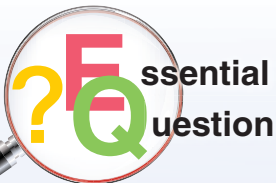


Section 14.1

Understanding Risk



How can a business identify and manage risk?

Objectives

After completing this section, you will be able to:

- Identify various types of risk.
- **Explain** the concept of risk management.

Section 14.1 Review

Check Your Understanding

1. What is business risk?
Answer: Business risk is the possibility of loss or injury that affects a business.
2. List four basic types of risk.
Answer: The four basic types of risk are natural risk, economic risk, market risk, and human risk.
3. What are some examples of pure risks?
Answer: Pure risks include personal risks, property risks, and liability risks.
4. Why are speculative risks not insurable?
Answer: Most speculative risks are not insurable because they are taken willingly in hopes of making a gain.
5. Once risks have been identified, how can they be managed?
Answer: Many potential risks identified can be avoided, reduced, transferred, or assumed.

Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

risk

Answer: Possibility of loss, damage, or injury.

natural risk

Answer: Situation caused by acts of nature.

economic risk

Answer: Situation that occurs when business activities suffer due to changes in the US or world economy.

market risk

Answer: Potential that the target market for new goods or services is much less than originally projected.

human risk

Answer: Negative situation caused by the actions of people.

risk management

Answer: Process of evaluating risk and finding ways to minimize or manage loss.

controllable risks

Answer: Situations that cannot be avoided, but can be minimized by purchasing insurance or creating a risk management plan.

uncontrollable risks

Answer: Situations that cannot be predicted or covered by purchasing insurance.

pure risk

Answer: Risk with a possibility of loss, but no possibility of gain.

speculative risk

Answer: Risk that can result in either financial gain or financial loss.

insurance

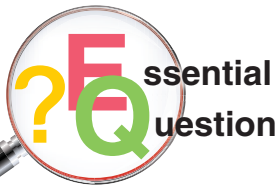
Answer: Financial service used to protect against loss.

uninsurable risk

Answer: Risk that an insurance company will not cover.

Section 14.2

Business Insurance



How can insurance help manage business risks?

Objectives

After studying this section, you will be able to:

- **Explain** the role of insurance companies in helping customers managing risk.
- **Identify** the types of insurance.
- **Describe** common insurance coverage for businesses.

Section 14.2 Review

Check Your Understanding

1. Explain the most well-known service provided by insurance companies.

Answer: The most well-known service provided by insurance companies is financial protection through insurance policies. The insurance company, the *insurer*, protects the *insured*, the policyholder. For a fee, the insurer provides the insured with protection against economic loss.

2. Name two types of insurance agents.

Answer: Two types of insurance agents are independent and contract.

3. How does the Small Business Administration (SBA) categorize some types of insurance needs?

Answer: The Small Business Administration (SBA) categorizes some types of insurance needs as general liability, product liability, professional liability, and commercial insurance.

4. List examples of types of common insurance coverage for businesses.

Answer: Most businesses have coverage for liability, property, auto, and employees of the business.

5. List three examples of coverage provided by employers for employees.

Answer: Examples of employee insurance include worker's compensation, unemployment, and disability insurance.

Build Your Vocabulary

As you progress through this course, develop a personal glossary of key terms. This will help you build your vocabulary and prepare you for a career. Write a definition for each of the following terms and add it to your personal glossary.

insurance policy

Answer: Defines the type of losses that are covered, amount of coverage in dollars, and other conditions to which the two parties agree.

premium

Answer: Amount the insured pays for insurance coverage.

claim

Answer: Process of documenting a loss against an insurance policy.

deductible

Answer: Amount the insured is responsible for paying when a claim is made.

general liability insurance

Answer: Protects against financial losses that result from legal issues.

product liability insurance

Answer: Protects against financial losses due to a product defect that may cause injury to the user of the product.

professional liability insurance

Answer: Protects service-based businesses from financial losses caused by errors and negligence in how a service is provided; also called *malpractice insurance*.

commercial insurance

Answer: Protects commercial property from risks, such as fire, theft, and natural disaster.

liability insurance

Answer: Covers financial losses caused by the actions or negligence of a person or business.

business interruption insurance

Answer: Covers the lost income and related expenses caused by a property damage loss.

fidelity bond

Answer: Covers financial and property losses caused by employee actions.

directors and officers insurance

Answer: Protects a business from financial losses caused by the actions of the company's executive officers.

data breach insurance

Answer: Covers the legal fees and other financial losses sustained when a company's data files are accessed without permission.

property insurance

Answer: Covers losses and damage to the assets of a business caused by a variety of events, such as floods, fire, smoke, and vandalism.

worker's compensation insurance

Answer: Covers medical expenses and lost wages for employees who are injured at work.

unemployment insurance

Answer: Provides certain benefits to workers who have lost their jobs through no fault of their own.

disability insurance

Answer: Provides some financial income to employees who become sick or injured due to a nonwork related event or condition.

Chapter Summary

Section 14.1 Understanding Risk

- All businesses activities involve risk. A risk is the possibility of loss, damage, or injury. Types of risk include natural risk, economic risk, market risk, and human risk. Potential business risks can be pure or speculative, as well as controllable and uncontrollable.
- Many of the risks identified can be avoided, reduced, transferred, or assumed. Risks can be managed through smart business strategies and by purchasing insurance.

Section 14.2 Business Insurance

- Insurance companies are for-profit businesses. The most well-known service provided by insurance companies is financial protection through insurance policies. The insurance company, the *insurer*, protects the *insured*, the policyholder. For a fee, the insurer provides the insured with protection against economic loss. Businesses and individuals typically purchase insurance from an insurance agent.
- Businesses buy insurance to protect against specific types of financial losses. Types of business insurance include general liability, product liability, professional liability, and commercial insurance.
- Most businesses have coverage for liability, property, vehicles, and employees of the business. Certain types of insurance are required by law when a business has employees.

Review Your Knowledge

1. Describe the four basic types of risk.

Answer: Natural risk is a situation caused by acts of nature. Economic risk is a situation that occurs when business activities suffer due to changes in the US or world economy. Market risk is the potential that a target market for new products or services is much less than originally projected. Human risk is a negative situation caused by the actions of people.

2. Explain the concept of risk management.

Answer: Risk management is the process of evaluating risk and finding ways to minimize or manage loss. Businesses are liable for their risks. *Liable* means responsible. When discussing the damages and responsibility related to risks, *liability* means legal responsibility for actions and costs.

3. Differentiate between controllable and uncontrollable risks.

Answer: Controllable risks are situations that cannot be avoided, but can be minimized by purchasing insurance or creating a risk management plan. Uncontrollable risks are situations that cannot be predicted or covered by purchasing insurance.

4. Differentiate between pure and speculative risks.

Answer: Pure risk is a risk with a possibility of loss, but no possibility of gain. Conversely, speculative risk is a risk that can result in either financial gain or financial loss.

5. Explain how businesses can self-insure.

Answer: A business may choose to self-insure by saving money to cover the financial losses of some risks. One way to self-insure is by setting up a bank account specifically for this purpose. Money can be automatically deposited into the account each month to cover a future loss. Setting up a special account is similar to paying a premium to an insurance company, but the premium is paid to the business, and the business assumes 100 percent of the risk.

6. Explain the role of insurance companies in managing risk.

Answer: Insurance companies provide financial protection through insurance policies. By purchasing insurance policyholders become members of a large pool of customers. Each customer's risk is transferred to the insurance company. The insurance company charges its customers premiums to assume their risk.

7. Identify the common types of commercial insurance that a business might purchase.

Answer: Examples of commercial insurance that a business might purchase include property, auto, inland marine, equipment breakdown, and ordinance or law insurance.

8. Identify and describe types of liability insurance that a business might purchase.

Answer: Business interruption insurance covers the lost income and related expenses caused by a property damage loss. Fidelity bonds cover financial and property losses caused by employee actions. Directors and officers insurance protects a business from financial losses caused by the actions of the company's executive officers. Data breach insurance covers legal fees and other financial losses sustained when a company's data files are accessed without permission.

9. Describe the coverage provided by commercial vehicle insurance.

Answer: Vehicle insurance covers all types of commercial vehicles owned by the business. This includes trucks, cars, and trailers. The coverage includes damage to the vehicles, property damaged as a result of the vehicles, and injuries to individuals resulting from accidents.

10. What types of insurance are required by law for businesses to provide for their employees?

Answer: Businesses with employees are required by law to carry workers' compensation, unemployment insurance, and disability insurance.

Apply Your Knowledge

1. Make a list of some tasks and activities in which students participate on a daily basis in your school environment. Examples could be as basic as walking down the hall or as involved as playing on the football team. Next to each activity in your list, identify a potential natural risk, economic risk, market risk, and human risk that could occur. What did you learn from this exercise?

Answer: Student answers will vary. Evaluate each response individually.

2. Many of the risks identified by a business can be avoided, reduced, transferred, or assumed. Select a business with which you are familiar, such as a local retail store or restaurant. Create a chart with three columns. Label the columns as Avoid/Reduce, Transfer, and Assume. Identify specific risks your chosen business might encounter. Sort the risks into the appropriate columns on the chart, indicating if each risk can be avoided, reduced, transferred, or assumed.

Answer: Student answers will vary. Evaluate each response individually.

3. Security risks are an important consideration for all businesses, especially retail businesses. To avoid or reduce risk, some businesses install security systems. Make a list of the types of business risks that can be avoided or reduced by installing a security system.

Answer: Student answers will vary. Evaluate each response individually.

4. Select a business in your area with which you are familiar. Identify the activities that the business performs, as well as the location of the business. Make a list of items that would be covered by property insurance for this business.

Answer: Student answers will vary. Evaluate each response individually.

5. Employees pose various risks to their employers. How can a business plan to reduce risks that pertain to employees?

Answer: Student answers will vary. Evaluate each response individually.



You Do the Math

Statistical Reasoning

Qualitative data include things that can be observed, but not measured. Smell, taste, color, appearance, and texture are all examples of types of qualitative data. On the other hand, quantitative data include things that can be measured. Distance, weight, cost, speed, and temperature are all examples of types of quantitative data.

Solve the following problems.

1. The catalog description of a product reads as follows: attractive, blue product has a smooth finish, fits in a space 5 inches wide, and weighs 14 ounces. List the qualitative data and quantitative data in this description.

Answer:

Qualitative: attractive, blue, smooth finish.

Quantitative: 5 inches wide, 14 ounces in weight.

2. A business describes its customer service staff as follows: a staff of 17 pleasant and helpful representatives includes five certified technicians and two master technicians. List the qualitative data and quantitative data in this description.

Answer: Qualitative data include: pleasant, helpful.

Quantitative data include: 17 representatives, five certified technicians, and two master technicians.

3. Look around your classroom. Describe your classmates using only quantitative data.

Answer: Answers will vary.