Loss prevention and corporate risks: prevention is better than cure (part 1)

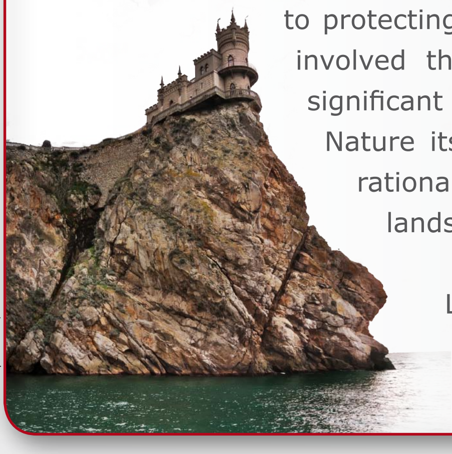
Prevention and insurance

In the developing societies of the past, insurance, intended as transferring risk to a specialist, was considered an activity to be avoided. The mere thought of seeking economic protection against possible future setbacks was tantamount to unleashing a barrage of adversities on yourself or on your possessions! Notwithstanding technological progress, the culture of "**superstition**" continues to survive – albeit in a veiled form – as a personal attitude. Criticism of the insurance contract was firmly entrenched within Islamic orthodoxy, which has only recently accepted the institute of ***takaful***, a solidarity-based form of cooperative insurance.

Over time, though, most industrial and commercial activities have increasingly felt the need to take out insurance **against** present and **future risks** for themselves and their employees, at the same time working out ways to curtail the number and impact of losses that can occur.

Loss prevention – a historical perspective

Pile-dwellings of prehistory can be considered as an example of loss prevention, for those stilts offered man a system of defence against natural adversities and beasts of prey. Successively man started developing stronger loss prevention systems such as defensive walls and ditches. Enclosed medieval castles that could be accessed through guarded gates were a further example of how physical separation contributed to protecting lives and property. Another form of loss prevention involved the construction of agricultural canals which led to significant land amelioration in malaria-infested marshlands. Nature itself seems to possess an engrained loss prevention rationale if you consider the function of trees in preventing landslides and avalanches.

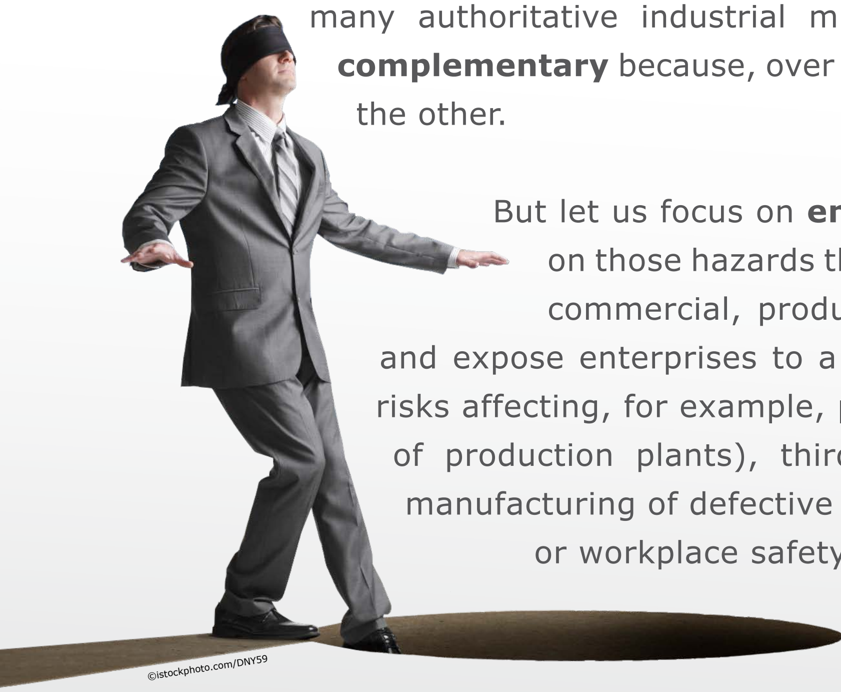


Loss prevention as a human activity has underpinned man's progress in history, protecting his achievements and technological development.

However, insurance covers are **not always** in a position to provide a **total protection** against the negative consequences – economic and otherwise – of a serious loss. And this for a variety of reasons starting with the fact that the policy may be insufficient in terms of insured limits but above all because many of the direct and indirect costs relating to the loss may not be transferred to the insurer. These costs, in fact, pertain to the **insured's enterprise risk**, such as, for example, loss of competitiveness in the market or with regard to intermediate clients or suppliers, or loss of income due to consumer apathy or to falling share prices. Such risks are either non-insurable, inasmuch as they cannot be quantified, or a consequence of the insured's conduct.

Moreover, if an insurance policy has been impacted by several serious losses, its premium to offset imbalances may have to be significantly increased, when it comes up for renewal, to the detriment of the insured. Or else, the insurer may be forced to include limits, deductibles or other thresholds, or even refuse to renew the policy as a consequence of loss experience.

There has consequently been a growing awareness that **prevention and insurance** are not, after all, two alternative concepts as upheld even in many authoritative industrial milieus. On the contrary, they are **complementary** because, over time, the one economically sustains the other.

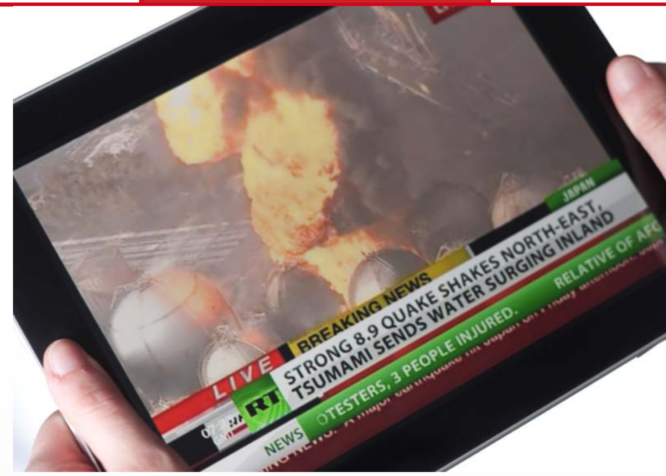


But let us focus on **enterprise or corporate risks**, i.e. on those hazards that can impact industrial plants and commercial, productive and organisational activities and expose enterprises to a multitude of serious and complex risks affecting, for example, property (fire in business premises of production plants), third party liability (pollution or the manufacturing of defective items that may affect consumers), or workplace safety and health.

In such cases, loss prevention activities are key to obtaining a cover that is adequate to the enterprise's needs and also reasonably priced.

But what exactly is loss prevention ("LP") and how can it be maximised?
It is by no means an easy answer to provide because prevention is **not just an activity** to be activated whenever the **risk is either very high or recurrent** (magnitude and frequency – the two key tenets of insurance). LP entails a prior process of analysis aimed at identifying and assessing the risk, where it lies and is concealed, why it emerges, what happens when it accrues, in order to mitigate, control and possibly eliminate it.

It is in all effects a **methodological process** that entails a high technical knowhow of the type of risk involved – a process relying on the full understanding of that risk's physical characteristics, operative modes and triggering factors and whose aim is to prevent it from accruing. For



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example, the risks arising from an oil refinery or chemical plant located in proximity to densely populated area are much different from those run by a soft drink producer with plants spread across the world. Just consider, in this light, the gas leak incident that killed nearly 4,000 people at a pesticide plant in Bhopal, in India.

But this too may prove insufficient to answer that all-important question because a methodology depends also on the environment where it is activated, meaning that the analysis must be broadened so as to go beyond the single risk, contextualising the latter within a **far larger framework**. Consider, in this light, natural catastrophes such as floods or earthquakes (the seismic event that triggered a tsunami destroying the nuclear power plant at Fukushima (in Japan) or the railway accident at Viareggio (Italy) when a cargo train transporting inflammable liquid gas derailed causing the death of 30 victims).


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We are, therefore, dealing with a process that goes well beyond the company that requires insurance to include not only physical abut also financial aspects. As an example of the latter, consider the losses due to the failed delivery of raw materials leading to a break in manufacturing, or indirect losses, as a consequence of poor organisation or the inefficient storage of finished inflammable products. The loss prevention process implies, in other words, a **systematic multidisciplinary approach** to insurance.
Bringing together these assessments – physical, economic, organisational – may lead to the definition of a **loss prevention programme** that applies to and informs the operations of the enterprise that is seeking insurance.