

ANALYSIS OF ALTERNATIVE RISK TRANSFER STRATEGIES IN MANUFACTURING ORGANIZATIONS

¹**Prof. Sunday, C. Nwite** (ACII, ACIB)
Ebonyi State University – Abakaliki,
Nigeria.

²**Torutein, Oki Isiya** (CIFIAN)
Federal University Otueke- Bayelsa State,
Nigeria.
Email: okitirutein@gmail.com

Abstract

Man's inability to accurately predict the outcome of his undertaking, the consequences of his action or inaction portrays the nature of man as being finites and fallen. As a result, risk becomes inevitable incidence in our day-to-day activities. Though most of the times, no individual, firm, organization, or society certainly knows what the future holds in stock. However, life is full of surprises, sometimes pleasant, at other time unpleasant, some unexpected events are important, on other occasions catastrophic. Some unexpected events are the result of one's own action, perhaps due to failure to exercise care, or through tackling things for which one is ill-equipped. Other experiences may be due to the actions of other individuals, group, or society as a whole and sometime nature is the culprit. For the fact that risk cannot usually be avoided, because running out of one will invariably expose us to another risk. Other strategies should be adopted as an alternative to risk transfer mechanism. This study is mainly on the analysis of alternative to risk transfer strategies in manufacturing organizations. It was observed that; alternative risk transfer strategies impact positively to manufacturing firm such as; peace of mind for good business and venturing, prevention of economic loss etc. it was also found that it is beneficial to staff in so many ways; enhancement of their skills etc. it was equally found that for the strategies, to excel, the alternative risk transfer consultant firms have been developed which provides all variety of services to their clients.

Keywords: *Alternative, risk transfer, risk, strategies, firm, manufacturing.*

Introduction

Man's everyday activity is full of risk. Some of these risks are self-imposed, for instance, a gambler infected to gamble. There is a chance of losing his bet, yet, he chooses to gamble. There is a chance of passing and failing in an examination, yet, students decide to study, sometimes, at very high financial stake (Nwite, 2005).

A businessman that opts for a particular line of economic endeavour exposes himself to the uncertainties of business life. The risk is unending, focus on the topic "man and risk" suggests an underlying feature of reality of life, the inability of man to foresee exactly the outcomes of his activities. Omniscience is a quality ascribed to God alone. If everyone renews everything, then everyone would be self-assured and there would be no fear of the unknown. Despite all the advances in science, technology and psychology, man has a limited knowledge of himself, his future and the universe (Franklin, 1980).

Given the scenarios, it becomes easier to appreciate the fact that man cannot live a meaningful life without being involved in one form of risk or the other. However, the only wise option left for manufacturing firms is to always adopt effective alternative way of transferring risk since insurance as a risk transfer mechanism does not give full protection (Morton, 2002).

In manufacturing industries, risks arise in different forms; it could be at the process of staffing, production stage, distribution etc. The most common form of risk transfer is by way of insurance which involves shifting of the financial liability for loss, injury or damage to another person or persons. Other mechanisms for transferring risk include; non-insurance transfer and transferring the activities that causes the loss (Nwite, 2006).

The Concept of Credit Risk

Credit risk management can be explained with simple meaning, individually and jointly. Credit can be defined as an amount of money that is given by a creditor and taken by a debtor that will be paid for at some future date, in return for benefits received earlier such as goods purchased or loan obtained.

Risk on the other hand is defined by Nwite (2002) as chances of mishap, chances of miscalculation, and chances of an event happening or not happening. Mordi (1989) defines risk as the uncertainty of an event, the chance that an event will happen or will not happen. Management on one hand is the step taken for effective planning, control, coordinating and directing to achieving a company's desired goal. Management with relevance to risk can be defined as all the steps, strategies, taken to reduce the severity or the impact of the loss. The three words now combined can mean all the strategies taken to reduce the risks that arise in given out credit (Nwite, 2006).

Historical Development of Credit Risk

Man by nature is an investor. Any person created on earth has plan, programme on what to do. Most of the hindrances to these plans are lack or inadequate finance. Because of this, the banking industry comes up to provide some categories of loan to meet up his or her obligations ranging from building houses, marriages, buying vehicles, business expansion etc. the banking industry may decide to give short-term loan, medium term and sometimes with special preference long term loans. It is through giving out these various categories of loans that bank make their profits. It is always said that an idle fund is a wasted fund. Banks must be very careful not to be over liquid (having much cash) and not to hold cash- illiquidity (not having much cash) to meet up the obligations of their customers. Without given out loan, there could have been no investment in the economy and one wonders how the world would be without credit. Risk is a form of counterparty risk that arises in giving out credit.

Counterparty risk is the risk that the other party to a contract or agreement will fail to perform his side of the deal. This could mean a failure to provide promised goods or services, a refusal to provide promised loan facilities or a failure to pay amount owed in full and on time.

It is more natural to think of credit risk from the point of view of the provider of credit that may be a lending bank or selling goods or services on credit (Orjih, 1999). A company that borrows from a bank might fail to repay the loan; the bank therefore has the risk of either incurring losses from bad debt or the potential cost of delayed payment. Similarly, a company that sells its goods or services on credit normally must accept the risk that the customer will fail to pay in full or that he will take him longer time to pay than agreed.

Risk Transfer in Insurance

Risk transfer in insurance connotes risk handling mechanism. Insurance risk transfer according to Nwite (2006) refers to a process whereby an individual or organization transfer the risk they cannot handle to the insurance company by paying a little consideration called premium so that if loss occurs to the subject matter insured, that the insurance company will put the individual or organization to the position he/they were prior to the loss. Hansel (1988) defined insurance as a risk transfer mechanism.

Types of Risk Transfer

There are two types of risk transfer. They are: insurance transfer and non-insurance transfer.

- a. Insurance transfer: This is referred to as the process whereby an individual or organization transfer the risk they cannot handle to the insurance company by paying a little consideration called premium so that if a loss occurs to the subject matter insured, that the insurance company will put the individual or organization to the position he/they were prior to the loss (Nwite, 2006). The loss might have occurred to the peril on risk that is the subject matter insured.
- b. Non-insurance risk transfer: These are the risks we take even in the villages. Giving somebody some money to keep for you without paying anything. Parking your

vehicles in somebody's garage etc. Assuming that any loss occurs to the subject matter insured, what will be the way out? There was no contract or legal binding and everything was done on trust. This non-insurance transfer mechanism in this modern age can be classified into; lease contract, transfer of carriage and sale; tenancy agreement, sub-contracting deposit money and valuables in the bank etc.

Physical method of risk transfer

These are the preventive and protective means of risk control mechanisms. They include the following;

1. **Education and training:** The human factor is nearly absent from risk situations. Often, carelessness, incompetence or lack of technical knowledge is the primary or at least a contributory cause of a loss-producing event. Likewise, the failure of an individual or group to respond in the correct way to a loss situation may contribute to the size of the ensuing loss (Chilekezi, 2006).

Consequently, education and training have a major role to play in loss reduction programmes, and should embrace everyone employed by or associated with the work of an organization at every stage of its production, distribution and after-sales processes, whether it be engaged in the manufacture and/or handling of goods, or the provision of services. This involves the followings:

- a. **Management education and training:** This is aimed to create in management an awareness of the risks to which the organization is exposed and of the ways in which they may be controlled. It could be termed "risk control". The lead in risk control must come from top management and although only a few members of the top management team will require a detailed technical knowledge of the various risks and hazards, all should understand and have a commitment to the principle of total risk control. Also, the organizational structure and the division of responsibilities should be geared as far as possible to the same end. This is necessary at: the planning stage, the production stage, after-sales usage and servicing and security management stage (Okonkwo, 2002).
- b. **Contingency planning:** Management awareness of risk should lead on to the preparation of contingency plans for coping with actual or potentially severe loss situation, such plans should embrace both salvaging operations and plans for carrying on the business of the organization, following operations and plans for carrying on the business of the organization, following the occurrence of a loss (Irukwu, 1999).
The success of salvaging operations (and under this heading would fall the minimization of both personal injuries and property damage) depends upon there being available at all times both a number of people trained to deal with emergencies, and the necessary equipment.

There is little point for instance in having available first aid boxes, or the equipment and supplies for shipping down and cleaning smoke or water – damaged machinery, if no one knows what to do and vice versa.

- c. **Training of employees:** There are several fundamentals in the training of employees, notably:
 - They need to be aware of the hazards to which they may be exposed in the course of their work and what steps they can take to minimize the risk of injury to themselves and fellow employees.
 - Training may be required regarding the use of special clothing and equipment provided for their safety.
 - Instruction for all employees as to what to do in emergencies. For example, upon the outbreak of fire, breakdown of plant and especially the breakdown of safety devices.
 - Installing a sense of safety- consciousness in all employees, both in relation to the way they carry out their work and in the avoidance of defects in the firm's products. The aim should be to instill in each employee a sense of responsibility towards fellow employees, customers and the general public (Mark, 2006).
- d. **Education and training of contractors, suppliers, retailers and servicing agents:** Frequently, the integrity of an organization's operations can be jeopardized by people other than its own employees, notably:
 - Sub-contractors who undertake work on its behalf.
 - Suppliers of components.
 - Contractors who may perform work on its premises and plant.

All these people should be made aware of such risks as may affect the principal, and their co-operation should be sought to control those risks. For example, training schemes may be provided for servicing agents and their employees. Besides providing technical training the after-sales servicing of the principal's products, instructions may also be given about the nature of any special hazards associated with those products and steps to be taken to report and remedy any potential defects etc.

2. **Procedural devices:** Procedural devices to reduce risks are closely associated with and have been emphasized on some of the headings above education and training. Therefore, it is sufficient to add that it is the responsibility of the management to:
 - Device procedures to reduce both the probabilities of loss producing events occurring and the severity of those events that do happen;
 - Ensure that employees are not only trained to carry out those procedures, but that instructions are observed;
 - Instruct other people coming in to sites under their control, or involved in handling their products, in safety procedures.

3. Physical devices: There is a wide range of physical devices available to reduce the probabilities and/or severities of many types of risk. They may be thought of as falling into two broad categories;
 - Active devices which continuously operate to reduce the probabilities of the loss-producing event occurring.
 - Passive devices which come into operation when a particular situation arises. Into the first category fall such devices as thermostats on boilers and refrigerating equipments, guards on power pressures and other hazardous machinery, overhead switches on electrical equipments and security locks and window bars. Passive devices include security and fire alarm sprinklers installations, automatic fire doors and vents.

Effects of Alternative Risk Transfer to Organizations

Effective non-insurance transfer is beneficial to individuals. Risk transfer mechanism affects corporate organizations as follows;

- It induces peace of mind for good business decisions and venturing which translates into general economic growth and development;
- It ensures the survival of individuals, private businesses;
- It helps to ensure continuity of business;
- It ensures profitability and growth of corporate organizations;
- It lowers the cost of business operations of the industry;
- It helps to minimize economic loss or waste in a manufacturing industry.

Effects of Training on Alternative to Risk Transfer Mechanism

It effects the organization in these following ways:

- i. It raises awareness of management personnel, operators or supervisors of various departments and units on the degree of risk carried and its possible consequences and the control measures;
- ii. It educates the management on employee safety and also the need to build safety into their plant and product designs;
- iii. Training equips the staff on the knowledge of risk during delivery, labeling servicing and possible way to avoid them;
- iv. It educates the employees' representatives on the dangers of certain hazards, such as smoking, faulty electricity wiring, accumulations of wasted materials etc.
- v. It helps the management to design a quality control and high technical standard for their products to avoid any risk carried against defects in their products;
- vi. It helps the organization to identify those risks that may jeopardize the existence or the confidence which public has in the organization and thereby institute a lay down and enforcement of security procedures;
- vii. It helps an organization in preparing its contingency plan to deal with interruptions to their business.

The Importance to the Staff

Human factor (moral hazard) has always been identified as a primary or contributory cause of a loss-producing event (Aneke, 2004). It could be identified in the lackadaisical attitude of an individual or group, incompetence or lack of technical know-how required to effectively respond to a loss situation. However, training as one of the panacea for loss transfer programme will be of great importance to the staff of manufacturing firms in the following ways;

- a. It will help to raise risk consciousness of the work force and others that associates directly or indirectly with the organizational activity(ies);
- b. It will enhance the skills and ability of the workforce in order to effectively and efficiently discharge their responsibilities;
- c. It will make the staff to become better equipped to respond to loss situations;
- d. It will also help the work-force staffs to know the dangers of certain hazards and possible means to escape or avoid them.

Prospects of Alternative Risk Transfer to Organizations

To ensure future growth on alternative risk transfer mechanisms, there has been a development of independent, alternative risk consulting firms that works with agents and brokers. These alternative risk transfer firms educates the agents and brokers on expertise general experience in the ART market as well as those that may need to supplement their ability to execute these tasks with a team of industry specialists (Artemis, 2010).

For instance, keystone, one of the independent, alternative risk transfer consulting firm, has designed some strategic ways to ensure that the alternative risk transfer market prevails.

Some of the strategies designed by keystone include; novel approach- building of practice on assisting agents to be in a position to offer highly complex, specialized ART products without the need to increase their staff.

- Designed for mid-sized agents – They are well suited to work with mid-sized agents. First of all, it has significant experience with a wide array of business segments and industry groups. Among the many industries served are transportation, hospitals and healthcare, real estate management, construction, employee services and manufacturing.
- Helping hand- In order to assist agents and broker partners, they have developed an array of services, which together form “The Keystone”. This keystone is a virtual product that is comprised of three distinct elements of expertise: risk transfer; risk mitigation and risk financing.

This product provides or can provide agents with a value proposition for their larger clients.

Therefore, with the help of the alternative risk consulting firms, manufacturing firms can now access information services needs for their alternative ways of transferring their risks or assuming them.

Conclusion/ Recommendations:

Alternative risk transfer is often used to refer to activities through which reinsurers, insurers or individual organizations transform risks from capital markets into insurance or reinsurance form (American Encyclopedia). This always arise when coverage in fully insured market place is unreasonably expensive or difficult to obtain, a captive or alternative risk transfer program blends risk retention and risk transfer at the lowest total cost of risk and results in mutually aligning the financial interests of both the insured and the insurer. These two segments are risk transfer through alternative carriers and risk transfer through alternative products.

These were discussed under the alternative risk transfer mechanisms. Most of these techniques permit investors in the capital markets to take a more direct role in providing insurance and reinsurance protection, and as such the broad field of alternative transfer is said to be bringing about a convergence of insurance and financial markets.

However, the alternative risk transfer consulting firms were developed to ensure that the stepping stone laid in 1990s does not go down the drain. Based on our conclusion, we recommend the following:

1. For manufacturing industries to ensure optimum risk transfer strategies through non-insurance risk transfer, they need to educate their staffs on the risk consciousness and the appropriate responds to them.
2. The firms need to seek for more appropriate advice from the specialists on the alternative way of risk transfer.
3. Education and training of staffs on the technical know-how so as to limit or eradicate wastage.
4. The staff should always try to minimize risk by doing things that can limit the ensuring losses once a loss-producing event has occurred.
5. The management, personnel operators or supervisors of various departments or units should be equipped with the knowledge on the degree of risk likely to occur, its possible consequences, and the remedies.

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