

# Preface

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## BACKGROUND

The vast majority of business students do not plan to enter the insurance field. They are being trained to be general managers or specialists in other fields. Business students therefore need a general framework for thinking about the effects of risk and a broad knowledge of risk management and insurance. In addition, they need to be aware of the many important public policy issues related to risk, including legal liability and economic security issues. Students who seek careers in risk management and insurance also need a strong conceptual foundation for understanding institutional details. Because institutional details are constantly changing, it is very important for students to learn general concepts that can be applied to new sets of problems, new types of risk, and new institutional structures. In addition, introductory courses in risk management and insurance should stimulate critical thinking and promote the development of problem-solving skills to better prepare students for meaningful careers in an information-intensive global economy.

## PHILOSOPHY AND OBJECTIVES

As was true for the first edition of this book, we have sought to achieve four major objectives:

1. Provide students with a broad perspective of risk management that, while emphasizing traditional risk management and insurance, introduces other types of risk management and stresses that the same general framework can be used to manage all types of risk.
2. Provide students with a conceptual framework for (a) making risk management and insurance decisions to increase business value and individual welfare; (b) understanding insurance contracts and institutional features of the insurance industry, including their relationship to contracts used to manage other types of risks; and (c) understanding the effects of and the rationale for public policies that affect risk and the allocation of risk among businesses and individuals.
3. Acquaint students with the essential details of insurance contracts and insurance markets without providing extensive descriptions of numerous types of insurance contracts, emphasizing how and why insurance contracts are designed as they are and how insurance markets function.
4. Enhance the ability of students to think critically and analytically and solve problems in order to better prepare them to confront the myriad opportunities and problems that confront business managers and individuals.

Examples of questions and issues that are examined in this book and receive much less coverage or no coverage in other texts include: (1) What are the economic functions of particular features of insurance contracts and insurer operations? (2) How does risk management affect the value of businesses with diversified shareholders, and why do these firms buy substantial amounts of insurance and use hedging instruments to reduce risk? (3) What decision rules are appropriate for loss control and the choice among loss financing methods, and how can these methods be applied? (4) Why are some types of risk insured, while other types of

risk are hedged with financial contracts, such as futures and options contracts? (5) What are the causes and consequences of government policies to protect citizens from risk?

The objective of providing a broader perspective than other risk management and insurance texts reflects several influences. Because most contracts allocate risk among the contracting parties, many of the concepts and tools that we discuss are drawn from and apply to a wide variety of contracts, not just insurance contracts. In addition, there obviously are many important types of risk besides the risks covered in traditional risk management and insurance courses. These risks often can be successfully hedged using tools that are in many respects similar to insurance. We introduce these risks and associated hedging methods, again emphasizing that the same general framework is applicable to all types of risk. Given the increased importance of overall risk management in business management in recent years, this broader perspective is important for students who are being trained as general managers or specialists in other fields. It also has become increasingly important for specialists in traditional risk management and insurance to be familiar with other types of business risk and the tools used to manage these risks.

Finally, we believe that the issues associated with the allocation of risk in society are of fundamental importance and are inherently interesting. Without losing sight of our main task of studying risk management and insurance, we have tried to convey our enthusiasm for the topics and the wide applicability of the concepts and tools.

## INTENDED AUDIENCE

This book is designed for use in introductory risk management and insurance courses at the undergraduate and MBA levels and in second level risk management courses. We have designed the book to be as flexible as possible. In particular, the structure and content allow instructors who do not wish to emphasize corporate risk management and financial issues in an introductory class to omit selected chapters or parts of chapters without loss of continuity. The main sections of each chapter are numbered to facilitate selective coverage. Moreover, while we frequently relate the material to concepts to which most business students will be exposed in basic economics, finance, and statistics classes, we have developed all of the key ideas assuming little or no student background in these subjects. Appendices to several chapters provide more in-depth treatment of selected subjects. Instructors who feel that their students could profit from more discussion can assign these appendices.

## CHANGES FROM THE FIRST EDITION

Although the basic philosophy and objectives of the book are unchanged from the first edition, we have made numerous improvements. Most important,

- We broadened the introductory chapters to include more discussion of personal risk management and placed the material on personal insurance (auto, homeowners, and life) earlier in the book to enhance the book's usefulness in classes that emphasize personal risk management.
- We incorporated new chapters on loss control (Chapter 11), business risk retention decisions (Chapter 22), commercial insurance contracts (Chapter 23), and enterprise risk management (Chapter 27) to enhance the book's usefulness in courses with a strong emphasis on corporate risk management.
- We placed some of the more difficult material in appendices.
- Examples, exhibits, and current events boxes have all been updated as needed.

The second edition is more flexible than the first edition. Thus, it is likely to fit the needs of more instructors teaching introductory courses with a personal insurance emphasis, while also expanding the treatment of corporate risk management for instructors that seek additional depth on those issues.

## PEDAGOGY

To further support the objectives of this text—that is, to present a broad perspective of risk management, provide a conceptual framework, and enhance critical and analytical thinking—the following features are included:

*Chapter Objectives.* Each chapter begins with a list of key objectives, which provide students with an overview of the material they will learn in reading the chapter.

*Concept Checks.* Strategically placed throughout most chapters, these self-test questions enable students to determine whether they have understood the preceding material and enhance critical thinking skills. Answers to these questions are found at the end of chapters.

*Key Terms.* Key terms are found in bold throughout the text and are listed at the end of chapters with page references for easy review.

*Examples.* The examples in the narrative of the text emphasize real-world applications of the material being covered. Students will recognize the context of the examples and therefore will be able to more easily apply concepts learned from this text to future situations.

*Current Events and Concepts Boxes.* Boxes containing business press and journal articles are included in various chapters to provide an additional view of current risk management issues. Also, concepts and issues that are more specialized or advanced are set off in a separate boxed feature. This enables the discussion to be easily skipped if it is not integral to the course, but it also provides a good summary if the instructor chooses to cover it.

*Exhibits.* Tables, figures, and diagrams are included to help illustrate the topics in each chapter.

*Summaries.* This bulleted feature expands on the learning objectives by revisiting the important points in the chapter, providing an extra study aid for students at the end of the chapter.

*Questions and Problems.* This section includes both numerical problems and conceptual questions that build on the material learned in the chapter. Solutions are included in the Instructor's Manual.

*References.* Key articles are included at the end of chapters, along with one-sentence descriptions.

## SUPPLEMENTS

*Instructor Resource CD.* This CD contains the following assets:

*Instructor's Manual.* Prepared by the authors, this teaching tool includes lecture outlines for each chapter, transparency masters, and solutions to the end-of-chapter questions and problems.

*PowerPoint Presentation Software.* Also prepared by the authors, the PowerPoint slides include the transparency masters in an electronic format. Instructors with

PowerPoint have the ability to edit, print, or rearrange the complete presentation to meet their needs.

*Test Bank.* Prepared by Joe Haley, Herberger College of Business, St. Cloud State University, the Test Bank includes multiple-choice questions, fill-ins, problems, and short answers. Each question is coded as a knowledge-based or an application-based question. There are 15–20 questions per chapter.

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The concepts and ideas developed in this book reflect our years of reading, thinking, and teaching about these subjects. Because this is a textbook and not a treatise, we did not attempt to cite a material fraction of the dozens of articles that have influenced us, apart from including a small number of end-of-chapter references that are likely to be appropriate for our target audience. Our intellectual debt is nonetheless very large.

*Scott Harrington and Greg Niehaus*

*Columbia, South Carolina*

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