UNITED
NATIONS

TD

United Nations Conference
on Trade and Development

Distr.
GENERAL

TD/B/C.3/218(Summary)
19 February 1987

Original: ENGLISH

TRADE AND DEVELOPMENT BOARD
Committee on Invisibles and Financing
related to Trade
Twelfth session (second part)
Geneva, 2 March 1987
Item 7 (d) of the agenda

THE PROMOTION OF RISK MANAGEMENT IN DEVELOPING COUNTRIES

CONTENTS

GE.87-50306/5830e

I. INTRODUCTION

1. In December 1984 the most tragic industrial accident in recorded history occurred in Bhopal, India. The release of a highly toxic chemical killed more than 2,000 individuals. Thousands of others were blinded and otherwise permanently disabled.

2. It was against this tragic backdrop that the UNCTAD Committee on Invisibles and Financing related to Trade held its eleventh session in February 1985. The Bhopal disaster crystallized the Committee's concern regarding disaster prevention and mitigation, compelling it to request the UNCTAD secretariat "... to undertake a study on the applicability of modern risk management techniques ... to the commercial and industrial enterprises, located in developing countries" (resolution 27 (XI)). In response to this request a study has been prepared by the Center for Risk Management and Insurance Research at Georgia State University and is being issued as a background document under the symbol TD/B/C.3/218 (English only).

A. Nature of risk management

3. The notions of risk, uncertainty and losses are implicit in the evolution of economies and technologies. Recognizing the numerous kinds of hazards that can lead to unexpected losses is not as simple as it may appear. As industrialization has proceeded, concentration and specialization have increased, with a consequent heightened risk of important losses.

4. Risk management is the process by which any unexpected loss contingency is managed. Risk management involves contingency planning and continually asking "what if" operations. Identifying and analysing loss exposures involves examining a firm's operations and repeatedly asking what can cause a loss here? And how serious might that loss be?

5. To be logical and complete, any procedure for identifying and analysing loss exposures should take into account the potential for (1) destruction of property; (2) legal liabilities to third parties; and (3) occupational hazards to employees. People responsible for coping with these exposures must decide what specific risk management measures and techniques are designed either (1) to prevent losses or limit their size and (2) to pay for these losses which do occur.

6. Risk management is not insurance management or a subtle way of promoting insurance sales; nor is it anti-insurance. Insurance is and will remain the most important way of financing losses for commercial and industrial enterprises in developing countries. Sound risk management permits a more effective and cost efficient use of insurance so that the limited financial resources of the enterprises and insurance companies of developing countries can be used in an optimum way.

B. Possible contributions of risk management to developing countries

7. By reducing long-term production costs, risk management may facilitate the development of new industry and can make domestic enterprises in developing countries better able to compete successfully with imported goods.

Risk management techniques can also reduce the number of commercial and industrial enterprises that became insolvent as a result of fire, windstorm and other causes of losses.

8. The most apparent benefit to individuals in society will result from the loss control phase of the risk management process. Effective measures can reduce the frequency and severity of work-related injuries and illnesses and reduce work interruption, a cause of wage loss. The number of off-job injuries and illnesses from industrial accidents (such as through the discharge of injurious chemicals), pollution, flood, and motor accidents also should be reduced.

9. The actual extent of benefit that each country might realize will vary depending on its particular characteristics, including its level of development. The magnitude of the benefits would also depend on both the ability and the will to make risk management work.

II. STRATEGIES TO IMPROVE RISK MANAGEMENT IN DEVELOPING COUNTRIES

10. It is the contention of the study that risk management in developing countries can be greatly improved at little short-term net cost to the national economy. It presents a discussion of the role that can be played in risk management promotion by several entities, including government, insurance enterprises, commercial and industrial organizations, lending institutions, educational and training institutions, religious and cultural organizations, unions and regional and international organizations.

11. An important conclusion of the study is that Governments in most developing countries must assume a major responsibility for promoting risk management within their countries. In many cases, government will have to design laws to foster risk management, workers' compensation rating to foster safety, reasonable environmental and worker safety laws and other measures such as building codes, fire safety and other inspection services, and product safety laws.

12. Sound risk management will help hold down loss costs through improved loss control. This implies reduced claims for insurers, which in turn implies a greater insurer surplus and therefore net retention, as well as a corresponding reduction in insurance premiums and reliance on reinsurance. This means that the role of the insurance industry in promoting risk management is particularly important, not only for the commercial and industrial enterprises but also for the entire national economy. The insurance industry should be encouraged in devising coverages and services better adapted to the fundamental needs in their respective countries.

13. If risk management is fully to play its integral part in development, responsibility for its successful integration must rest ultimately with the top executives of the commercial and industrial enterprises of developing countries. Profitability and risk management are not incompatible. When a multinational enterprise considers operating in a developing country, it should understand the economic, social, cultural and political nature of the Government and the people. Manufacturing and process standards followed in the enterprises' home country should also be applicable to its developing

country affiliate. Furthermore, local multinational enterprises may serve as a model for sound risk management and may promote risk management activity within the country.

14. Local, foreign and regional education and training institutions can play a vital role in the promotion of risk management. Developing countries should not ignore the education and training opportunities that exist in universities and other institutions.

15. Regional co-operative associations and organizations should also be sensitized to the benefits that can accrue to developing countries from appropriate risk management practices. Numerous international organizations are already involved in various aspects of risk management.

16. Through their power to influence borrower actions, lending institutions can be expected to do much to promote sound risk assessment and loss control. They are encouraged to devote more attention to these matters.

17. Labour unions, because of their long-term concern for worker safety, can join with management in creating a safer work environment. Religious and cultural organizations can also play an important role in helping to mould risk management practices so that they are in accord with the society's value system.

III. CONCLUSION

18. Risk management offers many potential benefits for developing countries. Although it is no panacea for the many problems they face, it does have a constructive role to play, provided practices are attuned to the prevailing legal, cultural, economic, environmental, and political realities. However, it would be unrealistic to believe that any one organization can be the cause of successful integration of risk management within a developing country. A co-operative approach is needed.

19. The successful promotion of risk management will require the endorsement and active support of government and governmental officials. Government alone, however, cannot achieve the goal. The insurance industry - both national and international - can play a particularly critical role provided certain changes are made in some practices in many developing countries.

20. Of course, the risk management process will not become an integral part of management in developing countries unless the relevant commercial and industrial enterprises are willing to allow this to occur. This has been a problem in developed countries and can be expected to be one in developing countries. Management must be convinced that the financial and non-financial benefits of sound risk management outweigh the costs. This demonstration requires both research and education.

21. Governments of developed market-economy countries and of the socialist countries of Eastern Europe should continue and increase the sharing of their risk management knowledge and skills, and it is important that they should encourage their own multinational enterprises to do likewise. The bilateral and multilateral sharing of data and loss control standards is encouraged. Delays by Governments in reporting results of important industrial accidents

and disasters that can have international implications should be avoided. Governments, to the extent feasible, should encourage or require disclosure by their multinational enterprises of the existence of hazards to host Governments and countries in a manner comparable to that which they themselves require.

22. Regional and international organizations should recognize their special opportunities to assist in risk management promotion. A better co-ordination of effort is needed.

23. It has been suggested that an inter-agency committee on industrial safety be established. The committee's purpose would be to achieve the dual goal of (1) providing a single focal point to which Governments could refer on matters relating to industrial safety and environmental impact, and (2) avoiding duplication of efforts by agencies involved in the same or complementary aspects of the problems under review.

24. This approach has merit but industrial safety is only a part of risk management, albeit a critically important part. If risk management ultimately is to make a meaningful contribution to the physical and economic well-being of a country, to its citizens, and to its commercial and industrial enterprises, a better co-ordinated approach is needed at both the national and international levels.

25. At present, it is unrealistic to expect risk management specialists to emerge in most developing countries. It is, therefore, all the more important to have co-operation among the various interested and affected entities and to draw from the available international expertise. One approach to stimulating this necessary international co-operation would be to establish a broad-based international working party to make detailed recommendations on how best to bring about this desired result.

26. At the national level, one seemingly sound approach to encourage greater co-operation would be to establish a specific pilot project for applying the risk management process. A large national commercial or industrial enterprise could serve as the target for this effort. All interested parties - the enterprise itself, government, insurers, labour unions, lending institutions, training institutions, etc. - could be involved in a detailed project of risk assessment, control and finance for the selected enterprise. Perhaps special assistance could be provided by those in developed countries who are risk management specialists. Such a pilot project could serve as the spark for further risk management promotion activities by all interested parties, each acting in its own way but with co-ordination.

27. In summary, no one entity can cause modern yet appropriate risk management practices to be adopted in developing countries. However, a concerted effort by government, the insurance industry, commercial and industrial enterprises and others can ensure that sound risk management contributes its share to economic and social progress.