INSIGHTS BUSINESS INSURANCE

Risk and reward

How to manage risk and control insurance costs

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Every business experiences risk, but determining the true cost of risk can be difficult.

"It's much harder to calculate the impact that negative publicity has on your revenue versus lost productivity due to equipment downtime," says Derek M. Hoch, president of Leverity.

"To develop the most appropriate risk management program for your organization, business owners should approach insurance through a variety of cost control strategies. These include identifying exposures, implementing control measures, transferring risk and managing your exposures," Hoch says.

Smart Business spoke with Hoch about developing a strategic action plan to effectively monitor and manage risk, ultimately resulting in reduced costs.

How do you identify exposures?

Exposures are both qualitative and quantitative. Partnering with an insurance agent who understands these aspects of your business will provide important details that help to solidify a game plan. What keeps you up at night? If your biggest concern were to occur, would you be prepared to keep your business viable? How would your income or cash flow be affected if there were unforeseen depletions of capital or a shutdown in the plant? Is the company in a financial position to take on risk or would you rather transfer that risk to an insurance carrier? It's also important to consider your industry, market position and competition in developing a risk management solution that fits the changing needs of your business.

Quantitative analysis supports the qualitative interview. Look at the hard numbers and review losses to identify:

- Average incurred costs per loss.
- Top loss drivers and trends.
- Fraud behaviors.
- Reporting lag time.
- Frequency and severity ratios.
- Occupational Safety and Health Administration (OSHA) recordable performance.

Both qualitative and quantitative analysis is important, as they help identify your total costs of risk and lead to the price of your risk management program.

What control measures can be implemented to reduce risk?

Once you've identified exposures, focus on control measures — an estimated 75 percent of commercial insurance expenses are claims-driven. A business can control and reduce this percentage through pre- and post-loss control measures. This process should help to establish a safety program that will deliver a comprehensive employee safety education campaign to address your exposures.

How do you decide what risk to transfer?

A trusted insurance adviser can help you balance how much risk you're willing to take versus the cost of transferring that risk. Important questions to ask are:

- How much risk can I afford to assume in-house?
- How can a business insurance provider assist with contractually transferring that risk to a third party?
- What portion of the exposures do I want to finance through an insurance policy?

Answers to these questions provide direction on how to approach the proper placement of insurance policies. You also need to consider current cash flow needs. If you have a mature loss control program and financial reserves to cover shock losses that occur, self-insurance retentions are also a consideration.

How do you manage exposures?

Roughly 25 percent of businesses that sustain a major catastrophe go out of business within a year. You have to be prepared to respond if there is an interruption in your operations. Planning ahead and developing a comprehensive business continuity plan is vital to achieve this goal and keep your business viable.

Implementing risk management strategies will reduce costs, because the total cost of risk is synonymous with price. ●