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**Small Business Protection:
Risk Management
and Insurance**

Source: Entrepreneurial Small Business, Katz & Green, 2e
McGraw-Hill/Irwin

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Risk in Small Business

- Risk is the very real likelihood that the business may not succeed
- Some business owners are **risk seeking**, although most small business owners are **risk averse**
- **Business risk**: probability that the future state of the business will be less successful than planned

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Example

Game of Risk

- Starting a business is a risk in itself, but getting a new company off the ground is the easy part
- Ramin Kamfar, who last year grew his Eaton, New Jersey-based company, New World Coffee-Manhattan Bagel Inc., from a robust \$40 million-dollar business into a \$400 million one
 - "Risk is part of any business, and it's inherent in any job, whether you're an entrepreneur or a midlevel manager. The trick is to learn to manage that risk and to make sure that all risks are calculated risks."

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- **Most commonly identified sources of risk:**
 - Financial risk
 - Nonpayment of debts
 - Changes in technology
 - Injury and illnesses suffered by employees
 - Injury from accidents incurred by customers
 - Natural events (storms, floods, fire, earthquakes)
 - Theft of business property
 - Misbehavior by employees

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- **Three general types of events that cause business risk:**
 1. Events related to the property of the business
 2. Events related to personnel
 3. Events related to customers and others

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1. **Property of the business:**
 - Property involves **specific forms of risk**
 - Inventory can be stolen, machinery can break
 - Buildings can be damaged or destroyed
 - Land may become contaminated
 - Patents may be infringed upon
2. **Events related to personnel:**
 - Theft, violation of government regulations, loss of key employees

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3. Events related to customers and others:

- Risk from customers primarily arises from:
 - Injuries suffered while upon business property
 - Injury or damage that is caused during the use of the business's products
- **Product liability:** payments for injury or damage that occurs during the use of the business's products

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• Events related to customers and others: (cont.)

- Risk of **nonpayment** by customers is experienced by all business that offer credit
- Balance **two conflicting things** when you decide to offer credit:
 - It will increase your sales
 - Offering credit guarantees sooner or later some customer will not pay as promised

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Managing Risks

- **Best strategy** is to develop a business environment that **minimizes:**
 - Probability of the event occurring
 - Amount of loss that can be experienced if the event does occur

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- **You create this strategy by:**
 - Making specific plans for, and arrangements to deal with, foreseeable events
 - Creating and enforcing an appropriate code of conduct for yourself and all employees
 - Ensuring that valuable assets are physically secure
 - Actively working to get rid of any physical hazards in your workplace

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- **Managing risk to tangible property:**
 - Land and buildings can be damaged or destroyed
 - Equipment can be stolen
 - Small items of high value can be stolen
- **Managing risk to buildings and land:**
 - Protection may be obtained through such measures as installing smoke alarms and sprinkler systems

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- **Managing risk to Computers and Data:**
 - Riskiest areas of business involves computers connected to the internet
 - Protecting your PC by installing a:
 - Firewall
 - Antivirus program
 - Antispyware program
 - Simplest answer is to buy an all-in-one collection of security programs
 - Norton Internet Security
 - ZoneAlarm Internet Security Suite

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- **Managing risk to intangible property:**
 - Intellectual property rights comprise the legal rights to use unique features of products of services that provide competitive advantage
 - Problem is that no government agency will assist you to maintain your legal rights
 - **Two things to protect from theft:**
 - Physically protect your property
 - Develop rules that prevent employee theft

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Example

Theft Prevention

- Shoplifting, employee theft, and theft in any form costs companies billions of dollars in lost revenues and profits each year
- Instructional classes can be taught in a group format that would include the business owner, management, and staff at the client's location during nonbusiness hours
- Theft prevention firms specialize in very in-depth and costly theft prevention programs as a method to separate their service from potential competitors

<http://www.entrepreneur.com/businesses/958.html>

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Sources of Theft



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- **Managing risks resulting from events involving personnel:**
 - Screen potential employees: background checks, drug tests, psychological tests
 - No hiring process is 100% foolproof
 - 2004 study (the Wells Report): most costly employee frauds occur in business with fewer than 100 employees
 - Internal Control: primary method of ensuring honesty in employees

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- **Managing risk from violations of tax regulations: limit your exposure**
 - Keep complete, accurate accounting records:
 - Control access to accounting system
 - File all source documents
 - Establish a relationship with both an accountant and lawyer who are expert in tax issues
 - Make paying your taxes your first financial priority

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- **Managing risk from employee violation of government regulations:**
 - Reducing risk is best accomplished through a proactive program of training and enforcing appropriate policies and procedures
 - You are financially responsible for employee violations, intentional or inadvertent
 - Few cases where employer has been held harmless all involve employers who:
 - Have a written policy provided to each employee
 - Have conducted training of managers and employees concerning those policies
 - Have immediately and consistently acted upon receipt of any complaint

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- **Managing risk from employee violation of government regulations:**
 - Assistance can be obtained from experts:
 - SCORE: www.score.org
 - EEOC maintains a website that contains myriad resources for small business owners
 - HR Personnel
 - Managers or Supervisors

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- **Managing risk from employee violation of government regulations:**
 - Must also keep accurate records of all employee job-related illnesses
 - Must report within eight hours any accidents resulting in fatalities or in hospitalization of three or more employees

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Insuring Against Risks

- Use of insurance can minimize the damage that such risks can cause
- **Using insurance to manage risks:**
 - Insurance provides a benefit by requiring a relatively small fee compared to amount of loss
 - The more likely an event is to occur, and the greater the potential amount the insurance company must pay, the higher the price you must pay for coverage

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- **Developing a comprehensive insurance program:**
 - Identifying risk is the first task
 - Determine which risks are to be covered
 - Vehicle liability
 - Worker's compensation
 - General liability
 - Various types of malpractice coverage

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- **Insuring the property of the business:**
 - Commercial property insurance covers losses to the business property from causes such as fire, storm, vandalism, and theft
 - **Insurance is determined:**
 - Property's insurable value
 - Amount of deductible loss
 - Amount of co-insurance required
 - Loss limits of the policy

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- **Insuring the property of the business:**
 - **Business interruption insurance:** funds to pay the ordinary operating expenses of your business should it be forced to close temporarily
 - **Crime insurance:** protection against losses from crimes committed against your business
 - **Theft insurance:** normally included in insurance on physical assets

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- Insuring the property of the business:
 - Credit insurance: covers abnormal losses from credit customers not paying their bills
 - Personnel insurance: available to protect both you and your employees from specific risks
 - Life
 - Disability
 - Medical coverage

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- Insuring the property of the business:
 - Key person: protects you in the event that a key employee dies or is disabled and cannot work
 - Life insurance: provided to employees to provide security for their families
 - Disability: usually part of life insurance; stand-alone or part of medical coverage
 - Medical: most highly desired form of insurance for most employees

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Sharing Risks

- Very effective method to reduce and to control business risk is to **share that risk** with other entities
 - By forming joint ventures, by joining industry groups, and by obtaining government grants and guarantees

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Summary

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