

Cheque: An instrument used for withdrawing **money from** bank. It is an unconditional order in writing on the specified bank by its customer, instructing the bank to pay the amount specified therein to the person named therein or to his order.

Pass Book: A book supplied by the bank to its customers showing his transactions with the bank.

Standing **Instructions:** Instructions to the bank for making certain payments and collections regularly on behalf of the customer.

Bank Draft: An instrument drawn by one branch of a bank upon another branch of the same bank, directing the other branch to pay the amount mentioned therein to the person named or to his order.

Overdraft: An arrangement between the bank and its customer **where the** customer can withdraw **from** the bank more money than is available in his account.

13.13 ANSWERS TO CHECK YOUR PROGRESS

- A. 4) (a) bailee (b) an agent (c) debtor
8) i) True ii) False iii) True iv) True v) True vi) True vii) False viii) False
- B. 5) i) True ii) False iii) False iv) False v) False vi) **True** vii) False viii) True
- C. 6) i) False ii) True iii) True iv) True v) False vi) True vii) False viii) False ix) False

13.14 TERMINAL QUESTIONS

1. **Define** the **term** "Banker", Explain briefly the functions of a modern commercial bank.
2. Who is a customer? When does a person become the customer of a bank?
3. Explain briefly the various types of banks.
4. What is the relationship between a banker and his customer?
5. "The relation between a banker and customer is primarily that of a debtor and creditor". Discuss.
6. Explain the nature of banker's right of lien.
7. Explain the rights and obligations of a bank.
8. Discuss various ways in which a commercial bank renders **financial** assistance to **business**.
9. Discuss the various modes of creating charges.
10. Distinguish between:
 - i) Pledge and Hypothecation
 - ii) Hypothecation and Mortgage.
 - iii) Loan and Overdraft
 - iv) Cash Credit and Overdraft

Note : These questions will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University for assessment. These are for your practice only.

UNIT 14 BUSINESS RISK AND INSURANCE

Structure

- 14.0 Objectives
- 14.1 Introduction
- 14.2 What is a Business Risk
- 14.3 Pervasiveness of Risks in Business
- 14.4 Types of Business Risks
- 14.5 Risk Management
- 14.6 What is Insurance
- 14.7 Insurable Risks and Non-insurable Risks
- 14.8 Contract of Insurance
 - 14.8.1 Components of an Insurance Contract
 - 14.8.2 Legal Aspects of Insurance
- 14.9 Kinds of Insurance
 - 14.9.1 Life Insurance
 - 14.9.2 Marine Insurance
 - 14.9.3 Fire Insurance
 - 14.9.4 Motor Insurance
 - 14.9.5 Miscellaneous Insurance
 - 14.9.6 Difference between Life Insurance and Other Insurance
- 14.10 Let Us Sum Up
- 14.11 Key Words
- 14.12 Answers to Check Your Progress
- 14.13 Terminal Questions

14.0 OBJECTIVES

After studying this unit, you should be able to:

- define business risk and explain the pervasiveness of risks in business
- identify various types of business risks and state the process of risk management
- define insurance and identify insurable and non-insurable business risks
- state the components of an insurance contract and the legal aspects of insurance
- explain various kinds of insurance and identify their suitability for different purposes in business.

14.1 INTRODUCTION

As you know that all human activities which eliminate the hindrances and facilitate the flow of goods from producers to consumers come under 'aids-to-trade' or 'auxiliaries to trade'. The whole range of activities coming under aids-to-trade are classified under five categories viz., transportation, warehousing, insurance, advertising and banking. You have already studied about advertising in Block 3 and about transportation and warehousing in the previous units in this block. In this unit you will study about insurance. This unit discusses in detail the meaning and types of business risks, and various aspects of insurance such as meaning, contract, legal aspects, and types.

14.2 WHAT IS A BUSINESS RISK

The term 'risk' has been defined by different people in different ways. For this reason there is no single standard definition of this term which is universally used. The term is used to refer to (a) an insured object such as a home or a car, (b) a peril such as fire or earthquake, (c) the probability of an event which may cause loss, (d) the loss itself, (e) the hazardous condition, (f) the variation in the outcome that could

such as fire or earthquake, (c) the probability of an event which may cause loss, (d) the loss itself, (e) the hazardous condition, (f) the variation in the outcome that could occur over a specified period in a given situation, etc. Although the underlying meaning of most of these definitions may be the same, these definitions are suitable in different contexts. In the present context, we may use the term 'risk' mainly to mean the uncertainty of occurrence of economic loss. Based on this, the term 'business risk' may be defined as the uncertainty of occurrence of economic loss in the event of any business activity.

As you know business enterprises face a variety of perils. They run the risks of injury to their employees in job related accidents. They face the risk of loss or damage of property due to fire, floods, theft, natural calamity, etc. Due to changing consumer tastes, a company may lose its market share, and transform into a loss making company from a profit making one. For instance, as you know in 1984 a leak of deadly methanyl isocyanate gas manufactured in the Union Carbide factory in Bhopal killed more than 2000 people and many more became permanently disabled. This had resulted in a few hundred crore rupees law suits, which are yet to be settled. Thus, all business enterprises face a wide range of risks which can cause the losses.

14.3 PERVASIVENESS OF RISKS IN BUSINESS

Different risks pervade all kinds of business activities. Many failures of management can be traced to failure to recognise and deal with risks. It is the normal tendency for the managers to over emphasize the profit aspect of enterprise and under mind the risk factors. Let us understand how risk pervades all aspects of business. Let us examine how risk prevails in all the following main aspects of business: (1) property and personnel, (2) marketing, (3) finance, (4) production, and (5) environment.

Property and Personnel Risks: Every business firm is confronted by potential loss to its property and personnel through common perils such as fire, explosion, wind storm, flood, theft, business liability damage suits, earth quake and death or disability of its personnel. These perils may cause direct loss by damaging property or killing personnel. Losses may occur to business from the occurrence of some of these perils.

Marketing Risks: Marketing activity includes all those business activities necessary to move goods from producers to consumers. The major functions include buying, selling, transportation and storage. Activities like standardization, market information and research are also other important functions of marketing activities. There is an element of risk in all these activities. For instance, you may not be able to sell your products at the prices you want. Due to market conditions, you may be forced to sell at lower prices and incur losses. Similarly, due to sudden spurt in the raw material prices, your cost of production may go up and you may incur losses. Goods may be stolen, damaged or destroyed in transit from perils for which the transporter is not liable. Similarly, improper facilities for storage may cause unexpected losses. Normal perils such as fire, floods, storm, explosion, theft, etc., can cause extensive damage to goods in the storage. For instance, the fire due to electric short circuit may cause extensive damage to the goods in the storage.

Financial Risks: All business firms borrow money and also extend credit to customers. There is always scope for loss from both credit received as well as credit extended. Bad debts due to insolvency of customers is a continuous problem in business. Similarly, creditors like banks and financial institutions may fail or cancel the loans due to bad business conditions. This can cause financial loss to the firm due to curtailed operations. Similarly, unexpected rise in interest rates on bank loans may reduce profits. Business firms' investments in stocks and bonds always face risk.

Production Risks: Manufacturing enterprises face the problems such as production losses due to breakdown of machinery, defective products due to faulty machinery or

poor quality of raw material, under **utilisation** of installed capacity, inventory build up to levels much higher than current demand, improper plant layout, uneconomical plant capacity, etc. Such production risks may be minimized by careful planning.

Environmental Risks: Business environment is a crucial factor for every enterprise. Environmental factors such as competition, changing tastes and preferences of consumers, technological developments, governmental policies, **ecological** issues, political developments, etc., have lot of impact on each and every business firm. All these environmental problems pose risks to business **firms**.

14.4 TYPES OF BUSINESS RISKS

We have already discussed the meaning of risk in the context of business and how risk is pervasive in all aspects of business. Let us now study various types of business risks.

Pure vs. Speculative Risks

The occurrence of perils like **fire**, windstorm, explosion, flood, earthquake, riot, etc., generally cause losses only. Their occurrence never result into gains. The uncertainty concerning their occurrence may be termed as pure risks. Thus, Pure risks are those risks in which the occurrence of events causes losses only. For instance, car drivers always face the risk of accidents. If an accident occurs, the driver may suffer physical and financial losses. If the accident did not occur, there would not be any gain. Thus, in the case of a pure risk, there is loss when it occurs, otherwise there is no loss or gain. On the other hand speculative risks involve events which may produce either gains or losses. For instance, expansion of operations in a new market (**area**) may lead to higher profits or loss of invested funds. Most business decisions relating marketing, production, finance, etc., are taken with the idea of making gains, but there are possibilities of incurring losses also. Thus, all business enterprises face both pure risks as well as speculative risks. Many pure risks can be handled through insurance, while most of the speculative risks are not generally handled through insurance. So business enterprises must find their own ways of handling speculative risks.

Dynamic vs. Static Risks

Risks can also be classified as dynamic risks and static risks. Dynamic risks are related to uncertainties caused by an ever-changing business environmental factors such as consumer wants, technology, competition, governmental policies, firms internal organisation, etc. On the other hand static risks are those which occur even if there are no changes in the business environment. Normally static risks are closely related to pure risks such as fire, flood, windstorm, etc., where as dynamic risks are more closely associated with speculative risks. Therefore, as discussed in the case of pure **and** speculative risks, most of the static risks can be **handled** through insurance while most of the dynamic risks may not be handled by insurance. However, it is increasingly becoming difficult to separate or distinguish clearly between the losses caused by dynamic risks and static risks. For instance, fire which is a static risk may be caused by an irate crowd during a **demonstration** which is a dynamic risk.

Risk Classified by Loss Severity

Risks may also be classified as follows into three groups on the basis of the extent of loss and its importance on the financial position of the business firm:

Class 1: **Those** losses which do not disturb a firm's basic finances.

Class 2: **Those** losses which would require borrowing or selling firm's property.

Class 3: **Those losses** which might bankrupt the firm.

Here Class 1 risks cause small losses, Class 2 risks cause much bigger losses, and the firm may not survive with the occurrence of Class 3 risks. Therefore, Class 1 and 2 risks can be handled by various internal methods but Class 3 risks are beyond internal capabilities of the business firms.

Objective vs. Subjective Risks

Objective risk is the measure of the degree of variation in the proportion of actual **from** the expected events. This proportion declines **as** the number of observed events increase. Hence we can say that the objective risk as a proportion declines **when** larger and larger number of events are involved. Subjective risk may be defined as the uncertainty of an event as seen or perceived by an individual. This perception depends on the attitudes of the concern individuals towards risk. Among people, there are 'risk lovers' who prefer a situation with a great deal of uncertainty, and also 'risk haters' or 'risk averters' who do not like to face risks.

14.5 RISK MANAGEMENT

We have already discussed various types of risks faced by business enterprises. Now the question is, how to handle these risk? Now let us briefly discuss various steps involved in the risk management process. Risk management involves five basic steps:

1. Risk identification is the first step and also the most difficult function. Failure to identify all the loss exposers of the firm means you will not be in a position to deal with those risks. Therefore, as a first step you should identify all types of loss exposers of your business.
2. After identifying the risks, you should assess the intensity of financial loss associated with each of those risks. At this stage you have to determine two aspects: (a) probability of the occurrence of each of the perils or risk identified in the first stage, and (b) extent of financial loss to the firm, if that peril occur. With this assessment, you can identify the relatively more serious risks and can pay more attention to them.
3. After risk identification and **proper** measurement, at the third stage you should consider various tools of risk management and decide upon the best combination of the tools to be used for attacking the problem. There are basically six tools of risk management **viz.**, (a) assumption (or retention) (b) loss prevention, (c) avoidance, (d) transfer (insurance), (e) separation, and (f) combination. Business **firms** may adopt any one of these six methods or a combination of them. Let us discuss these methods briefly.
 - a) Risk Assumption or Retention: This is a common way of handling risks. Business enterprises assume or retain risks consciously (intentionally) or unconsciously (unintentionally). Under conscious assumption, one is aware of the risk to which **his/her** business is exposed, but essentially does nothing to avoid it. A manager of a business who consciously assumes risk is doing something about it by the very act of being aware of those perils and hazards which may cause loss. Being aware of risk, he may knowingly or unknowingly make adjustments in operations which will help to alleviate the impact of that risk. Awareness of risk itself is a significant achievement in better management. In the case of **unconscious** risk assumption, risk is **not** recognised. As you are not even aware of the existence of some risk, losses stemming from it can cause disastrous surprises **to your** business.

- b) **Loss Prevention:** Another method of handling risk is to take appropriate measures to prevent the occurrence of a peril, or minimise its financial impact on business. This approach is known as loss prevention. For instance, by using fire resistant building material, you can prevent the occurrence of fire in the building. However, in most cases loss prevention measures may not totally eliminate the risk, but can reduce its probability in terms of frequency as well as severity.
- c) **Avoidance:** Avoiding situations which have the potential to cause loss, is another approach. For instance, a **firm** can avoid the risk of loss due to bad debts by simply stopping credit sales. Similarly, a firm may avoid operations in certain areas which are known for some perils like terrorism.
- d) **Transfer:** Transferring the risk to another party is a very widely followed approach to handle risks. Insurance is the most common method of **transferring pure risks** such as fire, windstorm, flood, riot, theft, etc. Business enterprises normally transfer the pure risks to the insurance company and devote their full efforts to their **normal** business.
- e) **Separation:** Fifth method of risk control is separation of the firm's exposer to loss instead of concentrating them at one location where all of them might be involved in the same loss. For example, when a firm keeps its entire raw **material** in one warehouse, the **entire** raw material may be damaged if fire occur in that warehouse. Therefore, the firm may decide to store the raw material in ten separate warehouses. If fire occur in one warehouse, inaterials stored in that warehouse are damaged and the remaining nine warehouses are safe. Here **through** separation the firm increases the **number** of independent **exposere** units under its control. This methods is also a kind of loss prevention.
- f) **Combination:** Strategies like diversification of products, law of large numbers, formation of more **companies** with unrelated lines of business, etc., come under this method. For example, if a **firm** is engaged in more products, the losses incurred in one product may be upset by **the** gains in another product. Similarly, if there are **more** companies, the losses incurred by one company may be upset by **the gains** by the other companies. Insurance companies work on this combination principle where a sufficiently large number of similar objects are **combined** to make the loss predictable within **narrow** limits.

Subjective risks can be reduced by having more knowledge about such perils. A person with better knowledge of the perils can handle them more easily than a person who do not have the knowledge. Therefore, subjective risks may be reduced through knowledge and research. An important aspect you should remember **here** is that **while** managing risks you should not just rely on any one method, instead you should usually employ some combination of various methods.

4. After taking a decision regarding the combination of risk management tools, the next step is the implementation of the decision made. For instance, if you have decided in the previous stage to transfer the risk, you have to get the insurance policy at this stage.
5. Finally, you have to evaluate the effectiveness of the **risk** management tools you have implemented.

The result of the decisions made in the four stages must be evaluated to determine their effectiveness and change the strategy, if required.

Check Your Progress A

1. What is business risk ?
.....
.....
.....
2. Differentiate between risk avoidance and risk transfer.
.....
.....
.....
3. Differentiate between pure and speculative risks.
.....
.....
.....
4. List the five steps of the risk management.
.....
.....
.....
5. State which of the following statements are True or False.
 - a) Business enterprises face risks only in some specific aspects.
 - b) Occurance of pure risks may result into gains to the business firms.
 - c) Speculative risks sometimes can result into profits.
 - d) Objective risks as a proportion declines with the increase in the number of events.

14.6 WHAT IS INSURANCE

As discussed earlier, risk is born out of uncertainty and it is inseparable from business. You have also learnt that the business risks can not be eliminated, but they can be controlled to some extent by adopting appropriate measures. One of such risk control measure is risk transfer by means of insurance. Let us now understand what is insurance ?

Insurance is a device by which a loss likely to be caused by uncertain event is spread over a large number of persons who are exposed to it and who voluntarily join to insure themselves against such an event, Let us take the example of the peril of fire. It is a common knowledge that every year a certain number of houses are destroyed by fire, but no body can predict which particular house will be destroyed. Thus, all house owners run the risk of loss through fire. If all of them pay a small sum into a **fund** every year, anyone who does lose his house can claim money from such fund to build a new house. In the absence of such a fund, the owner of the house has to bear the whole loss by himself. In the case of insurance, in the similar way, loss is being shared by a large number of persons instead of being borne by one. People are willing to lose a small sum in order to be certain that they will not lose a much bigger sum. In the above illustration the persons who got their houses insured are known as 'Insured'. The agency which helped them in entering into this arrangement is known as 'Insurer' or the Insurance Company. The agreement or contract between the insurer and insured is known as 'Policy'. The amount paid by

the insured in **return** of which the insurer undertakes to make good the loss is known as 'Premium'.

To conclude, we may define insurance as a form of contract between two parties (insurer and insured) whereby one party (insurer) undertakes in exchange for a fixed amount of money (premium) to pay the other party (insured), a fixed amount of money on the happening of a certain event (death or attaining a certain age in case of life) or to pay the amount of actual loss when it takes place through the risk insured (in case of property).

Insurance vs Assurance

Sometimes these two terms are used synonymously. But it is necessary for you to know the difference between these two **terms**. In fact insurance is now commonly used in a general sense to include assurance, though it is customary to speak of assurance in connection with life policies. The term 'assurance' is used in those contracts which guarantee the payment of a certain sum on the happening of a specified event which is bound to happen sooner or later. For example, human beings certainly attain a certain age or death. Thus, all life policies come under assurance. On the other hand 'insurance' contemplates the granting of agreed compensation on the happening of certain events stipulated in the contract which are not expected, but which may happen. Thus, insurance refers to risks such as fire, accident, theft, etc., which are contingent in nature.

14.7 INSURABLE RISKS AND NON-INSURABLE RISKS

You should know that all risks can not be transferred to the insurer. Mostly, pure risks can be transferred to the insurer. Now let us discuss the characteristics of risks which can be transferred to the insurer. The characteristics of the **insurable** risks are as follows:

1. The risk should be accidental or random in nature. The loss causing factor should not be within the control of the insured. Thus, the loss which has occurred already or which is very likely to occur can not be insured. For instance, a building which is on fire or which is already destroyed by fire can **not** be insured against fire. Similarly, a person who is infected with AIDS disease can not be insured because he is sure to die as there is no treatment to AIDS so far.
2. The amount of loss should be measurable and possible to estimate. This condition is necessary to set the premium at appropriate levels.
3. There should be a sufficiently large number of units exposed to the same risk. In other words, **there** must be a large number of people interested to insure against the **same** risk. This requirement follows from the law of large numbers, since an insurance operation is safe only when the insurer is able to predict fairly accurately its expected losses.
4. The units facing the same risk must be spread over large geographical area. In other words, the risk must be spread over a wide geographical area so that the happening of a single event in a small region may not cause heavy burden to the insurer. For instance, if an insurance company had accepted against fire for the buildings located in one area only, an incidence of fire in that area can destroy all those builds. The insurance company may become bankrupt with that **single** incidence as it has to pay to all the insured. Therefore, it is necessary that the values exposed to loss should not be concentrated in **one** area.

Normally, pure risks fulfill all the above four features and they are insurable. There are certain risks which do not fulfill these four requirements explained above, and cannot be insured against. They are called non-insurable risks. These **non-insurable** risks include:

1. Risks due to war (except cargo at sea) and certain risks such as radio activity arising from nuclear **fusion**.
2. Risks incapable of measurement such as unforeseen changes in fashion, marketing of new products, etc.
3. Risks too **small and recurring** too frequently, or risks so large and recurring so infrequently. For instance, a hotel can not insure the crockery against breakages.

14.8 INSURANCE CONTRACT

When a person buys insurance from an insurance company (insurer), it is essentially a contract between the insured and insurer. An insurance contract is a vehicle used for transferring risk from an individual or business **firm** to the insurer. **Insurance contract, constitutes the agreement between the insured and insurer, and details the conditions under which the risk transfer takes place.** Before we discuss the components of an insurance contract, you should understand the meaning and importance of the following three aspects.

The Proposal: A person wishing to effect an insurance contract is required to submit a proposal to the insurer. This proposal may be made either orally or in writing. Proposal form consists of a number of questions to which the person must give **truthful** answers. The insurer can reject the proposal if the proposal is incomplete or incorrect.

The Cover Notes: Insurance contract comes into existence only when the proposal is accepted by the insurer. While the proposal is under consideration by the insurer, sometimes the person making the proposal may wish to have immediate cover. In such case, on request, the insurer may issue a cover note which grants temporary protection. Thus, the main purpose of cover note is to **confirm** the risk cover prior to the issue of policy by the insurer,

The Policy: Insurance **policy** contains all the **terms** of the contract. Having accepted a proposal, insurer **must** issue the policy within one month of receiving the first premium. Most policies are for fixed periods, usually a year. Under a life policy the assured has an **indisputable** right of renewal while other policies are renewable by mutual agreement. Although not obliged to do so, the insurer usually issues a renewal notice **reminding** the insured of the date for payment of the next premium. It is, moreover, the voluntary practice of insurers to allow extra days, called days of grace, within which the renewal premium may be paid. Usually, grace period is 15 days for fire **and accident** insurance and 30 days for life assurance. With types of policy other **than** those mentioned, cover will usually cease with the day on which the policy **expires**. It is, therefore, not proper to delay payment of renewal premiums beyond the **date** on which they fall due.

14.8.1 Components of an Insurance Contract

Basically all insurance contracts consist of the following five parts (1) declaration, (2) **insuring agreement**, (3) exclusions **and** limitations, (4) conditions, and (5) binder. Let us discuss these five parts briefly.

1. **Declaration:** This is the first part of any insurance contract. It contains the information relating to identity of the **insured**, the property, the **type(s)** of coverage, term of the contract, insurance amount and the premium. Other

information may also be added to declaration depending on the type of contract and the specific circumstances surrounding the risk transfer. The declaration covers most of the basic information needed by the insurer in deciding whether to issue the contract and at what price.

2. **Insuring Agreement:** The insuring agreement is a formal statement detailing what the insurer promises to do in return for the premium paid. The perils insured against and services promised are stated and defined in the agreement. If there are limitations on the amount of recovery, these may be stated in the agreement. In the insurance contract, this agreement ordinarily follows the declarations. The insuring agreement is the most important section of the contract, since it contains the basic information about the nature of the risk transferred and what may be recovered in the event of loss.
3. **Exclusions and Limitations:** Insurance contracts may be written on an all risk basis, where the contract insures against all risks except those specifically excluded in the contract. The contract may be also on the named perils basis, where only losses resulting from the perils named in the contract are covered. Though the insured may prefer an all-risk contract since it **offers** the broader coverage, insurers normally do not **undertake** to insure against all risks. Perils which are covered in the contract are normally subject to limitations **and/or** exclusions. In general, such exclusions are of two types (1) certain kinds of **property** are excluded or certain perils are excluded or both things may occur, and (2) excluded property may be added by endorsement and the same is true of perils. It is important that the insured must understand the exceptions surrounding the transfer.
4. **Conditions:** The clauses are the conditions to be fulfilled by **the insured** to enforce his rights under the contract. Most of these conditions refer to the type of **information** that must be supplied by the **insured** in the event of loss or refer to the right of the insured if dispute arises in regard to the loss. It is essential for the insured to know his duties. Unless he fulfils all the terms of the contract, he may not be able to recover the loss from the insurer.
5. **Binders:** Sometimes a memorandum called a binder is issued by the insurer. The binder is a temporary insurance contract. **The** binder contains the essential facts about the transaction such as date, amount, name of insured, and risk to be covered. In the event of loss, the binder serves in lieu of the policy and has the same force as if the policy had been issued.

14.8.2 Legal Aspects of Insurance

The validity of every insurance contract rests upon certain principles. The basic principles which are applicable to various kinds of insurance contracts are: (1) utmost good faith, (2) proximate cause, (3) insurable interest, (4) indemnity, (5) subrogation, and (6) principle of mitigation of loss. Let us discuss these principles briefly.

1. **Utmost Good Faith:** A basic condition of every contract of insurance is that the insurer and insured should display utmost good faith towards each other. Each party must reveal to the other party, whether asked or not, all material facts which would influence the other party's decision to enter into the contract. It is not enough that the insured gives truthful answers to all the questions in the proposal **form**, but it is legal obligation to disclose all other information known to him that is likely to affect the **insurer's** estimation of the risk. If the material fact is not disclosed or if there is misrepresentation or fraud, the insurer is entitled to avoid the contract or **refuse** payment under it. This requirement of good faith is essential for the

Normally, pure risks fulfill all the above four features and they are insurable. **There** are certain risks which do not fulfill these four requirements explained above, and cannot be insured against. They are called non-insurable risks. These non-insurable risks include:

1. Risks due to war (except cargo at sea) and certain risks such as radio activity arising from nuclear fusion.
2. Risks incapable of measurement such as unforeseen changes in fashion, marketing of new products, etc.
3. Risks too small and recurring too frequently, or risks so large and recurring so infrequently. For instance, a hotel can not insure the crockery against breakages.

14.8 INSURANCE CONTRACT

When a person buys insurance from an insurance company (insurer), it is essentially a contract between the insured and insurer. An insurance contract is a vehicle used for transferring risk from an individual or business firm to the insurer. **Insurance contract, constitutes the agreement between the insured and insurer, and details the conditions under which the risk transfer takes place.** Before we discuss the components of an insurance contract, you should understand the meaning and importance of the following three aspects.

The Proposal: A person wishing to effect an insurance contract is required to submit a proposal to the insurer. This proposal may be made either orally or in **writing**. Proposal **form** consists of a number of questions to which the person must give truthful answers. The insurer can reject the proposal if the proposal is incomplete or incorrect.

The Cover Notes: Insurance contract comes into existence only when the proposal is accepted by the insurer. While the proposal is under consideration by the insurer, sometimes the person making the proposal may wish to have immediate cover. In such case, on request, the insurer may issue a cover note which grants temporary protection. Thus, the main purpose of cover note is to **confirm** the risk cover prior to the issue of policy by the insurer.

The Policy: Insurance policy contains **all** the terms of the contract. Having accepted a proposal, insurer **must** issue the policy within one month of receiving the first premium. Most policies are for fixed periods, usually a year. Under a life policy the assured has an indisputable right of renewal while other policies are renewable by mutual agreement. Although not obliged to do so, the insurer usually issues a renewal notice **reminding** the insured of the date for payment of the next premium. It is, moreover, the voluntary practice of insurers to allow extra days, called days of grace, within which the renewal premium may be paid. Usually, grace period is 15 days for fire and accident insurance and 30 days for life assurance. With types of policy other than those mentioned, cover will usually cease with the day on which the policy expires. It is, therefore, not proper to delay payment of renewal premiums beyond the **date** on which they fall due.

14.8.1 Components of an Insurance Contract

Basically all **insurance contracts** consist of the following five parts (1) declaration, (2) **insuring** agreement, (3) exclusions and limitations, (4) conditions, and (5) binder. Let us discuss these five parts briefly.

1. **Declaration:** This is the **first** part of any insurance contract. It contains the information relating to identity of the insured, the property, the **type(s)** of coverage, term of the **contract**, insurance amount and the premium. Other

information may also be added to **declaration** depending on the type of contract and the specific circumstances surrounding the risk transfer. The declaration covers most of the basic information needed by the **insurer** in deciding whether to issue the contract and at what price.

2. **Insuring Agreement:** The insuring agreement is a formal statement detailing what the insurer promises to do in return for the premium paid. The perils **insured** against and services promised are stated and defined in the agreement. If there are limitations on the amount of recovery, these may be stated in the agreement. In the insurance contract, this agreement ordinarily follows the declarations. The insuring **agreement** is the most important section of the contract, since it contains the basic information about the nature of the risk transferred and what may be recovered in the event of loss.

Exclusions and Limitations: Insurance contracts may be written on an all-risk basis, where the contract insures against all risks except those specifically excluded in the contract. The contract may be also on the named perils basis, where only losses resulting from the perils named in the contract are covered. Though the insured may prefer an all-risk contract since it offers the broader coverage, insurers normally do not undertake to insure against all risks. Perils which are covered in the contract are normally **subject** to limitations **and/or** exclusions. In general, such exclusions are of two types (1) certain kinds of property are excluded or certain perils are excluded or both **things** may occur, and (2) excluded property may be added by endorsement and the same is true of perils. It is important that the insured must understand the exceptions surrounding the transfer.

4. **Conditions:** The clauses are the conditions to be **fulfilled** by **the** insured to enforce his rights under the contract. Most of these conditions refer to the type of information that must be supplied by the insured in the event of loss or refer to the right of the insured if dispute arises in regard to the loss. It is essential for the insured to know his duties. Unless he fulfils all the terms of the contract, he may not be able to recover the loss from the insurer.
5. **Binders:** Sometimes a memorandum called a binder is issued by the insurer. The binder is a temporary insurance contract. The binder contains the essential facts about the transaction such as date, **amount**, name of insured, and risk to be covered. In the event of loss, the binder serves in lieu of the policy and has the same force as if the policy had been issued.

14.8.2 Legal Aspects of Insurance

The validity of every insurance contract rests upon certain principles. The basic principles which are applicable to various kinds of insurance contracts are: (1) utmost good faith, (2) proximate cause, (3) insurable interest, (4) indemnity, (5) subrogation, and (6) principle of mitigation of loss. Let us discuss these principles briefly.

1. **Utmost Good Faith:** A basic condition of every contract of insurance is that the insurer and insured should display utmost good faith towards **each** other. Each party **must** reveal to the other party, whether asked or not, all material facts which would influence the other party's decision to enter into the contract. It is not enough that the insured gives **truthful** answers to all the questions in the proposal form, but it is legal obligation to disclose all other **information** known to him that is likely to affect the insurer's estimation of the risk. If the material fact is **not** disclosed or if there is misrepresentation or fraud, the insurer is entitled to avoid the contract or refuse payment under it. This requirement of good faith is essential for the

protection of the insurer, since he can evaluate the risk only on the basis of what he is told by the insured.

2. **Proximate Cause:** To recover compensation under a policy, it must be proved that the loss sustained was proximately caused by the event insured against. In other words, the loss must be the result of the occurrence of the peril stated in the policy or a peril very closely related to it. For instance, a fire insurance policy will cover not only loss caused directly by fire but **also** the loss caused due to the efforts made to put out the fire (such as the loss due to demolition of part of the building to prevent the **fire** from spreading). Similarly, theft also can be a cause proximate to a fire, if goods removed from the burning building are pilfered before the arrangements were made for their safe custody.
3. **Insurable Interest:** A person can not legally insure a risk in which he has no legal interest. For instance, a person can insure his own property but not that of his neighbour's property. In the same way, a creditor may insure the life of a person who owes him money. But you should note that sometimes interest may arise without ownership also. For instance, if a **person** had taken loan from a housing finance **company** to build his house, the housing finance company had an interest in the house, and is entitled to insure it. In the case of life insurance, it is well established that a man had unlimited interest in his own life and in that of his wife, and similarly the wife had unlimited interest in the life of her husband. In life insurance, the insurable interest must be present at the time when insurance is effected. In marine insurance the interest need exist only at the time of loss, but in fire and burglary, it must exist throughout the period of the contract.
4. **Indemnity:** Here the term indemnity is synonymous with compensation. Under the contract of indemnity, the policy holder is entitled to get the compensation from the insurer so that the policy holder neither gains nor losses from the mishap. For example, a building is insured against fire for Rs.1,00,000 and it is partly damaged by fire. It is estimated that it requires Rs.50,000 towards repairs. In this case the insured can recover only Rs.50,000 from the insurer although the total sum insured is Rs.1,00,000. This clause is applicable in fire and marine insurances only, and not applicable in other insurances (life, personal accident and sickness insurances). The **main** purpose of indemnity is to compensate the loss incurred and not make profits out of mishaps. However, if the same interest (property) is insured with several insurers, the total sum recovered from all the insurers should **not** be more than the actual loss. As a rule, in case of multiple insurances the insured should claim the loss proportionately from each insurer. In case of life assurance, the insurer must pay the agreed amount irrespective of the true value of the loss suffered. For instance, a person insured life for a very huge sum of one crore and died in an accident. The insurer must pay the total amount of one crore stipulated in the policy. Thus the principle of indemnity is not applicable in life, personal accident and sickness insurances.
5. **Subrogation:** The doctrine of subrogation applies only to **contracts** of indemnity. According to the **doctrine** of subrogation, after the insured is compensated for the loss, the right of ownership of such damaged part of the property passes on to the insurer. If the damaged property has any value left or the lost property is recovered, such property can not be allowed to remain with the insured because in that case the insured will realise more than the actual loss, which is against the principle of indemnity. For example, if a car belonging to Mr. Satish is damaged due to negligence of Mr. Raju, and Mr. Satish is fully **compensated** by the insurer. In that case Mr. Satish can not sue Mr. Raju to recover any compensation. In fact the insurer can sue Mr. Raju for negligence. Here if insurer recovers from Mr.

Raju more than the compensation already paid to Mr. Satish, insurer must pass on the surplus to Mr. Satish. Similarly; an insurer who has paid on a burglary claim is entitled to the stolen goods when they are recovered. You should note that, as stated earlier, this doctrine of subrogation applies only to the contracts of indemnity.

6. Principle of Mitigation of Loss: An insured must take all reasonable care to prevent and reduce the loss. For instance, if a house is insured against fire and there is accidental fire, the owner must take all reasonable steps to extinguish fire and keep the loss to the minimum. Similarly, if a person had insured household goods against theft and burglary, he must take all normal precautions (such as locking the house) to prevent theft.

Check Your Progress B

1. Differentiate between insurer and insured.

What is an insurable risk ?

List the legal aspects of an insurance.

4. Match the items in Group A with Group B

Group A	Group B
i. Binder	a) Insurer's right of ownership of damaged property.
ii. Indemnity	b) Life Policies
iii. Subrogation	c) Risk due to war
iv. Assurance	d) A temporary insurance contract
v. Non-insurable risk	e) To make good the loss

5. State whether the following statements are True or False ?
- Insurance is nothing but risk transfer.
 - Insurer pays premium to the insured.
 - A house already on fire can be insured.
 - Risks too small and recurring too frequently can not be insured.
 - Man had insurable interest in wife and vice versa.

14.9 KINDS OF INSURANCE

You have already studied the meaning of insurance, risks which can be insured, legal aspects and components of insurance contracts. Now let us discuss how different kinds of insurances cover various types of risks under the following five categories:

- Life Insurance
- Marine Insurance
- Fire Insurance

4. Motor Insurance
5. Miscellaneous Insurance

14.9.1 Life Insurance

Life insurance is a contract under which one person, in consideration of a premium paid (either in lump sum or by monthly, quarterly, half-yearly or yearly payment), undertakes to pay to the person for whose benefit the insurance is made, a certain sum of money either on the death of the person whose life is insured or on the expiry of a specified period of time. As you know, insurance policy may be taken by a person who had insurable interest. In section 14.8.2 of this unit we have already discussed the principle of 'insurable interest'. In case of life insurance, under this principle, any person who had a pecuniary claim against another or a right to support and maintenance from him can insure the life of that another person. The following persons, thus, have the insurable interest.

- o A person has an unlimited insurable interest in own life
- A husband has an insurable interest in his wife while the wife had insurable interest in her husband
- A child had insurable interest in the life of the father while father do not have the insurable interest in the life of his son, **unless** father is dependent on son.
- An elder brother do not have insurable interest in the life of the younger brother.
- A creditor has an insurable interest in the life of debtor, to the extent of the amount of debt.
- A servant has an insurable interest in the life of his employer.
- A surety has an insurable interest in the life of his co-surety and the principal debtor.
- A company has an insurable interest in the life of its officers, whose death may seriously affect its business (Profits)

As discussed earlier, life policies are considered as life **assurance** policies. You have already learnt the difference between assurance and insurance in section 14.6. Life assurance contracts are not the contracts of indemnity. Therefore, in the case of life policies the insurer must pay the agreed amount (policy amount) on the occurrence of the agreed event (death or expiry of the specified time). As you know, marine and fire policies are the contracts of indemnity, where the insurer is compensated to the extent of loss only if the actual loss is less than the amount specified in the policy

Types of Life Policies: There are eight broad types of life policies as discussed below:

1. Whole Life Policies: Under this policy, the sum assured is payable after the death of the assured. The premiums on whole life policies may be payable regularly through out the life of the assured, or alternatively they may be payable for a **fixed** period only (say 20 or 30 years). If the premiums are paid throughout the life, it is called 'ordinary life policy'. In the other case when premiums are paid for a limited period, it is called 'limited payment life policy'. Even in the case of the limited payment life policy also, insurer will pay the sum assured only after the death of the insured. Whole life assurance policy is ideal for a person who wishes to provide support for **his/her** dependents after the death.
2. Endowment Life Assurance: Under this policy the insurer undertakes to pay the sum assured either at the end of a specified period or on the death of the assured, whichever is the earlier. **In** case the assured dies before the expiry of specified period (or before attaining the specified age), the **sum** assured is payable to the legal heirs or nominees. On the other hand, if the

insured survives till the policy matures (i.e. expiry of the specified period), the sum assured is paid to the insured himself. The premium for endowment policy is a bit higher than the whole life policy.

3. **Term Assurance:** This is also called temporary assurance. Under this policy, the sum assured is paid when the assured dies before the stipulated date. No payment is made if the assured survives to that date. For example, policies of this kind are taken out by persons who travel abroad, to cover **short-period** bank loans so that the sum assured will be available to repay the loan if the borrower die before the policy lapses, etc.
4. **Joint Life Policy:** This type of assurance involves the insurance of two lives simultaneously in the same policy. The sum assured (policy money) is payable by the insurer upon the death of any one of the assured to the surviving person. If both the policy holders die at the same time, their legal heirs or nominees will be paid the assured sum. A **good example** of a joint life policy is that of a policy on the lives of a husband and wife, payable to the survivor on the death of either of the two.
5. **Group Insurance:** Under group insurance, a group of **persons** under the same employer **are covered** under a single policy. Premium is paid by the employer alone or by the employer and employee jointly. A group insurance policy may cover all the employees or a particular **category/section** of the employee of the same organisation. However, the employees are covered under this policy as long as they serve with that employer. In group insurance, the insurance contract is between the employer and the insurance **company** (insurer). A master policy is issued to the employer, while the each employee receives a certificate. The certificate issued to the employee stipulates the amount of coverage that person had, his beneficiary (nominee) **and** any other rights and privileges he may have under the plan.

The policy is taken for a fixed period, usually 20 years. If the employee (assured) dies before the expiry of the term, the nominee (beneficiary) gets a fixed annual income for the remaining part of the period and the **full** assured sum at the end of the term. On the other hand, if the assured survives the term, the **full** assured sum is paid at the end of the term.

6. **Childrens' Endowment Policies:** These policies are taken for the purpose of education of children and marriage expenses of daughters. These policies are just like the endowment life policies discussed earlier. Premium (annual or lump sum) is payable by the person (father or guardian or other person) entering into the contract. Policy matures when the child attains certain age. Then the sum assured is paid either in lump sum (when intended for the marriage of the female child) or paid by installments **over** a specified period (when policy is meant for education).
7. **Annuity Policies:** This policy is suitable when people desire to have certain income after the **attainment** of certain age. **Annuity** policies are, for example, taken by employees who want some income after their retirement from service. Premium may be paid in instalments or in lump sum at the beginning. After the assured attains certain age, insurer pays the amount in instalments (**monthly/Quarterly/half yearly/annual**)
8. **With Profit or Without Profit Policies:** Most of the above discussed types of policies may be with profit or without profit. In the case of with profit policy, the assured is paid, in addition to the sum assured, a share in the profits earned by the insurer. The profits are declared by the insurer after certain intervals and credited to the policy-holder as bonus. Without profit policy is one under which the policy holder does not get any share in the

profits earned by the insurer. The premia on without profit policies are lower than those on with profit policies. With profit and without profit policies are also known as participating and non-participating policies respectively.

14.9.2 Marine Insurance

Marine insurance is an arrangement by which the insurer undertakes to compensate the owner of a ship or cargo for complete or partial loss at sea. Marine insurance covers ship, cargo and freight. Perils of the sea also includes any land risk incidental to sea voyage. The marine policy must specify the following aspects:

- The names of the insured and the insurer
- The subject matter insured and the risks insured against
- The voyage or time period or both
- The sum assured
- The amount of premium

Under marine insurance, *insurable interest must exist only at the time of loss. It is not necessary for the insured to have the insurable interest at the time of taking the marine insurance policy.* Marine insurance is a contract of indemnity. The insured is entitled to recover only the actual amount of loss from the insurer. Similarly, the principle of contribution and subrogation is applicable to all marine policies. In case of several policies relating the same subject matter, each insurer is liable to contribute to the amount of compensation proportionately. Once the insured receives the compensation, all rights on the remains of damaged property passes on to the insurer.

Types of Marine Policies: The main kinds of marine policies are as follows:

- Voyage Policies: This type of policy covers a ship or cargo during a specified voyage only. Thus the limits of the risk are from the port of departure to the port of destination. The risk which is covered starts from the departure of ship from the port and it ends when that ship reaches the port of destination. For example, you are shipping the export cargo from Bombay to Amsterdam in Netherlands and you have taken a voyage policy. This policy covers the risk of damage to cargo from Bombay port till it reaches the Amsterdam port. In the case of a voyage policy, insurer is not liable if the destination of the ship is changed or the ship deviates from the agreed route. However, deviation from the agreed route is allowed when it is necessary for the safety of ship/cargo or saving the human life or any other circumstance stated in the contract.
2. Time Policy: This type of policy covers the risk during a stated period of time irrespective of number of voyages made. This policy would cover all the risks from the perils of sea for a stated period of time, say 1st April 1998 to 30th March 1999. Normally a time policy covers a period not more than 12 months. However, most time policies include a *continuation clause* providing against expiration of the policy if the ship is still on the voyage. A monthly prorata premium is payable for the continuation.
 3. Mixed Policy: This combines the elements of a time policy and voyage policy. Mixed policy covers the risk during a particular voyage for a specified period. For example, a mixed policy may be taken to cover the ship or cargo during voyage from Bombay to Amsterdam from 1st November 1998 to 31st January 1999.
 4. Valued and Unvalued Policies: Under valued policy, the value of the subject matter insured (ship/cargo) is specified on the face of the policy. In the event of full loss the insurer compensates the amount specified in the

policy. If the loss is partial a proportionate amount is paid by the insurer. On the other hand, in the case of an unvalued policy, the value of the subject matter is not stated in the policy. In case of loss or damage, the compensation is ascertained by assessment of loss, subject to the limit of the sum insured.

5. Floating Policies: This policy is suitable to a merchant who makes regular shipments. To avoid the botheration of taking a separate policy for every shipment, an exporter can take a floating Policy. A floating policy is taken for a round amount, and leaves the details to be declared at a later time. Whenever some cargo is shipped, the shipper (insured) makes a declaration stating the sum for which it is to be insured. Then the total value of the floating policy is reduced by that amount. With each shipment, the value of the policy goes on decreasing. Thus the amount outstanding on the policy reduces progressively as shipments are made and premiums calculated. When the policy is fully covered, it is said to be fully declared and a new policy is taken.

14.9.3 Fire Insurance

Fire policies cover the losses directly caused through fire. However, it is necessary that fire must happen by ignition. If the fire is caused through the malicious act of the insured himself, he would not be able to recover the loss from the insurer. The fire insurance contract is an indemnity contract. Each contract specifies the maximum amount that can be claimed by the insured in case of loss. The insurer is liable to make good the actual amount of loss caused by fire, not exceeding the maximum amount fixed in the policy. In order to cover a particular loss or damage under a fire policy, the following three conditions should be fulfilled:

- The loss or damage should relate to the subject matter of policy.
- The loss or damage must be caused by ignition or fire.
- The ignition must be either of goods insured or the premises where it is placed.

In addition to fire, the standard fire policy covers such perils as lightning, explosion of domestic boilers, gas used for lighting and heating, and damage by water used to extinguish a fire on neighboring property. For a small additional premium the policy may be extended to cover such other items as storm and flood, earthquakes and impact from road vehicles or aircraft, but not glass and china, jewellery, manuscripts and other items of value, except where specially mentioned. However, all these items may be covered in an 'all other contents' clause. As per the cause proxima condition, as discussed earlier, loss/damage by fire also includes the loss/damage caused by efforts to extinguish fire with a view to mitigate the loss.

Therefore, the following causes are covered by fire insurance:

- Damages due to usage of water to extinguish the fire.
- Wages paid to persons employed to extinguish the fire.
- Losses arising from efforts to avert damage by fire. For instance, property destroyed (e.g. adjacent building) by the fire brigade to prevent the spread of fire.

Usually a fire policy is for a fixed period. During that period if there are successive fire accidents, the insurer is liable to make good of all those successive losses.

Types of Fire Policies: Broadly, there are six types of fire insurance policies, as explained below;

- Specific Policy where the liability of the insurer is limited to a specified amount, which is normally less than the actual value of the property insured.
- Valued Policy where the insurer agrees to pay a fixed amount in the event of loss, irrespective of the actual loss suffered. Under this policy, the insured recovers a fixed amount, irrespective of the amount of actual damage
- Floating Policy where the amount of the policy may vary from time to time. This type of policy is useful in the case of goods in store where quantity and value change from time to time.
- Replacement Policy where the insurer has the option to replace the property/goods damaged by fire, instead of paying the loss by cash.
- Loss of Profit Policy where insured is protected against the loss of profit due to dislocation of business due to fire. Under this policy, insurer compensates to the extent of the loss in profits.
- Comprehensive Policy which provides cover against not only fire but also several other risks such as lightning, riot, earthquake, flood, storm, burglary, war, etc.

14.9.4 Motor Insurance

Owners of motor vehicles (two or four wheelers) can take insurance policies to cover different types of risks viz., (a) loss or damage to the vehicle, (b) injuries to or death of any passenger, and (c) damages payable to the third parties for accidents. Every motor-vehicle driver must be insured for against liability for death of or injury to third parties and for the cost of their medical/surgical treatment. Though there is no statutory duty to insure against damage to property as well as personal injury, most of the third party policies cover both of these risks. A comprehensive motor insurance policy covers not only full third party risks (property as well as persons including passengers), but also damage to the insured vehicle, loss of rugs and other articles, and may also cover the cost of hiring a substitute vehicle, if necessary. If no claims are made during the year, a discount or 'no-claim bonus' is allowed at the time of renewal. The discount is cumulative and after 4 or 5 years may reduce the premium rate by as much as 60 per cent

14.9.5 Miscellaneous Insurance

You have studied four major kinds of insurance viz., life insurance, marine insurance, fire insurance and motor insurance. Besides these, there are several other types covering various other aspects of risks. Some of them are discussed below.

Engineering Insurance

This is a highly technical branch of insurance. It is a branch of insurance that has expanded rapidly under recent legislation and especially under the Factories Acts, which prescribe compulsory inspection at regular intervals of certain types of industrial equipment, such as boilers, electrical plant, cranes and other lifting gear. Policies cover the inspection service, the cost of repairing or replacing plant, and also injury to persons and damage to property. Cover is also available for machinery in transit or in course of erection.

Aviation Insurance

Under aviation insurance, cover is available for loss of or damage to aircraft, personal accidents to passengers, third party risks in respect of both person and property and for cargo sent by air. However, accidents to staff who fly regularly are covered by group insurance schemes.

Most fire companies now offer an extensive range of cover on the buildings and contents of private dwellings under householders' or all-in policies. Normally, these policies are designed to provide protection in one document against a variety of risks (additional to those already covered by a standard fire policy) including burglary, housebreaking, theft, accidents to domestic servants, liability to third parties, glass breakages and other hazards. Under these policies it is normally insisted to insure buildings and contents for their full value to enable the insurer to earn an adequate premium.

Fidelity Guarantee Insurance

As you know, cashiers and others who handle money are frequently required by their employers to provide security as protection against their personal dishonesty. In such cases, fidelity guarantee insurance policy may be taken by the employer. The policy indemnifies the employer against losses from the dishonesty of his employees. The employer himself often takes out the policy. He may insure a number of employees either individually or on a group basis under a variety of policies.

Burglary, Theft and Robbery

Burglary is the act of unauthorised entry with criminal intentions, into any building or residence. Theft is the act of dishonestly taking property belonging to another with the intention of depriving him of it. Robbery is theft with violence or the threat of violence. Burglary insurance covers the loss caused on account of burglary, housebreaking or theft.

14.9.6 Difference Between Life Insurance and Other Forms of Insurance

You have studied various kinds of insurance policies and how they cover various types of business risks. Now let us study the basic difference between life policies and other policies. Study the following table carefully to understand this difference.

Life Insurance	Other Forms
1. Relate to human lives.	Mostly relate to property.
2. The event (i.e., attainment of certain age or death of insured) is certain to happen.	The peril insured may or may not occur.
3. There must be insurable interest must at the time of taking the policy	In fire and marine insurance, insurable exist only at the time loss occurs,
4. It is a contingent contract. The Insurer is liable to total sum assured is payable on assured, whichever is less. of the event (death or attainment of certain age).	These are contracts of indemnity, make good only the actual loss suffered or the sum the happening
5. These are long term contracts. subject to renewal at the end of the year.	Mostly one year contracts,

Check Your Progress C

1. Differentiate between joint life policy and group insurance.
.....
.....
.....
2. Differentiate between voyage policy and time policy.
.....
.....
.....
3. State whether the following statements are True or False ?
 - a) Life assurance contracts are indemnity contracts.
 - b) Some of the marine insurance policies are not indemnity contracts.
 - c) A surety has an insurable interest in the life of the borrower.
 - d) In the case of life insurance, only actual loss is compensated by the insurer.
 - e) Losses arising from efforts to avert damage by fire are covered under a fire policy.
 - f) Motor insurance covers the damages payable to third parties for accidents.
 - g) Marine insurance do not cover the recovery of freight.

4.10 LET US SUM UP

Risk means the uncertainty of occurrence of economic loss. Based on this the term business risk may be defined as the uncertainty of occurrence of economic loss in the event of any business activity. Business enterprises face a variety of risks, and thus risks prevail in all activities of business enterprises. Depending on the nature, business risks may be classified as pure risks and speculative risks, dynamic risks and static risks, risks classified by loss severity, objective risks and subjective risks, etc.

Business enterprises have to manage the risks systematically. Risk management process involves five steps: (1) identification of the risks, (2) assessment of the intensity of financial loss associated with each risk, (3) identifications of various tools of risk management and selecting the best combination of tools to be used, (4) implementation of the decision, and (5) evaluation of the effectiveness of the risk management tools.

Insurance is a device by which a loss likely to be caused by an uncertain event is spread over a large number of persons who are exposed to it and who voluntarily join together to insure themselves against such an event. Thus, insurance is a form of contract between two parties where by one party (insurer) undertakes in exchange for a fixed amount of money (premium) to pay the other party (insured) a fixed amount of money or compensate the loss on the happening of a certain event.

All risks are not transferable to the insurer. Only pure risks can be transferred. Characteristics of insurable risks are: (1) risk should be accidental or random in nature, (2) loss should be measurable, (3) there should be sufficiently large number of units exposed to the same risk, and (4) those units should be spread over a large geographical area. Risks which do not fulfill these conditions are non-insurable.

An insurance contract consists of five main parts: (1) declaration, (2) insuring agreement, (3) exclusions and limitations, (4) conditions, and (5) binders. Insurance



contracts must fulfill six conditions viz., utmost good faith, proximate cause, insurable interest, indemnity, subrogation and principle of mitigation of loss.

Business enterprises can transfer several types of risks to insurance companies. There are different kinds of insurance such as fire insurance, marine insurance, life insurance, motor insurance, fidelity guarantee insurance, burglary and theft insurance, etc. Within each of these kinds there are again different types to suit various requirements. Life insurance relate to human lives while other types of insurances cover properly.

4.11 KEY WORDS

Risk: Uncertainty of occurrence of economic loss.

Business Risk: Uncertainty of occurrence of economic loss to a business firm in the event of any business activity.

Pure Risk: A type of risk whose occurrence causes loss only.

Speculative Risk: A risk whose occurrence may cause either gain or loss.

Static Risk: A risk which may occur without any change in the business environment.

Dynamic Risk: A business risk which arises due to changes in the business environment.

Insurance: A form of contract between two parties where one party undertakes in exchange for a fixed amount of money to pay the other party a fixed amount of money or pay the amount of actual loss on the happening of a certain event.

Insurable Risks: Pure risks which can be transferable to the insurer.

Non-insurable Risks: Risks which cannot be transferred and therefore not insurable.

Insurance Policy: A document containing all terms of contract between the insurer and insured.

Kindred: A document in lieu of the insurance policy issued by the insurer.

Marine Insurance: An agreement whereby the insurer undertakes, in return for a consideration, to compensate the owner of a ship or cargo for complete or partial loss due to perils of the sea.

fire Insurance: An agreement whereby one party in return for a consideration undertakes to indemnify the other party against financial loss which the later may sustain by reason of certain defined subject matter being damaged or destroyed by fire or other defined perils upto an agreed amount.

Life Insurance: An agreement whereby the insurer, in consideration of a premium paid either in lumpsum or by regular instalments, undertakes to pay a certain sum of money either on the death of the insured or on the expiry of a specified period of time.

14.12 ANSWERS TO CHECK YOUR PROGRESS

- A. 5 (a) False (b) False (c) True (d) True
 B. 4 (i) d (ii) e (iii) a (iv) b (v) c
 5 (a) True (b) False (c) False (d) True (e) True
 C. 3 (a) False (b) False (c) True (d) False (e) True (f) True (g) False

14.13 TERMINAL QUESTIONS

1. What is risk? Explain how risks are pervasive in business.
2. What is a business risk? Explain the process of risk management.
3. What is a business risk? Describe various types of business risks.
4. 'All business risks are not insurable'. In the light of this statement, explain insurable risks and non-insurable risks.
5. What is insurance? Discuss the general principles of insurance.
6. What is an insurance contract? Describe the parts of insurance contracts.
7. Comment on the following statements:
 - a) 'A contract of insurance is a contract of indemnity and indemnity only'.
 - b) 'All risks are not insurable'.
 - c) 'Insurance is sometimes spoken of as pooling of risks'.
8. Explain the principle of insurable interest. State the significance of this principle in the case of life, fire and marine policies.
9. Briefly explain salient features of various types of life insurance policies.
10. Write **short** notes on the following:
 - a) Cause **proxima**
 - b) Doctrine of subrogation
 - c) Insurable interest
11. Distinguish between the following:
 - a) Risk transfer and risk separation
 - b) Risk avoidance and loss prevention
 - c) Life insurance and other insurances
 - d) Whole life policy and endowment life policy
 - e) Voyage policy and time policy
12. **What** is marine insurance? Explain various types of marine policies.
13. Explain the features of a fire policy and State various types of fire policies available.

Note : These questions will help you to understand the unit better. **Try** to write answers for them. But do not submit your answers to the University for assessment. These **are** for your practice only.

UNIT 15 TRANSPORT AND WAREHOUSING

Structure

- 15.0 Objectives
- 15.1 Introduction
- 15.2 Trade and **Barriers** to Trade
- 15.3 Transport– Its Importance
- 15.4 Essentials of a Good Transport System
- 15.5 Modes of Transport
 - 15.5.1 Road Transport
 - 15.5.2 Rail Transport
 - 15.5.3 Sea Transport
 - 15.5.4 Air Transport
 - 15.5.5 Miscellaneous Modes
- 15.6 Choice of Mode of Transport
- 15.7 Containerisation
- 15.8 Clearing and Forwarding Agents
- 15.9 Warehousing
- 15.10 Types of Warehouses
- 15.11 Let Us Sum Up
- 15.12 Key Words
- 15.13 Answers to Check Your Progress
- 15.14 Terminal Questions

15.0 OBJECTIVES

After studying this unit you should be able to:

- explain the role **and** importance of transport as an adjunct of trade
- state the essentials of a good transport system
 - enumerate the various modes of transport
- describe the procedures involved in different modes of transport
- explain the suitability of the various modes of transport
- discuss the basis on which choice of a mode of transport can be made
- describe the meaning and importance of containerisation in transport
- enumerate the functions of forwarding and clearing agents
- describe the **purposes** served by **different types** of warehouses.

1.1 INTRODUCTION

Modern business involves manufactures of goods on a large and **making** them available to consumers in distant places. Thus goods must be moved **from** the place of production to the place of consumption to create place utility to them. Similarly, trading involves distribution ensuring the availability of goods to consumers as and when needed. This involves holding of stocks by traders as near as possible to the markets and supplied to buyers. Thus transportation and warehousing functions ensure consumers to get a ready supply of goods as the right place and right time. In this unit you will study these **functions** in detail. You will study the nature and importance of transport service modes of transport, procedure involved and the suitability of various modes. You will also learn the meaning and usefulness of warehousing and the purpose served by different types of warehouses.