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The Impact of Risk Management on the Performance of Insurance Companies

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Abstract

Risk Management Like other fields of knowledge management and its application utilize specific knowledge, instructions, regulations and principles to achieve predefined predictions and objectives. Risk management has developed principles and procedures that individuals, enterprises(commercial and industrial),insurance companies and governments can use to perform the foresight task of assessing, controlling and financing losses based on the systematic risk management approach. To this end, it is always working to answer two fundamental questions about the likely future consequences of the risk management criteria, securing organizations and investments against risks and losses requires the formation of an intellectual and practical system that integrates risk-based policymaking. The study show that insurance companies with great risk management have better return on equity and better performance in other key business factors in comparison with competitors who do not provide good importance to risk management.

Key words: Risk, Management, Insurance companies, Performance

Introduction

After identifying the risks of each insurance company, the extent and impact of each loss should be examined for the entire insurance company, and it undoubtedly needs to determine what is the probability of each damage occurring first and second, what steps it will take if it occurs and what is the impact of these amounts on the financial structure of the company, in other words, the first stage (risks identification) provides a set of data on the risks that company is exposed to and the next stage of the findings, It is classified and processed based on the foundation of ancompany risk management system, which is prioritized to process validated information. For this purpose, two types of risk assessment are carried out. The first is in terms of severity or extent and the second in terms of frequency or probability of occurrence(Wenk, 2005). As a consequence, the potential severity of any risk of the foreseeable loss is measured. Risk assessment, like any other assessment, can be done quantitatively or qualitatively, and the use of statistical rules and probability theories makes it possible to obtain more accurate predictions of the frequencies.The main objective in this research paper is to bring out a brief study on the risk management in insurance sector, particularly, on the importance of the advancement of risk management in insurance companies and their performance.

Risk Management in Insurance

Insurance company has linked to risk reduction and safeguard against financial loss from adverse happenings. Insurance company with such loss-sharing between a hugegroup, decreases the risk confronted by the individual party providers.The nature of an insurance company's operation is to take the risk of its policyholders in exchange for a premium, and insurance companies are taking

these risks as a technique to profit. In the insurance companies, essential elements of the risk management process include “merging and risk allocation, control exposures and providing sufficient protection through reinsurance.In most instances, insurance companies ' bankruptcies were caused not by a single factor, but rather due to a mixture of internal and external factors. An insurance company's prevalent reason for bankruptcy is a combination of weak quality management procedures and insufficient risk management dealing with significant risks to which the company is unprotected.

This reality highlights the requirement for sufficient internal models to support in the risk management process (KPMG , 2002).

Risk management process as well as general management quality is regarded as significant factors in insurance companies and together with adequate financial resources are key factors in protecting against insolvency by insurance companies. Furthermore, the efficient risk management process should cover all key components of the business set and, more significantly in order to properly manage the risks to which the company is unprotected. Risk management needs to be further transparent in the identification and management of risk (Lam, 2003).

Risk Financing

Risk financing is simply the financial planning that an organization does to deal with accidental loss(Mazlumi, 2009). The purpose of such measures is to provide sufficient funds to restoration potential losses to the company at the lowest possible cost. Risks that cannot be eliminated or reduced to a reasonable extent must be financed. Risk financing refers to a set of measures that provide various forms of financing required for the reconstruction of the losses at the lowest cost (Asudeh, 2006). The financial resources required for compensation can be obtained from the company internal resources or from outside facilities of the company. Therefore, at this stage, it is necessary to identify the risks that are feasible and reasonable to maintain for the company and transferred the other risks out of the company with using existing strategies and techniques. An informed approach is very important in deciding whether to maintain or transfer risks because if the risks are not sufficiently precise or the aspects of significance and frequencies are ignored, they may be subject to risks and accidental occur does not provide the necessary financing for the loss, and the company activity may be stagnated or completely shut down.

Given the task of the financial manager in providing the necessary finance, the co-operation of the financial manager and the risk manager in financing the risks is essential when the risks are held or when the risks are transferred. From a financial point of view, when risk is transferred through insurance or otherwise out of the company, financial forecasting and planning will be easier and clearer because in such a case the amount and timing of the payments will be clear while Keeping Risks it is not simply possible to predict the amount of funds needed and use timingof them. Although risk financing is one of the most common risk management techniques, some believe that it cannot be considered as one of the methods of risk management and the group's argument is this approach does not allow us to influence the risks we are exposed to., and the various methods of financing are aimed solely at the consequences of the risk, but it must be noted however, that manager who is planning to do so is actually demonstrating his awareness of the risks that can result in loss. Awareness of risk can be knowingly or even unknowingly moderated by the methods of its implementation, and which in turn reduction of risk or reduces its side effects.

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Awareness of risk can lead to improved management practices while not being aware of it can lead to a surprise for management that has a far more negative impact.Risk financing as a method represents a kind of risk bias and the necessity or saving of two main factors justifying its use. Financing techniques are often divided into two groups, grouped into actions that imitation of insurance and are practically quasi-insurance operations carried out by the company.

The application of these methods is subject to the same considerations and limitations as insurance companies operation. Self-Insurance and establishment of an affiliated or exclusive insurance company. The other groups are methods that are inherently financial and are primarily non-insured (Mazlumi, 2009). The company can accept a loss in two ways. If an institution is exposed to risk, but is unaware of its existence and origin, it can result in unintended loss that can only be absorbed when it occurs. In such cases, if the loss is serious, there will be no financial maneuvering due to the company surprise financial system, resulting in the collapse of the entire system or its severe loss. The risk is then involuntarily accepted.

Considering the risks that the company is exposed to and taking measures to prevent sudden disasters from accidental loss are essential for a prospective management. Getting ready to absorb at least some of the losses from an organization's financial resources is one of the measures called conscious acceptance of loss and not knowingly accepting loss when it is not done with financial planning (Dorofee, 2010).

Different Types of Risk

The term risk is widely used, but different audiences often have relatively different explanations of it (Kloman, 1990). For example, how risk relates to opportunity depends on the conditions of risk. Sometimes, it provides a situation of profitability and potential loss. But in other cases, there is no opportunity for profit, only the potential for loss. So risk can have two other subdivisions:

- **Speculative risk**
- **Peril risk**

At speculative risk, you can have a realized profit or improvement in the routine of the situation relative to your existing situation. And at the same time, you have the potential to experience loss or worsen the situation. Gambling is an example of speculative risk taking. When you make a bet, you should evaluate the likelihood of earning more money than expecting to lose your bet.

In this example, the overall goal is to increase your wealth, and your willingness to invest in risk is to provide a profitable opportunity. In contrast, peril risk only has the potential to be a loss and does not provide any opportunity to improve the conditions. For example, consider how security is viewed as a peril risk. Suppose you are concerned about protecting valuables stored at home. Your main goal in this example is to make sure that the objects in your home are not seized without your awareness and permission. After reviewing the quality of your valuable security, you may decide to install a security policy in your home to prevent thieves from entering and stealing objects. Note that the purpose of this example, by definition, is to focus only the risk on the range of potential losses. In most appropriate circumstances, you only protect what you already own. And there is no potential for profit.

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Operational risk

Managers in all organizations deal with risk. The focus of management at the highest levels of the organization is often on the nature of risk traders. Management moderates the investment risk of an organization's assets against the potential return on that investment and, with strategic considerations, manages the risk in the organization's portfolio activities and investments (Marcelo G, 2002). However, at the operational levels of an organization, employees and management as usual focus on managing a type of risk that is called operational risk. As employees implement and manage business processes, operational risks begin to emerge. Deficiencies in the nature of processes can lead to inefficiencies and problems during operations that can have an inappropriate effect on the success of the organization. There is no general definition of the term operational risk unfortunately. The Basel Banking Supervisory Committee has released a fully-fledged framework known as Basel II, which includes a definition of operational risk that is widely used by the financial community. Operational risk is defined by the Basel II framework as the risk of loss due to inadequacy or failure of internal processes, individuals and systems or from external events. There is also another definition of operational risk: operational risk, that is, the potential failure to access mission objectives. This definition includes loss and uncertainty (Andreas Kolb, 2013).

At the same time, this definition is suitable for usage in most different contexts. Financial companies play an important role in the economic structure of any country. These institutions, as the beating heart of the economy, operate in both the capital and money markets and contribute to the flow of money and liquidity into the community. The money market is a short-term securities market. Consider the capital market in both the primary and secondary markets. The primary market is a market, in which securities issued by companies are first offered and the financing process takes place in that market.

The Secondary market as the second-hand market is the previously published securities market. Financial companies, as an agent for transferring capital from households to economic enterprises, are required to monitor the performance of manufacturing firms on behalf of households. Environmental complexity, intensity of competition, the prevalence of new and advanced technologies, development of information and communication technology, new ways of delivering goods and services, environmental issues and the orientation of organizations from tangible and intangible assets, etc. It is one of the major factors that have led many organizations and economic enterprises have faced numerous risks and even unforeseen risks during their lives. Therefore, in order to reduce the risk and the losses caused by it, there are different types of risk management in the scientific literature such as enterprise risk management, business risk management and strategic risk management and each has a special place.

Obviously, every organization experiences different risks due to the nature of its work, and in today's changing environment, basically every enterprises success is in mastering the risks and the type of management that applies the types of risks. Risk management becomes meaningful when conditions are likely to suffer losses and uncertainty. This type of management encompasses broad areas that cover financial, operational, commercial, strategic and broader areas of risky events. In sum, risk management is the process of assessing or evaluating risk and then outlines strategies for managing risk.

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Thinkers have outlined four common strategies for risk management: risk transfer (Take the risk by another), risk avoidance (Failure to do risk-taking activities), risk reduction (Practices that reduce the severity of loss), and risk acceptance(Accept losses when they occur).
But the main point in economic enterprises is that there is no strategic vision for identifying risk management in them, so no specific place for this type of management has been set in organizations and enterprises. Obviously, given the complex and competitive business environment of today, risk management has become more important than ever before, and managers are committed to implementing and sustaining it in order to survive and reduce their losses. Risk is the reason for insurance, and without risk, insurance actually loses its meaning. The insurance business deals with risk, risk taking, risk reduction and risk calculation.

The concepts of risk management can be summarized in three groups: The first group believes that managing the risks that a company with an organization is exposed to is within the scope of its risk management tasks. The second group believes that risk management relates exclusively to the management of legal risks and the third group is called the risk management unit of the organization. However, risk management is the process of finding and implementing risk management techniques, in other words, risk management is a set of actions that can safeguard the assets of an enterprise. The pleasant aspect of risk can be called luck. Now if we want to get into the insurance category from this point of view, what is the job of the insurer? Insurance is a cooperative business and the insurer must classify the risks, bring together the owners of uniform risks, set up a cooperative fund, get all the membership fees we call premiums. So those if some unfortunate accident occurs, cover it. So can the insurer's main job be to pay losses? Basically the loss is negative and no one wants to suffer. But to put it another way, the insurer is the supplier of insurance, rather than the payment of losses, means it sells to those who gather around the insurance cooperative fund, so that they can easily access their day-to-day business. In this case, insurance is no longer an unpleasant affair and the insurer's job is not just to pay losses (IbishMazreku, 2014).
Therefore, premium payers should not expect a loss, but should be happy to pay membership fees. If something unpleasant happens to someone, the insurer will compensate that person. At the same time, we see the insurer as the seller. In all types of insurance, the role of insurers in reducing financial and life losses should not be overlooked. Insurers have a high motivation and willingness to identify and eliminate risky situations in the process of insuring risks, including through initial visits to risks or discounts on good and safe risk premiums or discounts for non-life insurance in some fields such as car insurance played this role and when an accident occurs, the insurer tries to know the cause of the accident to reduce the risk involved in the future. That is why the premium paid by the policyholder is commensurate with the risks covered, and in fact we should also consider this crucial role of the insurer in enhancing community safety. In countries where the insurance culture has developed, insurers have become increasingly important in investigating, researching resistant materials, new construction methods, and etc.

Conclusions:

To equip managers and organizations to use risk management, information infrastructures are needed that are outside the domain of managers. This discussion naturally leads us to risk

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management. They evaluate risks based on two important parameters: intensity or impact and repeatability. If there are risks that are highly-repetitive and have little impact, these types of risks are called common or current costs of the company and we are not too concerned about them. If there are risks that happen, but the impacts are high, companies sometimes accept or admit them consciously. There are also risks that are repeated, but their intensity is low, such as car accidents and fires, which insurance companies have information about and insurance provides this type of service. Our problem comes from the fact that there may be risks and their impacts are huge and duplicate, but insurance does not provide such services. The reason is that different industries, organizations and companies may have different risks.

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