



Enterprise Risk Management

PRESENTED BY

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Concept of Risk.

Learning Unit 2



Learning Outcomes.

- Explain the elements of risk;
- Analyse the definitions of risk;
- Classify risk;
- Identify strategic risks, including sustainability;
- Apply managerial risk classifications;
- Describe psychological influences on risk;
- Study market failure and separate public, merit and private goods;
- Examine the economic viability of insurance companies;
- Defend the economic viability of insurance markets.



Elements of Risk.

Outcomes: Negative

1. Damage to property
2. Consequential losses
3. Death or injury to people
4. Legal liability claims
5. Purely financial

Outcomes: Positive

1. Usually in monetary terms

Events – specific time and place

Sources - peril

Environmental factors – more hazardous



Definitions of Risk.

Various definitions - P29

Risk is defined as the variation of the actual outcome from the expected outcome.

- Therefore standard deviation is an appropriate measure of risk.
- Risk therefore also implies the presence of uncertainty.

Risk as deviation of an actual outcome from the expected result or outcome:

- Uncertainty surrounds the outcome of the event.
- The extent of uncertainty determines the level of risk.



Risk Classifications.

Basic classification and Managerial classification

1. Basic classification

Risk and uncertainty

Whether it will occur and

What the outcome if occurs

Perils and hazards

Pure and speculative risks

Insurable and non-insurable risks

Fundamental (impersonal) and particular (personal) risks

Systematic risks – market related

Systemic risks – system related eg Banking system

2. Strategic risks: Sustainability



Risk Classifications.

3. Managerial risk classification

- Inherent business risks and
- Incidental risks
- Operational risks

Psychological influences on risk

- Quantitative methods
- Perceived differently
- Reaction influenced by various factors eg wealth, previous experience.
- Attitude is unstable
- Influence of group
- Type of risk – pure vs speculative



Market failure and insurance.

Market failure

Discussed in terms of insurance

Public goods,
Merit goods and
Private goods

Market failure and insurance

Viability of insurance companies

Law of large numbers

Pure premium

Commercial premium

Insured's rationale for insurance



Economic viability of Insurance Companies.

Moral Hazards

- Asymmetry of information
- Adverse selection
- Indemnity and co-insurance



Thank you.

