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Industrial Risk Management in Financial Institutions: A Case Study of the Nigerian Insurance Industry

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Abstract
Risk management is of great importance in the recent years in Nigeria due to volatility and harsh economic conditions. Insurance companies being risk bearers have continued to play a significant role in the country's risks management. Thus, this study examined the contributions of risks management in Nigerian Insurance Companies with the aim of highlighting the importance, benefits and the risk management process. It was established that risk management is not a panacea to the problems of developing countries, but it offers potential benefits through its incorporation into the legal, cultural, economic and environmental settings of developing nations. Risk management practices present opportunities of getting rid of risk or hazardous situation. In this regards, there is need for government to design and implement laws to promote effective risk management practices. Also, insurance companies should have working internal controls and sustainable risk management programmes to enhance performance. Therefore, the study concluded that, suitable risk management structure is necessary to facilitate effective and efficient risk management in a developing economy.
Keywords: Risk management, Financial Institutions, Nigeria

1.0 introduction

Risk forms an integral part of an organization because no business can operate in isolation of risk. The core objective of business decision making is assessing the potential risks and gains involved in various courses of action. Thus, business activities of an organization involve taking risk with the objective of making profit. Also, risk can be regarded as the possibility that an actual outcome will deviate from expected result. It is the probability of the occurrence of expected outcome. Omondi (2015) defines risk as a probable harm or hazardous misfortune which may occur to an organization that might not be favorable to the normal functioning of firms. Odele (1991) argued that risk is the possibility that positive expectation of a goal oriented system will not be fulfilled. Broadly, risk can be regarded as the uncertainties of future occurrences. While Fadun (2013) opined that managing risks from negative aspect may result in complete omission of opportunities embedded in risky situation. However, Kelman (2003) asserted that there are different perspectives in risk definition which largely depends on the risk observer. Moreover, risk sometimes entails some economic benefits, as firms may derive considerable gains by taking risk. Business grows through greater risk taking (Drucker, 1997; Fadun, *ibid*).

Insurance industry serve as the life wheel of any nation`s economy. The survival of the insurance industry is a necessity for the survival of other industries and the nation through its risk mitigating role. The main financial objective of any insurance company is to make profit.

Risk management is the mechanism or tools employed to reduce or eliminate risk borne by their insured through the process by which an unexpected lost contingency is managed. The provision of insurance cover by the insurance companies results in the protection of assets, earnings, liabilities and properties if an enterprise with maximum efficiency and at minimum cost. (Odele, 1991). Gibson (2009) viewed risk management as a management tool which can be used by any organization or department, regardless of size, for the purpose of minimizing the adverse financial effects of accidental loss. In addition, Olowude (1992) opined that the goal of risk management is the continuity in operations and stability of an organization in order to deliver its products or services optimally. The goal is not only limited to the protection of assets and income of an organization from the occurrence of potential loss, but also protect the interest of other stakeholder's depending n the organization (Gibso, 2009). Thus, risk management contribute immensely to the promotion of efficiency, allocation and usage organizational resources.

Many developing countries including Nigeria are faced with diverse challenges. Some which includes political instability, poverty, high foreign debt, budget deficit, unstable exchange rate, technological backwardness among others which require proper risk management which include preservation of existing resources, assets, industrial growth, export promotion and political considerations. Thus, through effective risk management, the risk associated with hazardous or unwanted situations will be kept within an acceptable level.

Risk management in the industrial sector is an essential tool through which optimum productivity is achieved. It guarantees uninterrupted production activities through adequate control of hazard inherent in operational activities and ensures cost effectiveness in the overall process of management. The dawn of industrialization and technological innovations brought with it the menace of risk. Industrial and commercial activities involve risks which jeopardize health, life, assets and other properties. The exposure to risks and other

forms of losses could affect industries negatively when there are poor risk management practices. As the country become more industrialized, concentration increase not only in terms of benefits but also in terms of dependencies on the supplier of raw materials, equipment and technology. However, this carries with it the possibility of disastrous business activities through risk exposure which calls for effective risk movement.

2.0 The Concept of Risk Management

Risk management is the procedure of loss exposures identification confronting by an organization with an informed view of proper selection of the practically suitable methodologies for the treatment of these specific exposures successfully (Rejda, 2003). Fadun (2013) argued that risk management is not a process for avoiding risks, but adequately manages risks linked with firms' operational activities, thereby resulting in the maximization of opportunities and minimization of threats.

Risk management is a priceless instrument for managing improbability associated with business. Meulbroek (2002) stated that business enterprises have always practiced some forms of risk management either implicitly or explicitly. Thus, the concept of risk management is not new because risk management techniques like: risk reduction through safety, quality control and hazard education, alternative risk financing and insurance, including self-insurance and captive insurance, have been in existence for a long time (Doherty, 2000).

3.0 Risk Management Process

Industrialization and commercialization present high complex and multi-dimensional risk situations some of which are not insurable. However, when an insurance company is offered a risk, its underwriter assesses the acceptability of the proposed risk through an effective risk management process which includes:

Risk Assessment: This is the first element in risk management process. It involves the identification and evaluation of loss exposures. It entails a comprehensive audit and assessment of a company`s level of exposure to loss. It involves recognition of functions and events which could result in loss. Risk Assessment will assist an organization to determine their self insurance and insurance protection needs. The assessment will bring an assurance that the organization will be covered in the event of a significant or catastrophic loss (Gibson, 2009).

Risk Control: Risk control is the major important element in risk process management. Risk control can be regarded as the process of identifying and eliminating the risks of hazards or losses that could occur in an organization. It can also be viewed as a way of reducing the risks of the company to acceptable levels, thus protecting the company's future health and wealth. Identified exposures to loss can be reduced to acceptable levels of risk by examining the risk control methods used to manage and reduce the frequency and/or severity of losses (Gibso, *ibid*). Risk control involves the avoidance of the loss exposure which is the elimination of the possibility of loss by not engaging in the activity. It also involves the prevention of loss which entails all conscious efforts to avoid, reduce or prevent losses arising from accidents. It involves taking the following measures which include preventive measure, protective measure and minimization measure with the aim of eliminating the possibility of occurrence of hazard or unwanted situations.

Both in the areas of loss identification and potential loss assessment, the prevailing practices in most developing countries leave much to be desired. Most concerns in developing countries lack an adequate, cohesive systematic strategy in risk reduction and loss prevention. In some of them, many of the basic loss prevention methods are overlooked. Risk control also involves the identification and elimination of the pre-conditions (hazards) for losses. Pre-conditions such as improper training of workers and failure to maintain working areas can cause loss. Whenever these pre-conditions can be identified and eliminated, loss potential is reduced.

Risk Finance: This is the third element in the risk management system. This is the process of having enormous resources available following a loss so that the continuity of the organization as a producer of products or services can be preserved. It takes the following procedures such as retention-which involves a conscious effort to retain a portion or all of a future loss as well as relying on internal funds to pay for losses. Insurance on the other hand, is the process of safeguarding or shielding assets or properties from loss or unknown occurrence. It is the most important loss financing tool and the only way an organization can protect itself from catastrophic loss.

Loss Retention: Loss retention involves the conscious decision to retain a portion or all of a future loss. Although in many instances commercial and industrial enterprises retain loss exposures out of lack of knowledge or inadvertence, as where a risk has failed to be identified or it is underinsured because of inflation or lack of available cover. Retention is adopted when losses are predictable and within the funding capability of the organization.

Administration: Administration is the final element of the risk management process. It involves the effective implementation, monitoring and control of the overall risk management plan. It is the sector responsible for providing necessary feedback to an effective plan in the organization. It is also responsible for detecting changes in plans and reacting quickly to them.

Risk Evaluation: In order to come to decisions on the terms and conditions for a contract of insurance, the

underwriter assesses both physical and moral hazard. Physical hazard relates to the physical or tangible aspects of the subject matter of insurance, which are likely to influence the occurrence and severity of loss. Also, moral hazard is concerned with the attitudes and conduct of the insured, employees, contractors and the society at large.

4.0 The Need for Compatibility

Effective risk management practices in developing countries require the adoption of developed countries risk management practices. Risk management practices should be compatible with a country's cultural and physical environment, its level of infrastructure and other development and its financial and human resources.

In developed countries such as USA, United Kingdom, Japan, Canada, capital is relatively less expensive than labour and solutions to safety and loss control matters tend to be capital intensive rather than labour intensive. The emphasis is on safety design in equipment, buildings and construction methods and on physical ways of preventing or controlling losses and accidents.

In developing countries (Nigeria, Ghana, Kenya, Tunisia, Cameroun) the opposite occurs. Capital is relatively scarce and labour is plentiful. And because capital goods are expensive and difficult to repair and replace, risk management practices are vital. Thus, safety and other loss control activities should emphasise the human aspect and rely less on the capital aspect. Individuals should assume a relatively greater role in loss control in developing countries. This, in turn, connotes an increasing need for training of specialists and for encouraging employee safety awareness. This is one of the chief differences that underscore the need for risk management practices of developing countries not to be mere clones of those of developed countries.

The importance of the culture within of a country is too often ignored. For example, the logic pattern of individuals varies by culture and can influence greatly the success of certain loss control measures. Strong interpersonal and family ties must always be respected. Such intangibles as the cultural expectation as to duty, obligation, and loyalty can have a great impact on the success of a risk management programme. Religion is especially important in many societies and can play a key role in helping to deal with risks and minimizing their adverse impacts (Akinwale, 2007; Akinwale & Abiola, 2007).

5.0 Strategies To Improve Industrial Risk Management

5.1 The Role of Government: The protection of citizens is the most important obligation of government. This makes it imperative for government to assume major role for promoting risk management. Appreciable sum of money should be budgeted for protection measures related to hazardous products, unsafe work environments, natural calamities, chemical exposure and other forms of environment pollution. Also, appropriate laws and legislations should be designed to compliment this through adequate enforcement and compliance mechanism.

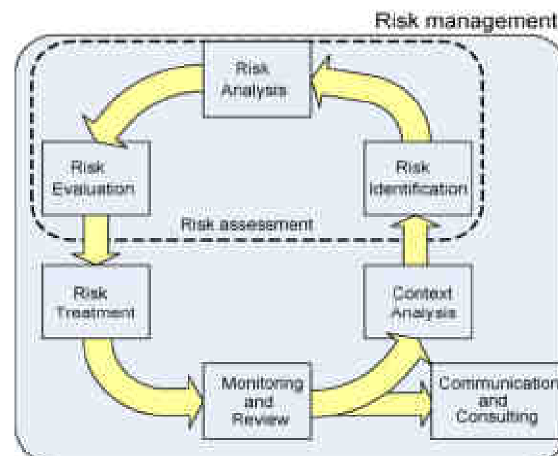
5.2 The Role of Intermediaries: In the recent years, insurance intermediaries have played significant role in insurance business by helping the buyer in focusing on the buyer's specific insurance needs and locating the appropriate insurance markets to meets these needs. However, insurance intermediaries should do more than insurance placement by involving in the area of loss control, appraisal of risks and rendering of claim management and axillary services.

5.3 The Role of Commercial and Industrial Enterprises: The management and top executives of commercial and industrial enterprises have more responsibility to play by successfully integrating risk management practices into their operations. There is need for executives to embrace the minimization of loss concepts through training schemes for both top and lower level management. Also, commercial and industrial enterprises should encourage the development of risk management organizations among the risk management specialists in the country. These risks management organizations will facilitate the exchange of ideas, education and enlightenment to promote the practices of risk management in the country.

5.4 The Role of Reinsurers: Many national, regional and international reinsurers are interested in loss prevention and mitigation by policyholders and may offer extensive loss prevention services. Reinsurers at all levels should be encouraged to undertake practices that encourage local insurers to develop plans and offer rating systems that are compatible with promotion of risk management principles. Reinsurers can play a most important role in providing the environment that encourages such behavior and in providing quality loss control and rating advice.

5.5 The Role of International Insurance Market: Many international reinsurers, insurers, brokers and consultants have been active in the promotion of risk management, taking positive steps in numerous aspects of loss control as well as in providing other fee-for-service risk management consulting services. Such entities have incentives, through increased business opportunities, to make their skills and expertise available to developing

countries.



The Diagram above shows the step involved in Risk Management
Source: Fadun (2013). Risk management and risk management failure: Lessons for business Enterprises.

6.0 The Relationship Between Industrial Risk And Insurance

Risk permeates firms' economic activities, because risk is the lifeblood of every Organisation (Shimpi, 2001). Successful firms manage risk effectively, while those that do not suffer. Risk has no universal definition; hence, variability of outcomes is a common way of expressing risk (Skipper, 1997). Although definitions risk of varies; risk has two dimensions or components: uncertainty and consequences. Therefore, risk can be described in terms of its effect (positive or negative) on objective (Damodaran, 2008; Kannan & Thangavel, 2008).

The insurers are the risk bearers or risk taker while the insured are the risk providers. The effectiveness of risk management by insurance firms has a critical outlay of their financial standing. Gold (1999) asserted that the survival of insurers evolved through a delicate balance between claims and operational expenses in connection with amount of premiums collected. Ali & Luft (2002) suggested that the firm seeks to engage in risk administration and mitigation procedures which results to increase in shareholders' worth.

Insurance relates to a type of risk exchange where one party (the insurance company) accepts to repay the other (insured) in the case of a insured risk occurring in respect to a premium charged in advance (Rejda, 2003). Payment or compensation occurs only after the insured risk materializes under the agreed circumstances. Thus, risk management is vital for the insurance industry.

All industrial undertakings involve risks of loss through aberrations of nature, the economy, technology and society as well as through conventional perils of fire, explosion, flood e.t.c. These risks are managed in different ways with the aim of reducing the frequency of occurrence and severity of any one occurrence. However, insurance is by far the most popular and widely used management tool. Insurance is a risk transfer mechanism, through which the individual or business enterprise can shift some of the uncertainties of life on the shoulders of others. In return for a known premium, usually a very small amount compared with potential loss, the cost of that loss can be transferred to the insurer. However, there are factors which constitute insurability of risks, a lot of which are peculiar to specific types of risks. The existence of these characteristics obviously places some limit on the range of risks which can be insured.

Insurance is the most important loss financing tool and is critical to the successful management of an organization's loss exposures. It is the only way that an organization can protect itself from disastrous loss. Insurance is and will remain essential factor in economic development. In recent years, insurance firms have improved their scope on the aspect of risk management. Okotha (2003) suggested that risks require careful judgment by administration of insurance organizations, with a keen focus on the insurable risks to evade excessive losses claimed by policyholders. Thus, the vital factor in enhancing the financial performance of insurance companies lies with effective risk management. Inappropriate management of risk could result in failure of risk bearing companies. Merton (1995) asserted that spreading of risk across many clients is one of the major important functions of an insurance firm. Saunders & Cornett (2010) stated that risk management process should allow the insurance firms to have an explicit control of compensations on behalf of the policyholders through pooling the risks of the policy holders together.

Management of policy holders' risks ought to take the center stage in the operations of any insurance firm. In risk management, prioritization process must be followed whereby the risk of the higher loss and greatest chances of occurrence is controlled first while risks with lower chances of occurrence are handled last (Stulz, 2003). However, no model exists that can predict with utmost accuracy the frequency of occurrence of lower loss

or higher loss and even the probability level. The unpredictability of risk occurrence poses the most difficult challenge while balancing the claim settlement and premium pricing. Management of the risks requires prioritization over the elimination of risks in the attempt to achieve high returns for the investors of the insurance firms (Mburu, 2016).

7.0 Concluding Remarks

The role of effective and efficient risks management practices in an economy cannot be overemphasized. While risks management is not insurance, it provides a medium through which the possibility of occurrence of a hazardous or unwanted situations can be reduced or mitigated.

Risk management is not a panacea to the problems of developing countries, but it offers potential benefits through its incorporation into the legal, cultural, economic and environmental settings of developing nations. Risk management practices present opportunities of getting rid of risk or hazardous situation.

However, the successful promotion of risk management practices requires the endorsement and active support of government and it agencies. There is need for government to design and implement laws to promote effective risk management practices. Effective risk management practices cannot be achieved by the government alone, but through the support of both national and international insurance companies through changes in some practices in the country.

Thus, there is need for cooperation and collaboration among insurance companies, commercial and industrial enterprises in order to promote risk management in Nigeria. Management must be enlightened on both the financial and non-financial benefits of risk management practices.

Similarly, educational and training institutions have the capacity to contribute to successful implementation of risk management practices through the inculcation of risk management into their curriculum. From the foregoing, the place of effective risks management cannot be ignored and insurance should have working internal controls and sustainable risk programme to enhance performance.

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