

Session 7: Introduction to Enterprise Risk Management

1. Scaffold Equipment manufactures and sells scaffolds and ladders that are used by construction firms. The products are sold directly to independent retailers in the United States. The company's risk manager knows that the company could be sued if a scaffold or ladder is defective, and someone is injured. Because the cost of products liability insurance has increased, the risk manager is considering other techniques to treat the company's loss exposures.

a. Describe the steps in the risk management process.

Answer: There are four steps in the risk management process: (1) identify major and minor loss exposures; (2) measure and analyze the loss exposures in terms of loss frequency and loss severity; (3) select the appropriate technique or combination of techniques for treating the loss exposures; and (4) implement and monitor the program.

- b. For each of the following risk management techniques, describe a specific action using that technique that may be helpful in dealing with the company's products liability exposure.

1. Avoidance
2. Loss prevention
3. Loss reduction
4. Noninsurance transfers

Answer:

(1) *Avoidance.* The firm could discontinue manufacturing certain ladders and scaffolds that could result in a products liability lawsuit.

(2) *Loss prevention.* The firm could issue detailed instructions on how the ladders and scaffolds can be safely used.

(3) *Loss reduction.* Claims involving injured persons should be promptly investigated. Procedures for providing immediate medical attention to injured persons should be established. Such measures can reduce the severity of a loss.

(4) *Noninsurance transfers.* A hold-harmless agreement could be used by which retailers agree to hold Scaffold Equipment harmless if someone is injured while using a ladder or scaffold manufactured by Scaffold Equipment.

2. Avoidance is a risk-control technique that can be used effectively in a risk management program. Is it possible or practical for a firm to avoid all potential losses? Explain your answer.
3. Chris and Karen are married and own a three-bedroom home in a large Midwestern city. Their son, Christian, attends college away from home and lives in a fraternity house. Their daughter, Kelly, is a senior in high school. Chris is an accountant who works for a local accounting firm. Karen is a marketing analyst and is often away from home several days at a time. Kelly earns extra cash by babysitting on a regular basis. The family's home contains household furniture, personal property, a computer that Chris uses to prepare business tax returns on weekends, and a laptop computer that Karen uses while traveling. The Swifts also own three cars. Christian drives a 2004 Ford; Chris drives a 2009 Pontiac for both business and personal use; and Karen drives a 2011 Toyota and a rental car when she is traveling. Although the Swifts have owned their home for several years, they are considering moving because of the recent increase in violent crime in their neighborhood.

a. Describe briefly the steps in the personal risk management process.

Answer: A personal risk management program has the following steps:

- Identify loss exposures
- Analyze the loss exposures
- Select appropriate techniques for treating the loss exposures
- Implement and review the program periodically

b. Identify the major pure risks or pure loss exposures to which Chris and Karen are exposed with respect to each of the following:

1. Personal loss exposures
2. Property loss exposures
3. Liability loss exposures

Answer:

(1) Major personal loss exposures include the following:

- Premature death of Chris or Karen and the subsequent loss of financial support to surviving family members
- Catastrophic medical bills incurred by Chris or Karen
- Catastrophic medical bills incurred by Christian or Kelly
- Total disability of Chris or Karen and the subsequent loss of financial support to the surviving family members

(2) Major property loss exposures include the following:

- Physical damage or theft of household personal property
- Physical damage or theft of family cars
- Theft of the laptop computer used by Karen while traveling
- Damage or theft of the business computer used by Chris
- Residing in a high crime-rate area, which increases the probability of theft or robbery

(3) Major liability loss exposures include the following:

- Legal liability arising out of the operation of a family car by family members
- Legal liability arising out of the use of a rental car by Karen when she is traveling
- Legal liability arising out of other activities of family members that can result in bodily injury or property damage to others

c. With respect to each of the loss exposures mentioned above, identify an appropriate personal risk management technique that could be used to treat the exposure.

Answer: Chris and Karen should purchase adequate life insurance and disability income insurance to deal with the risk of premature death and total disability. Chris and Karen and the children should be insured under a group or individual major medical expense policy to deal with the risk of catastrophic medical bills. Loss control could also be used by practicing healthy lifestyle habits.

A homeowners policy would cover the physical damage and theft of household property. Collision and comprehensive auto insurance would cover the possible physical damage or theft of a family car; retention could also be used by having a deductible for collision and comprehensive losses. Chris and Karen should also check with their insurance agent to see if their homeowners policy provides adequate insurance on the business computer and laptop computer. Karen could also use risk control when she is traveling by not leaving the laptop computer unattended.

The legal liability loss exposures can be handled by a homeowners policy, which provides personal liability insurance. Auto legal liability insurance could insure the legal liability arising out of the negligent operation of a family car by family members.