

## **ENTREPRENEURSHIP AND SMALL FIRMS**

**DEAKINS AND FREEL**

**5<sup>th</sup> EDITION**

**STUDENT'S ON-LINE LEARNING RESOURCE MATERIAL**

### **Additional Material: Risk Management and the Role of Insurance**

Although Knight identified the importance of risk taking, the entrepreneur needs to be able to assess which risks to accept and which risks to transfer. In this process, the entrepreneur may decide to accept some risk, reduce risk through risk management, or transfer risk through insurance. As indicated before, however, we know little of the extent to which an entrepreneur attempts to perform this function.

The availability of insurance is important because it enables the entrepreneur to transfer risk instead of accepting the full risk liability. For example, in the case of Hullachan, Craig Coussins, with a manufacturing concern, was faced with a number of risks that can prevent the business operating successfully. These included theft of stocks, fire, damage to vehicles through motor accidents, personal injury from the product and injury to employees and visitors on company premises. All of these risks can easily be transferred through insurance policies and, in some cases, such insurance is compulsory, for example, employer's liability. Some risks, of course, are not transferable. The risk of making losses cannot be transferred through any insurance policy, although it is possible to transfer subsequential losses from some other risk, such as fire. In addition, the management of risk can reduce the extent of insurance needed, and risk can also be reduced by taking a number of measures that prevent the possibility of accidents. For example, special training for employees in health and safety may reduce the risk of employee accidents and hence reduce the amount of insurance premium required by the insurance company.

Some firms are faced with more risks than others. For example, Hullachan represents a case where risks are relatively high due to manufacturing a product where risks may exist in the product process (to employees and to customers); manufacturing small firms face greater risks than service sector firms. They may have product liability risks and, if their product is protected by a patent, they face the risk that another firm could copy their product, thus incurring expensive legal action to defend their patent.

The extent to which entrepreneurs undertake both risk management and the transfer of risks through insurance is largely unknown, yet the ability to manage risk (of which insurance is part) is an important subset of management skills for small firm survival. Previous research in the West Midlands and Scotland provide comparisons in the use of insurance by technology-based firms (ref 1). The evidence suggested that the use of more specialised insurance is low, with only 8 per cent and 9 per cent (West Midlands/Scotland) of firms taking out cover for the protection of patents and copyright. The low take-up of patent protection may reflect a low application rate of high-technology-based and innovative entrepreneurs to take out patents, which are time-consuming, relatively complicated and expensive. Follow-up research in Scotland indicated that 38 per cent of firms were concerned with acquiring patents, which would suggest that the low take-up rates of cover were due to difficulties in the insurance environment. In the case of Hullachan, it was important for Craig Coussins to lodge applications for patents for his designs, but he did not take out patent insurance.

A follow-up study by Bentley and Sparrow (ref 2), focusing on technology-based entrepreneurs and their perception of risks, revealed that the low take-up of some forms of insurance was due to 'cost reasons' in relation to overall risks, with high premiums for specialised insurance accounting for low take-up rates. The study by Bentley and Sparrow recommended that more

attention should be given to education of entrepreneurs with risk management, a potential area of intervention for support agencies. Clink (ref 3) has suggested that small firms' approach to risk management can be segmented through a typology related to the proactiveness of planning and risk control within the firm, which may provide a framework for further analysis and support.

Further discussions with the insurance industry and small firm representatives, such as the Federation of Small Businesses (FSB), indicated that risk management and the use of insurance was an important topic that suffered from a low profile in research. The FSB in a report (ref 4) have indicated that insurance was seen as a particular problem by its members, especially in the inner city, where the difficulties in obtaining adequate insurance cover were seen as a significant constraint in small firm entrepreneurship, start-up and development. For example, insurance premiums in these areas are expensive, yet risk management measures were difficult to impose due to local authority restrictions on the extent of security provisions.

## References for this section

[1] Deakins, D., Paddison, A and Bentley, P. (1997) "Risk Management, Insurance and the High Technology Small Firm", *Small Business and Enterprise Development*, vol. 4, no. 1, pp 21-30.

[2] Bentley, P. and Sparrow, J. (1997) *Risk Perception and Management Responses in Small and Medium-Sized Enterprises*, Enterprise Research and Development Centre, University of Central England, Birmingham.

[3] Clink, S. (2001) "Risk Management in Small Businesses", unpublished PhD thesis, Glasgow Caledonian University, Glasgow.

[4] Goodman, F. (1994) "Insurance and Small Firms: A Small Firm Perspective", paper presented to Insurance and Small Firms Seminar, University of Central England, Birmingham, April.