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## Small Business Protection: Risk Management and Insurance

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

## Chapter 17

### 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."

<http://www.entrepreneur.com/magazine/entrepreneur/2003/april/49792.html>

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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/businessideas/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](http://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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