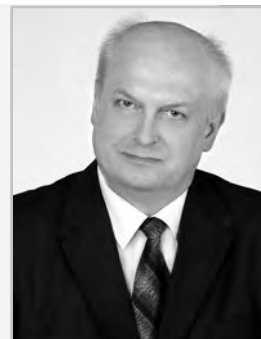


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EFFICIENT INSURANCE PROTECTION MANAGEMENT AS A DETERMINANT OF MICRO AND SMALL ENTERPRISES OPERATIONAL RISK LIMITING

Abstract. Problems discussed in the article deal with the efficiency of insurances as a tool for operational risk limiting among micro and small enterprises. The article presents possible risk categories that can destabilize the operation of a discussed segment of companies as well as possibilities created by insurance protection offered by insurers, aimed at optimising operation. Benefits from limiting risk for enterprise development under changing market conditions have also been mentioned.

Keywords: micro and small enterprises; operational risk; risk transfer; insurance protection; economic value.

JEL Classification: G22

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ЭФФЕКТИВНОЕ УПРАВЛЕНИЕ СТРАХОВОЙ ЗАЩИТОЙ КАК ДЕТЕРМИНАНТА СНИЖЕНИЯ ОПЕРАЦИОННОГО РИСКА МИКРО- И МАЛЫХ ПРЕДПРИЯТИЙ

Аннотация. В статье рассматриваются проблемы, связанные с эффективностью использования страхования как инструмента снижения операционного риска микро- и малых предприятий. Автором определены категории риска, которые могут дестабилизировать развитие данного сегмента бизнеса. Показаны возможности страховой защиты, которые предлагаются страховщиками и направлены на оптимизацию деятельности этих предприятий. Предложена методика расчета экономической выгоды, которую могут получить от снижения операционного риска микро- и малые предприятия, работающие в постоянно меняющихся рыночных условиях.

Ключевые слова: микро- и малые предприятия, операционный риск, передача риска, страховая защита, экономическая выгода.

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ЕФЕКТИВНЕ УПРАВЛІННЯ СТРАХОВИМ ЗАХИСТОМ ЯК ДЕТЕРМІНАНТА ЗНИЖЕННЯ ОПЕРАЦІЙНОГО РИЗИКУ МІКРО- І МАЛИХ ПІДПРИЄМСТВ

Анотація. У статті розглядаються проблеми, пов'язані з ефективністю використання страхування як інструмента зниження операційного ризику мікро- і малих підприємств. Автором визначено категорії ризику, які можуть дестабілізувати розвиток цього сегмента бізнесу. Показано можливості страхового захисту, які пропонуються страховиками та спрямовані на оптимізацію діяльності зазначених підприємств. Запропоновано методику розрахунку економічної вигоди, яку можуть одержати від зниження операційного ризику мікро- і малі підприємства, що працюють у мінливих ринкових умовах.

Ключові слова: мікро- і малі підприємства, операційний ризик, передача ризику, страховий захист, економічна вигода.

Introduction. Efficient corporate risk management in micro and small enterprises depends on a broad range of decisions on the part of owners and managers and on the character of stimuli that contribute to the occurrence of an adverse event. Bankruptcy of companies, unemployment growth, payment gridlocks, income reduction are only a few negative factors that destructively influence the enterprises segment, which is of high importance to every country's economy. Stable development of micro and small enterprises and provision of operational continuity under changing market conditions as well as reacting to possible threats constitute key elements of their functioning. It is also related to the identification of risks faced by micro and small enterprises as well as the selection of an optimal method of counteracting risk materialization. Beyond doubt, an insurance policy is a tool that facilitates the described process. However, we need to remember that insurance cannot replace the entire risk management system. It is only an auxiliary tool. Only a previous identification of risks for a given company allows the selection of those products from the rich assortment of insurance companies that when tailored to a company's specific features will protect its property, workers, civil liability and forecasted future profits. Therefore, insurance is a risk manage-

ment tool and its effectiveness depends on the effectiveness of other elements of this process. Counteracting risks and the selection of an optimal method of its limiting is a tool that helps entities achieves success. Modern micro and small enterprises need to anticipate events, be dynamic, react to changes and use available opportunities in an optimal way. Risk management and insurance protection is the basis of such actions.

Brief Literature Overview. Analyzing efficient risk management in micro and small enterprises as well as the use of insurance as a risk limiting tool is a subject of analyses in many countries. The following persons have dealt with this problem: K. Jajuga (2008) [1], E. Kafkova (2012; 2006) [2; 3], J. Monkiewicz & B. Hadyaniak (2010) [4], L. Gasiorkiewicz (2010) [5], T. Rojek (2011) [6], T. Tarczynski (2001) [7], I. Kwiecien (2010) [8], Jr. Williams, M. L. Smith & P. C. Young (2002) [9], G. Monahan (2008) [10].

Purpose of the article is to analyse opportunities for making use of the insurance spectrum available on the market as a risk limiting tool in relation to the operation of micro and small enterprises under dynamic market conditions.

Results. In the global scale, micro and small enterprises play a crucial role in building economic growth and innovative-

ness in all industries. Undoubtedly, they are worthy of the name of a driving force of the economy. Although their scope and influence on their surrounding is limited, gathered together they constitute an unbelievable force that imparts a completely new character on the economic sphere. Due to low levels of employment and ability to limit their expenditure, they also constitute a sort of a buffer for state economy in the light of volatile external factors and crises. It is micro and small enterprises who create most jobs on the market, demonstrating creativeness and involvement, which often results in working out new, advanced technologies. What is also important, companies operating in this segment of the economy contribute to the development of the global market. Looking at these companies as a whole, we can see that the development of these small enterprises confirms that owing to them the entire economy and each separate country gains energy for further development. Just to take a look at EU statistics, where 98.9% of existing business entities is micro and small enterprises – see Figure 1.

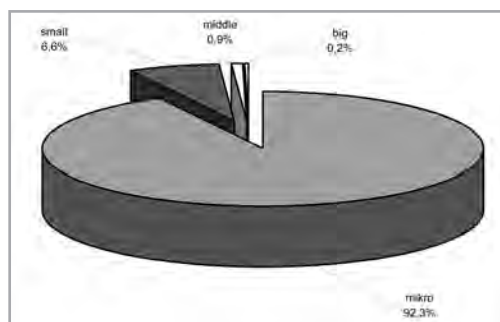


Fig. 1: Structure of enterprises by size in the EU in 2011 (%)
Source: [11]

Also from the point of view of the labour market, this is a very important group, since this sector generates about 70% of jobs, contributing to about 60% of the entire Community GDP. However, we need to emphasize that these companies are susceptible to an adverse impact of economic and political environment and not many entrepreneurs manage to survive on the market for more than five years. Therefore, creating conditions that support their growth by various public and social institutions is an important aspect related to their operation. Optimization of operation by entrepreneurs themselves, who make decisions related to an ongoing operation of an enterprise, aimed at safeguarding continuity of operation under dynamic market conditions and minimizing risks resulting from existing conditions is no less important.

The notion of business continuity is undoubtedly related to risk materialization mechanisms, as risk is one of the basic economic phenomena. Every market participant is exposed to it and counteracting risk materialization is one of the elements of efficient management. It particularly concerns business entities whose savings and capital accumulated by owners are not usually sufficient to conduct business activities in the face of risks directly and indirectly related to an enterprise that destabilize business operation. We need to emphasize that the risk is a popular term both in economic and colloquial language. It describes everyday situations, mainly in the context of danger, and is used as a term describing one of the main phenomena of economic life. A clear-cut definition of risk is hard to formulate. However, we can provide criteria for the term's use [8]:

- the fact that the future result of actions is unknown but the identification of future conditions is possible,
- probability of future materialization of particular results is known.

Talking about business continuity we can refer to a basic risk-depicting formula:

$$R = P * W, \quad (1)$$

where: R – risk, P – probability of a critical event, W – magnitude of critical event's impact on business operation.

Analyzing the possible spectrum of risks that occur during the operation of micro and small enterprises, it is worth getting

acquainted with Global Risk Alliance Pty Ltd. research, who together with NSW Department of State and Regional Development in Sydney, in a Guide on Risk Management for Small Enterprises, presented most common risks that accompany business operation of micro and small enterprises. Risks have been divided into fourteen categories, including [12]:

- financial – it covers cash flows, budget needs, fiscal obligations, management of receivables and obligations, remuneration and other issues related to account management;
- organizational – it refers to internal business requirements and covers cultural, structural and personal issues related to efficient operation of a company;
- compliance/law – it covers compliance with legal requirements, such as legislation, executive regulations, norms, codes of practice, requirements resulting from contracts; this category also covers compliance with additional «rules», such as policy, procedures and expectations specified in contracts by clients or the social environment;
- operational – it includes planning, operational activities, resources (including human) and support required within the framework of business operations, leading to the development of a product or service offered by a company;
- commercial – this category includes risk related to the introduction of a product/service on the market, development of an enterprise, diversification and commercial success; it also concerns profitability of a product or a service and extends to maintaining cooperation with previous clients and increasing their numbers in the future;
- safety – covering safety of all persons involved in operation; it concerns individual safety, workplace safety, public safety and safety of products/services offered by companies;
- strategic – it involves planning and determining the scope of resources for creating, maintaining and/or developing a company;
- equipment – it concerns equipment used during the operation; it includes usage of equipment, maintenance, depreciation, safety and updating;
- protection – it covers broadly understood safety of property and people as well as information, intellectual property and technology security;
- reputation – it is related to a loss or decline in company's reputation due to improper functioning of an entity, decline in product or service profitability or workers acting to the detriment of a company and other persons related to an enterprise;
- service provision – it refers to the provision of services, particularly to their quality and adequacy, method of supply and quality of contacts with clients (during and after the provision of service);
- project – it includes management of equipment, finance, resources, technology and sometimes persons involved; it concerns both internal operational projects, projects related to operational development and external projects initiated on client request;
- shareholder management – it refers to managing shareholders and covers the identification, establishment and maintenance of proper relationships; it concerns both internal and external shareholders;
- technological – it covers the implementation, management, maintenance and updating of used technology; it concerns the recognition of demand for a given technology and related costs and benefits within the framework of a company's development strategy.

As we can see, micro and small enterprises face many threats (risks), which can potentially destabilize or even terminate their operation. Therefore, proper management of risk related to business operation is a very important aspect for an entrepreneur.

Company owner or manager, before deciding on a method of limiting operational risk, should perform a cost-benefit analysis while introducing a risk management system to their company and to see in what way these benefits are related to the execution of company objectives. In the case of micro and small enterprises, it may be problematic do clearly define the objec-

tives and the strategy for enterprise development. However, we can use a broadly applied Porter's definition, which resolves the problem of company objectives in the following way:

- in a short term, the aim of the company is to gain profits,
- in the long term – increasing its actual value and value for owners.

In this context, we need to state that the basic objective of an enterprise should be the ability to create value added in the entire period of development and to execute the assumed strategy (MVA) [15]. In this way, both assumed objectives can be correlated:

$$MVA_n = \sum_{t=1}^n \frac{EVA_t}{(1+k_t)^t}, \quad (2)$$

where: EVA_t – economic value added in t ; $t = 1, 2, 3, \dots, n$ – strategy horizon;

k_t – average weighted capital cost in t -period.

Obviously, due to limited financial and human resources (and frequently no need for them), owners or managers of micro and small enterprises fail to apply advanced methods of preparing and monitoring a company strategy based on a broad spectrum of indicators, as it is practised at large enterprises and companies. They operate more intuitively, fulfilling own assumptions and flexibly reacting to the need for changes and potential risks. They also undertake actions aimed at limiting the operational risk of an enterprise. Obviously, the use of structured operational risk management is efficient in this regard. We need to stress that risk management increases the probability of making proper decisions by company's managerial staff, which consequently increases the probability of fulfilling objectives and safeguarding operational continuity. There is a question of solutions to be used to this end and methods of optimising risks at an enterprise.

Analyzing risk magnitude we can distinguish four basic methods of its limiting:

- risk avoidance, consisting in refraining from activity of this part of an enterprise or quitting the use of those resources or technologies that directly generate risk,
- risk transfer, as part of which the risk is transferred onto another entity, by means of legal mechanisms (insurance agreement, storage agreement, facility supervision agreement, etc.) and organizational or protective actions,
- risk probability reduction via regular risk measurement and undertaking preventive actions aimed at reducing risk,
- the effects of risk materialization reduction via developing response plans in case the risk appears.

However, specificity of an enterprise should be taken into account at making a decision in this scope. Insofar as large enterprises can manage most of risks almost freely, the situation of micro and small enterprises is radically different. Usually, they do not have any well-developed infrastructure at their disposal and are characterized by limited resources. They do not diversify their operation, since it is common that they manufacture only one product for one recipient. They do not accumulate reserves either – their operation is financed on an ongoing basis. They do not have any creditworthiness, that is why they finance their operation from own funds. So we can see that the significance of particular risks is different for a large enterprise than for a small one, similar as with the risk profile and risk hierarchy. Therefore, risk management or neutralization possibilities are far more limited for smaller enterprises. Most often, regardless of a risk spectrum that burdens these companies, they use the cheapest and the most available method of limiting them. Beyond doubt, insurance is this method, perceived by entrepreneurs as an element of optimal protection of company operations. Insurance, which is perceived by entrepreneurs as an element for the protection of business activities, can be one of the methods.

Obviously, insurance performs such function, however, it is not an element that substitutes business continuity process. Before making a more detailed evaluation, it is worth noting that we can distinguish two types of risks from the point of view of insurance:

- clean, which is a consequence of contingencies that are independent of our deeds or intentions, the results of which can only trigger losses (e.g. fire, theft, car accident etc.);
- speculative, which is a consequence of actions undertaken by us in hope that they bring about benefits (e.g. purchase of market shares).

The aim of such classification is mainly to separate insurable and non-insurable risks and to create risk groups that can be legally regulated, which is necessary to arrange overall terms and conditions of an insurance agreement. We need to note that insurances, being based on a risk dispersion mechanism and referring to future events, are used to provide protection from clean risks¹. In this context, we need to stress that insurance is an optimal risk transfer method from the point of view of an entrepreneur. Competitiveness of insurance compared to other risk management methods can be evaluated from the angle of criteria that are significant for the assessment and selection of risk management methods. From the practical point of view, we can name the following criteria [16]:

1. Efficiency – insurance is one of compensatory methods, i.e. those aimed at levelling out losses triggered by risk materialization in a financial way. Obviously, the efficiency in this area is measured by the scope and certainty of compensation for losses, which results from the scope and practicability of insurance protection. We need to emphasize that an appropriate evaluation of an insurance agreement, reliability of an insurer and its financial standing is indispensable. Analyzing the scope of insurance coverage, not only do we need to take account of compensatory elements, but also the assistance of an insurance company as regards the analysis of risks related to business activities and the preventive function of insurances, based on which measures to prevent an enterprise from damages and to minimize potential losses are initiated.

2. Cost – when it comes to a price, insurance belongs to very attractive protective instruments related to transferring risks related to conducting business activities. We also need to emphasize that it allows the reduction of fiscal commitments by incorporating an insurance benefit into tax deductible revenue.

3. Additional benefits – apart from a risk transfer method, insurances can provide additional benefits to an entrepreneur, as seen at two levels:

- additional (non-compensatory) insurer's benefits that can be expedient in conducting business activities (e.g. assistance).
- advantages derivable from an insurance, other than the right to compensation or benefit (having the feeling of security, entrepreneurs are more likely to make non-standard business decisions).

It is worth noting that decisions concerning the insurance of property and interests of an enterprise also derive from potential losses that are a consequence of an event, which obviously depends on assumptions made in the process of business continuity management.

We need to emphasize here that risk assessment and understanding of the essence and scope of insurance protection is a key question for entrepreneurs wishing to insure themselves properly. Especially in the context of a certain «conflict of interests» between an insured party, who wants to achieve the broadest possible protection for the lowest possible premium, and an insurance company, who undertakes actions to protect its interests. Insurance companies operating on the market offer a very broad spectrum of insurance protection aimed at enterprises, defining insurable and non-insurable risks for their own purposes. The most popular proposal of such pattern, put forth by E. J. Vaughan & T. M. Vaughan (2010) [14], assumes that insurable (acceptable) risk is the one that meets the following conditions:

- a given risk type concerns a large group (risk is dispersed); such situation allows forecasting the probability and economic results of losses, which constitutes a point of departure and

¹ Obviously, there are also insurance products that offer protection also in the case of speculative risks, but we will omit them in this study due to their specific nature.

a pre-condition for rational calculation of an insurance price by insurance companies,

- a materialized loss must be measurable and expressed in monetary terms; this condition is required to assess legitimacy of claims of persons affected by damage,
- risk materialization is accidental (unforeseeable circumstances), which means it is independent of will and acts of an insured person,
- risk materialization effects, i.e. losses, must not be of a catastrophic character.

Therefore, insurers take account of a number of factors which, on the one hand, allow them a better identification of risks a company is exposed to, and on the other hand, the best possible adjustment of products to client needs, taking account of its size, specificity and range of activities, organizational and human resources and many more.

The following Figure 2 presents exemplary areas of insurance protection offered by insurers, however we need to stress that they do not exhaust the entire assortment of an insurance offer.

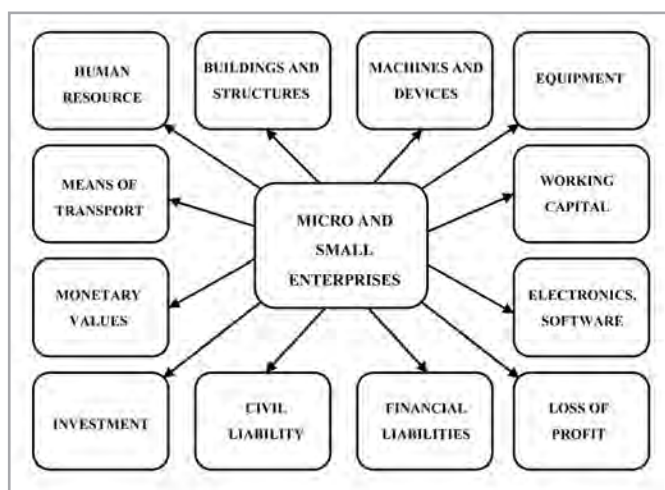


Fig. 2: Exemplary scope of insurance offered to micro and small enterprises
Source: Own research

Therefore, as we can see, the spectrum of insurance protection offered by insurers is very broad and insurance products (often so-called packages or all risk) are becoming more refined and tailored to individual needs, which are very important for micro and small enterprises, which often operate in a specific market environment and face non-standard risks. This is facilitated by market competition, development of modern risk management mechanisms both on the part of a client and an insurance company and the know-how transfer in the global scale that allows offering schemes matching client expectations to the greatest extent. Business entity wishing to conclude an insurance contract establishes such transaction details with an insurance company, as: amount of insurance, insurance variants, amount of yearly benefit, method of payment or amount of franchise or own shares [17]. Such approach allows the individualisation of an insurance scheme aimed at a company, as well as a more accurate determination of risk parameters, which will serve as a basis for insurance protection. It allows optimal use of insurance as a risk management tool in the framework of ongoing operations of micro and small enterprises, which will certainly contribute to the strengthening of their security and their development potential, allowing more efficient competition with other entities and achieving market success.

Conclusions. Analyzing the problem of using insurances as a risk limiting tool as regards micro and small enterprises' operations, we need to pay particular attention to the following aspects:

- at majority of these enterprises, risk management issues are treated somewhat formally and does not result in actually dealing with them;
- many micro and small enterprises neither carry out operational risk management processes at all, nor are they prepared for any events that disorganize their operation;
- applying risk management procedures leads to a better use of available resources and increases workers', contractors' and social confidence in an enterprise;
- many entities use insurance as a risk transfer tool to an insufficient extent, which limits the possibilities for optimizing operations and stabilizing operational activity.

Therefore, risk management and the use of insurance can play a crucial role in managing the company activity and in the implementation of changes faced by entities. This process is a tool for achieving success. Modern micro and small enterprises need to anticipate events, be dynamic, react to changes and use available opportunities in an optimal way. Risk management and insurance protection can constitute support for such activities.

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