. Risks that were of most concern (Deloitte & Touche)
Tabela 2. Najważniejsze rodzaje ryzyka (Deloitte & Touche)

| Types of Risk | Average Score (1 = low level of concern, 9 = high) |
|---|---|
| Failure to manage Major Projects | 7,05 |
| Failure of Strategy | 6,67 |
| Failure to innovate | 6,32 |
| Poor Reputation /brand management | 6.30 |
| Poor performance and Lack of employee motivation | 6,00 |

Source: Authors' study.
Źródło: Opracowanie własne.

**General principles of food safety risk management**

- Risk management should follow a structured approach.
- Protection of human health should be the primary consideration in risk management decisions.

- Risk management decisions and practices should be transparent.
- Determination of risk assessment policy should be included as a specific component of risk management.
- Risk management should ensure the scientific integrity of the risk assessment process by maintaining the functional separation of risk control and risk assessment.
- Risk control decisions should take into account the uncertainty in the output of the risk assessment.
- Risk management should include clear, interactive communication with consumers and other interested parties in all aspects of the process.
- Risk control should be a continuing process that takes into account all newly generated data in the evaluation and review of risk assessment.

Risk Management allows organizations to examine all the risks they face, measure the potential impact of those risks on the long-term viability of the company, and take the appropriate steps to mange or mitigate those risks. There is the systematic application of policies, practices, and resources to the assessment and control. Risk management is focused on the main factor – to ensure the continuation of an organization through whatever challenging scenario it may face. This process is exposures to achieve its objectives.

## RISK ASSESSMENT

The process of identifying, quantifying and prioritizing risks makes them more prominent and real to executive and managers who may not have given risk management significant thought before. Ultimately, line management has to be responsible for identifying, classifying, monitoring a controlling risk. An enterprise risk management team is also necessary to create a stronger tie to line managers.

**To identify risk firm need understand:**

- The business's services and product
- Know the business process risks
- Consider how people behave in different circumstances
- The quality of management team
- The changing external environment

Risk identification is process of recognizing those risks exist and trying to define its characteristics. Often risks exist and are even measured for some time before their adverse consequences are recognized. In other cases, risk identification is a deliberate procedure to review, and it is hoped, anticipate possible hazards. While the idea of identifying, quantifying and managing all the risk facing a company is compelling, the actual process of Risk Management can be a daunting and seemingly infinite task. Because it would be almost impossible for a company to quantify all the risks it faces, risk identification at the level of granular detail is not necessary and can even be detrimental to a thoughtful Risk Assessment. For Risk Management to be effective, an organization should define clear, realistic goals and their intended results. The Assessment's team should set priorities and concentrate its efforts only on the five or 10 risks that are significant enough to warrant quantifying and analyzing.

Table 3. Useful techniques for identifying business risk (Deloitte & Touche)
Tabela 3. Użyteczne techniki identyfikacji ryzyka w działalności gospodarczej (Deloitte & Touche)

| Method | Average Score<br>1 = low level, 9 = high |
|---|---|
| Round table Discussions<br>„Brainstorming" | 6,92 |
| Interactive Workshops | 6,62 |
| Strategic risk reviews | 6,58 |
| Specific Studies or reviews | 6,42 |
| Structured Interviews | 6,04 |
| Management Reports | 5,60 |
| Questionnaires and checklists | 4,43 |

Source: Authors' study.
Źródło: Opracowanie własne.

Once a company has identified its key risks, it must quantify the magnitude of those risks. Quantification helps an organization decide whether to control, prevent, finance or avoid risk. Risk analysis is the scientific determination of the characteristics of risks, usually in as quantitative a way as possible. These include the magnitude, spatial scale, duration and intensity of adverse consequences and their associated probabilities as well as a description of the cause and effect links. Risk evaluation is a component of risk assessment in which judgments are made about the significance and acceptability of risk

Analyze each potential action and establish possible outcomes from beginning to end. Assess potential business impact and cost implications on:

- Cash Flow
- Profit and Loss
- Public relations, outside reputation and image
- Bank and shareholder confidence
- Obligations

Impact should be considered not primarily in financial terms but in terms of potential impact on achieving the company objectives.

## RISK CONTROL

After identification and prioritization determine the following selection of preferred management options, including consideration of an appropriate safety standard, assessment of effectiveness of measures taken, review risk management and assessment as necessary.

The outcome of the risk evaluation process should be combined with the evaluation of available risk management options in order to reach a decision on management of the risk. In arriving at this decision, human health protection should be the primary consideration, with other factors e.g. economic costs, benefits, technical feasibility, risk perceptions, etc. being considered as appropriate. Implementation of the management decision should be followed by monitoring both the effectiveness of the control measure and its impact on risk to the exposed consumer population, to ensure that the food safety objective is being met.

**Important questions in process risk control:**

– **Is the risk accepted?**

Do the identified risks exceed the rewards obtained by achieving the objective?

Quantifying risk requires a large amount of historical data on the company's risk experience in that area. Once a company has identified and cleaned up its data, it can use the data to create a model of the impact a loss in a given risk category would resent, as well as the odds that the loss will occur.

– **What is the strategy to avoid or mitigate the gross risk?**

There is no set formula for determining the perfect risk management strategy. The selection of an appropriate strategy is driven by existing risk factors and cost/benefit analysis. Typical risk management strategies are:

- **Finance risk** – **Insurance** – One approach to risk management involves purchasing enough insurance to transfer responsibility for losses to insurer.
- **Transfer risk** – Where appropriate, company will want to shift the responsibility for risk to its lessors, vendors, subcontractors, competitors and even its customers.
- **Control risk** – There are things company can't prevent, like storms, power failures, or accidents. But there are ways of minimizing either the likelihood something will occur, or the impact it will have on its business after it occurs.

Companies generally deal with insurable risks by looking at what they did the previous year and what the insurance market is offering this year. When it comes to insuring some risks, companies' should take a fresh approach. With the large capacity of the insurance market, businesses can work with insurers and brokers to design a customized insurance solution. When adopting specialized insurance approaches, organizations need to develop long-term solutions. Finally, there are some types of risk, such as those associated with a company's brand or reputation, which insurance will not cover. In these cases, mitigation and risk management means making sure someone is responsible for that risk, has the resources necessary to manage it and has a disaster recovery plan in place should a problem occur.

– **Who is accountable for managing the risk and maintaining and monitoring the control?**

Delegation to those responsible for managing business activities.

– **What risk remains after the application of control processes?**

It is not possible to eliminate all risk – need to know risk profile and how to manage it, business objectives in line with risk appetite. The risk tolerance level, for the purposes of business planning, is that level of risk that the Senior Manager is prepared to accept. Criteria to establish the threshold for the risk tolerance level vary from issue to issue, and from organization to organization.

– **What is the early warning system?**

A company's system of internal control has a key role in the management of risks that are significant to the fulfillment of its business objectives. The company's objectives, its internal organization and the environment in which it operates are continually evolving and the risks faced constantly changing. A sound system of internal control therefore depends on a thorough and regular evaluation of the nature and extent of the risks to which it is exposed.

**Developing and implementing Business Continuity Plans**

Risk management prepare formal plan of the protection measure that have devised plus the recovery measures to be taken. Plan must exist on paper not in the head. Response is more effective if the thinking has been performed in advance. Plan should be copied to all managers and be easily accessed in the event of an emergency.

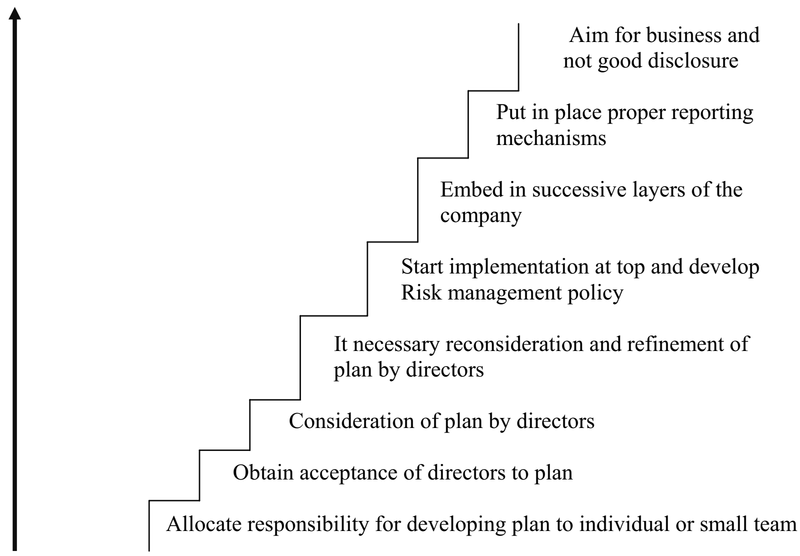


Fig. 2. Developing and implementing Business Continuity Plans and suggested steps
Rys. 2. Rozwój i wdrażanie planów ciągłości działalności gospodarczej oraz sugerowane kroki
Source: Authors' study
Źródło: Opracowanie własne

Develop ancillary program to make the all employees aware of its existence. Communicate to key employees the contents and actions required in the event of the plan being action. Prepare regular exercises to train and test the procedures. Correct plan and communicate changes should the exercises demonstrate flaws.

Building a culture of risk management is primarily a process of developing people in the organization who think and plan effectively, and who are supported by company systems that encourage them to think and plan effectively. A risk management culture can be defined as the „prevailing standard for how risk is handled. An organization with a strong risk management culture has policies and procedures that require its workforce to go through disciplined risk identification, assessment and planning.

**A Risk Management Culture and People Issues:**

- Do remuneration policies encourage good risk management?
- Do working practices encourage good risk management and discourage taking reckless or bad risks.
- Try and instill an attitude of doing things right first time.
- Is accountability sufficiently clear?
- Is there a culture where people are prepared to report problems not sit on them?
- Are different parts of the company appropriately coordinated?
- Have the personnel got sufficient knowledge, skills and tools to achieve the company objectives and manage the risks effectively?
- Have appropriate work practices and training been implemented?
- Is there a common risk management vocabulary within the company?

## CONCLUSION

The core challenge of Risk Management is to bring the company to a pint where it can identify the risks those are the greatest treat to its continued growth and success, quantify the size of those risks, and take steps to mange or mitigate them.

**Potential Benefits of Risk Management for the Company:**

- Gain early early-mover advantage by adapting to circumstances quicker
- Provides a better basis for strategy setting
- Fewer shocks and unwelcome surprises
- Greater likelihood of achieving business objectives
- Reduction in management time spent “fire-fighting”
- Increased likelihood of change initiatives being achieved
- More focus internally on doing the right things properly
- Move into business areas quicker
- Achievement of competitive advantage

## REFERENCES

Bruce T. Barkley: Project Risk Management. McGraw-Hill, New York, 2004. ISBN 0-07-143691-X

Culp, Ch.L.: The Risk Management Process. Business Strategy and Tactics. John Wiley and Sons, 2001. ISBN 0-47-140554-X

Vaughan, E. J., Vaughan, T.M.: Essentials of Risk Management and Insurance. Second Edition, 2000. ISBN 0-47- 133183-X

## IDENTYFIKACJA RYZYKA I ZNACZENIE UBEZPIECZEŃ W PROWADZENIU DZIAŁALNOŚCI GOSPODARCZEJ

**Streszczenie.** Wzrost obaw o zdolność przetrwania w przyszłości ma miejsce w wielu współczesnych organizacjach, szczególnie w przypadku dotkliwych zakłóceń w prowadzeniu działalności gospodarczej. Praktycznym wymiarem zdolności przetrwania jest identyfikacja ryzyka. W przypadku ciągłego ryzyka dochodzi do sytuacji, kiedy zarządzanie nim nie jest prowadzone prawidłowo. Niemożność zarządzania ryzykiem polega bowiem na niezdolności do podejmowania decyzji planistycznych oraz oceny stopnia realizacji celów. Zrozumienie ryzyka prowadzenia działalności gospodarczej wymaga spełnienia trzech kryteriów: pełnego zrozumienia procesów gospodarczych, aktywnych instrumentów i narzędzi generowania scenariuszy odnośnie możliwych efektów ryzyka, ram lub modelu ryzyka oraz wspólnego języka do dyskusji na temat ryzyka.

**Słowa kluczowe:** ocena ryzyka, kontrola ryzyka, źródła ryzyka, ubezpieczenie

Zaakceptowano do druku – Accepted for print: 21.11.2008