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INSURANCE SERVICES

You must have seen shops in the market. In these shops many articles are stored for sale. Some of you might have seen factories where machines are installed to manufacture products. You may also be knowing about trains, trucks, ships, etc. that carry goods from one place to another. All these involve lot of money and there is always a risk of loss on their way. For example, storing goods in the shop for sale involves lot of money spent on buying those products and there is always a risk that the products may get damaged before they are sold. The damage may be due to accidents like fire, natural calamities or even because of riot or theft.Similarly in factories the machines may break down causing heavy loss. During transportation the goods may get damaged or destroyed due to accident. Under all these circumstances there is always a loss incurred by the businessman. Not only the assets or properties of businessman, he himself is also not out of danger because of the risk involved in some of the activities unertaken by him on day-to-day basis. He may suffer any disease or face accident which may cause a great loss to his family.

Can these risks be avoided or minimized? Is there anything to take care of these risks? Let us learn all about it in this lesson.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the nature of business risks;
- define insurance;
- explain the importance of insurance;
- identify different types of insurance;
- describe the salient features of life insurance, fire insurance, marine insurance and other types of insurance; and
- state the principles applicable to a contract of insurance.

10.1 NATURE OF BUSINESS RISKS

If you decide to engage yourself in any business activity your main objective

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will naturally be to earn profit. It is the most important objective of every business because without profit your capital will get reduced and may be totally lost. So you will do your best to manage your business efficiently. Sometimes you may find that sale of goods produced in your factory is declining. That is a warning signal. You may then try to find out the reasons behind it. If you can identify the reasons, you may find some remedies. Suppose you find that imported goods of the same quality are being sold by competing traders at a much lower price. You have to face the loss as a result of the change in market conditions. There may be other reasons, that may also result in loss of income or profit. Goods may be lost in course of transportation. There may be accidental fire in the godown, workers of the factory may go on strike. You may not be able to anticipate or control some of these possibilities. This is the concept of risk. Risk is the possibility of loss or damage due to factors over which the businessman has little or no control.

All business activities are subject to uncertain events or happenings and may suffer loss or damage. Timely precaution can be taken to avoid some of the losses. But certain losses and damages have either to be borne by the businessman himself, or if possible, shared with others.

The possibility of loss or damage can be divided into two broad categories: uncertainties and risks. Uncertainties are the events, which cannot be foreseen. But risks can be anticipated in the light of past experience. The chances of fire in the factory or godown depend upon precautions taken to prevent its occurrence, or having necessary preparedness to keep the resulting loss to a minimum level. So, is the case with loss or damage by theft or accidents.

Now, take another type of situation. Every person has to think of his future needs when he is not able to work or suffers from old age and illness. This is not an uncertain occurrence. Illness is bound to be there for living beings sometime or the other and more likely after a certain age. It is also necessary to consider that death may strike at a time when there will be a family to be looked after and provided with a means of living.

There are also risks, which have a significant place in business. While goods are transported from place to place, there may be accidents causing, damage or loss of goods. Trains may be derailed, bridges may collapse, or airplane may crash due to engine trouble. Trucks may be looted on their way to another city. Damage may be caused to goods sent by ship at the time of loading or unloading at sea ports. Can such damages or losses be shared with any other party? Let us note how these can be shared by means of insurance.

TYPES OF RISKS

Speculative Risk :	Risks relating to business judgment based on speculation. For example change in fashion, govt. policy etc.
Pure Risk :	Risks where the chance of loss is predictable.
Property Risk :	Related to Loss of property.
Personnel Risk :	Related to life or health of the people.
Financial Risk :	Related to financial transactions of the business.
Marketing Risk :	Risk associated with marketing of goods.

10.2 MEANING OF INSURANCE

Simply speaking, insurance is the means by which risks of loss or damage can be shifted to another party called the insurer on the payment of a charge known as premium. The party whose risk is shifted to the insurer is known as the insured. Obviously insurer is generally an organization (Insurance Company), which is willing to share the loss or damage and it is also qualified to do so.

Insurance is a contract between the insurer and insured whereby the insurer undertakes to pay the insured a fixed amount, in exchange for a fixed sum known as premium, on the happening of a certain event (like at a certain age or on death), or compensate the actual loss when it takes place, due to the causes mentioned in the contract.

If you think about the basis of insurance, you will realize that it is a form of co-operation through which all the insured, who are subject to a risk, pay premium and only one or few among them who actually suffer the loss or damage is/are compensated. Actually, the number of parties exposed to a risk is very large and only a few of them might actually suffer loss during a certain period. The insurer (company) acts as an agency to spread the actual loss suffered by a few insured parties among a large number of parties.

INTEXT QUESTIONS 10.1

Which of the following statements are true and which are false?

(i) The possibility of loss or damage to goods or human beings is known as risk.

(ii) Change of fashion is a personnel risk.

(iii) Losses caused by uncertain events of insured goods have to be borne by businessmen themselves.

(iv) Some risks can be taken care of by precautions such as risk of breakdown of machinery.

(v) Insurance is the means of shifting risks of loss to a party willing and qualified to share the loss.

(vi) The amount paid by the insured to the insurer is known as premium.

10.3 IMPORTANCE OF INSURANCE

To appreciate the importance of insurance we have to discuss the benefits that we derive from it.

As explained in the previous section, insurance serves as a very useful means of spreading the effects of personal as well as business risks by way of loss or damage among many. Thus, the insured have a sense of security. Individuals who pay premium periodically out of current income can look forward to an assurance of receiving a fixed amount on retirement or his family being secured in the event of his death. Businessmen also pay premium for insurance of risk of loss without constant worry about the possibility of loss or damage.

Insurance plays a significant role particularly in view of the large-scale production and distribution of goods in national and international market. It is an aid to both trading and industrial enterprises, which involve huge investments in properties and plants as well as inventories of raw materials, components and finished goods. The members of business community feel secured by means of insurance as they get assurance that by contributing a token amount they will be compensated against a loss that may take place in future.

From the national economic point of view, insurance enables savings of individuals to accumulate with the insurance companies by way of premium received. These funds are invested in securities issued by big companies as well as by Government.

Individuals who insure their lives to cover the risks of old age and death are induced to save a part of their current income, which is by itself of great importance.

Insurance is also a source of employment for the people. The people get employed directly in its offices of the insurance company spread over the country and it also provides opportunities to the people to earn their livelihood by working as agent of the insurance companies.

INTEXT QUESTIONS 10.2

Fill in the blanks with suitable words given in brackets.

(i) Insurance is a means of spreading the ________ of a few among many. (loss, expense)

(ii) The members of the business community feel ________ because of insurance. (secured, unsecured)

(iii) Insurance companies invest their funds in corporate and Government ______ (loans, securities)

(iv) Insurance is an aid to ________ as well as commerce. (industry, trade)

10.4 TYPES OF INSURANCE

Insurance, which is based on a contract, may be broadly classified into the following types.

(i) Life Insurance

(ii) Fire Insurance

(iii) Marine Insurance, and

(iv) Other types of insurance such as burglary insurance, motor vehicle insurance, etc.

Until recently Life Insurance Corporation of India (LIC) and General Insurance Corporation with its subsidiaries happened to be the only organizations engaged in life and general insurance business in India. Now a number of other private companies have entered this service sector. Let us consider the salient feature of each of these types.

(i) Life Insurance

A contract of life insurance (also known as ‘life assurance’) is a contract whereby the insurer undertakes to pay a certain sum either on the death of the insured or on the expiry of a certain number of years. In return, the insured agrees to pay an amount as premium either in a lump sum or in periodical installments, annually, half-yearly, quarterly or monthly. The risk insured against in this case is certain to happen. Hence, life insurance is also referred to as life assurance. The written form of contract is known as life insurance policy. It provides for the payment of a fixed sum to the insured or his legal heirs as the case may be either on a fixed date or on the happening of an event, which is certain. Businessmen can provide for life insurance of all their employees by way of group insurance. It also develops loyalty among employees and can be used as a security for raising loans.

There are two basic types of life assurance policies (a) Whole-life policy, and (b) Endowment Policy. A whole life policy runs for the whole life of the insured and premium is payable all along. The sum assured becomes due for payment to the heirs of the insured only after his death. An endowment policy on the other hand, runs for a limited period or upto a certain age of the insured. The sum assured becomes due for payment at the end of the specified period or on the death of the insured, if it occurs earlier.

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(ii) Fire Insurance

A contract of fire insurance is a contract whereby the insurer, on payment of premium by the insured, undertakes to compensate the insured for the loss or damage suffered by reason of certain defined subject matter being damaged or destroyed by fire. It is a contract of indemnity, that is, the insured cannot claim anything more than the value of property lost or damaged by fire or the amount of policy, whichever is lower. The claim for loss by fire is payable subject to two conditions, viz; (a) there must have been actual fire; and (b) fire must have been accidental, not intentional; the cause of fire being immaterial. The basic principle applied with regard to claim is the principle of indemnity. The insured is entitled to be compensated for the amount of actual loss suffered subject to a maximum amount for which he had taken the policy. He cannot make a profit through insurance. For example, if a person takes a fire insurance policy of Rs. 20,000/- on certain goods. Out of these, goods worth Rs. 15,000/- are destroyed by fire. The insured can only claim an amount to the extent of loss i.e., Rs. 15,000/- (and not Rs. 20, 000/-) for the damage from the insurance company.

(iii) Marine Insurance

Marine insurance is an agreement (contract) by which the insurance company (also known as underwriter) agrees to indemnify the owner of a ship or cargo against risks, which are incidental to marine adventures. It also includes insurance of the risk of loss of freight due on the cargo. Marine insurance that covers the risk of loss of cargo by storm is known as cargo insurance. The owner of the ship may insure it against loss on account of perils of the sea. When the ship is the subject matter of insurance, it is known as hull insurance. Further, where freight is payable by the owner of cargo on safe delivery at the port of destination, the shipping company may insure the risk of loss of freight if the cargo is damaged or lost. Such a marine insurance is known as freight insurance. All marine insurance contracts are contracts of indemnity.

The followings are the different types of marine insurance policies

(a) **Time Policy** – This policy insures the subject matter for specified period of time, usually for one year. It is generally used for hull insurance or for cargo when small quantities are insured.

(b) **Voyage Policy** - This is intended for a particular voyage, without any consideration for time. It is used mostly for cargo insurance.

(c) **Mixed Policy** – Under this policy the subject matter (hull, for example) is insured on a particular voyage for a specified period of time. Thus, a ship may be insured for a voyage between Mumbai and Colombo for a period of 6 months under a mixed policy.

(d) Floating Policy - Under this policy, a cargo policy may be taken for a round sum and whenever some cargo is shipped the insurance company declares its value and the total value of the policy is reduced by that amount. Such shipments may continue until the total value of the policy is exhausted.

DIFFERENCE BETWEEN FIRE, MARINE AND LIFE INSURANCE

S.No.	Basis of Difference	Fire Insurance	Marine Insurance	Life Insurance
1.	Compensation	Amount insured or Actual loss which ever is less is given as compensation.	Purchase price of goods and 10-15 percent profit is given as compensation.	No loss is compesable only specific amount is paid.
2.	Insurable Interest	Insurable interest must exist both at the time of taking policy as well as the time of loss.	Insurable interest must exist at the time of loss.	Insurable interest must exist at the time of taking policy.
3.	Assignment of Policy	No Assignment without permission of Insurance Company.	No Assignment without permission of Insurance Company.	No Assignment is done.
4.	Nature of Risk	Uncertain	Uncertain	Certain but the time is uncertain.
5.	Period	Normally for one year.	Normally for one year.	It is taken for a long term.
6.	Premium	Premium depends upon the amount insured.More the amount insured more will be the Premium.	Premium depends upon nature of perils.	Premium depends upon the age of the insured and term of policy.
7.	Object	To cover the risk of fire.	To cover the sea perils.	Protection and Investment.
8.	Surrender	Cannot be surrendered before expiry.	Cannot be surrendered before expiry.	can be surrendered before maturity.

(iv) Other types of Insurance

Apart from life, fire and marine insurance, general insurance companies can insure a variety of other risks through different policies. Some of these risks and the different policies are outlined below.

(a) **Motor vehicles Insurance**: Insurance of all types of motor vehicles- passenger cars, vans, commercial vehicles, motor cycles, scooters, etc., covers the risks of damage of the vehicle by accident or loss by theft, as also risks of liability arising out of injury or death of third party involved in an accident. Third party risk insurance is compulsory under the Motor Vehicles Act.

(b) **Burglary Insurance**: Under this insurance the insurance company undertakes to indemnify the insured against losses from burglary i.e., loss of moveable goods by robbery and theft by breaking the house.

(c) **Fidelity Insurance**: As a protection against the risks of loss on account of embezzlement or defalcation of cash or misappropriation of goods by employees, businessmen may get policies issued covering the risks of loss on account of fraud and dishonesty on the part of employees handling cash or in charge of stores. This is called fidelity insurance policy. The employees may also be required to sign a fidelity guarantee Bond.

(d) **Personal accident and sickness Insurance:** These are policies which can be taken out against death or disability in special circumstances, for example by traveling through flights, etc.

(e) **Liability Insurance:** This type of policy covers the risk of liability for the injury or death of someone else. These are two main forms as (i) Employers liability- covers the employers legal liability for the safety of each employee.(ii) Public liability- covers the liability of individuals and business for members of public visiting their premises.

(f) **Property Insurance**: Covers a wide variety of items from goods in transit or in store to building or contents. Applies to both the business persons and the private householders.

INTEXT QUESTIONS 10.3

Which of the following statements are true and which are false?

(i) Marine insurance contracts are ordinary contracts while life insurance is a contract of indemnity.

(ii) Fire insurance covers the risk of loss by fire where the cause of fire is immaterial for making a claim from the insurance company

(iii) A ship may be insured against loss by perils of sea.

(iv) For an endowment policy, the insured has to continue paying premium for the whole life.

(v) In life insurance, premium may be paid in a lump sum or in annual installments.

(vi) In marine insurance, time policy is often used for hull insurance.

(vii) Fidelity insurance is not compulsory for owners of business.

(viii) The principle underlying the contract of indemnity is to ensure that the insured cannot make profit out of insurance.

10.5 PRINCIPLES OF INSURANCE

There are certain principles that may apply to the contracts of insurance between insurer and insured. These principles are discussed below.

i. Utmost goods faith

Insurance contracts are the contracts of mutual trust and confidence. Both parties to the contract i.e., the insurer and the insured must disclose all relevant information to each other.

The insurer must honour all the promises made in the policy, intentional withholding of information invalidates the contract. For example, while entering into a contract of life insurance, the insured must declare to the insurance company if he is suffering from any disease that may be life threatening. If he fails to do so and afterwards it is established that the insured was suffering from a desease which was the cause of his death, then the insurance company shall not be liable to pay any claim.

ii. Insurable interest

It means financial or pecuniary interest in the subject matter of insurance. It means that if there is a loss due to the damage of the insured property or to the assured life it will be the personal loss of the insured. A person has insurable interest in the property or life insured if he stands to gain from its existence or loose financially from its damage or destruction. In case of life insurance, a person taking the policy must have insurable interest at the time of taking the policy. For example, a man can take life insurance policy in the name of his wife and if later they get divorced this will not affect the insurance contract because the man had insurable interest in the life of his wife at the time of entering into the contract.

In case of marine insurance insurable interest must exist at the time of loss or damage to the property. In contract of fire insurance, it must exist both at the time of taking the policy as well as at the time of loss or damage to the property.

iii. Indemnity

The word indemnity means to restore someone to the same position that he/she was in before the event concerned took place. This principle is applicable to the fire and marine insurance. It is not applicable to life insurance, because the loss of life cannot be restored.

The purpose of this principle is that the insured is not allowed to make any profit from the insurance contract on the happening of the event that is insured against. Compensation is paid on the basis of amount of actual loss or the sum insured, which ever is less.

iv. Contribution

The same subject matter may be insured with more than one insurer. In such a case, the insurance claim to be paid to the insured must be shared or contributed by all insurers in proportion to the ammount of insurance of individual insurers.

v. Subrogation

In the contract of insurance subrogation means that after the insurer has compensated the insured, the insurer gets all the rights of the insured with regard to the subject matter of the insurance. For example, suppose goods worth Rs. 20,000/- are partially destroyed by fire and the insurance company pays the compensation to the insured, then the insurance company can take even these partially destroyed goods and sell them in the market.

vi. Mitigation

In case of a mishap the insured must take all possible steps to reduce or mitigate the loss or damage to the subject matter of insurance. This principle ensures that the insured does not become negligent about the safety of the subject matter after taking an insurance policy.

The insured is expected to act in a manner as if the subject matter has not been insured.

vii. Causa-proxima (nearest cause)

According to this principle the insured can claim compensation for a loss only if it is caused by the risk insured against. The risk insured should be nearest cause (not a remote cause) for the loss. Only then the insurance company is liable to pay the compensation. For example a ship carrying orange was insured against losses arising from accident. The ship reached the port safely and there was a delay in unloading the oranges from the ship. As a result the oranges got spoilt. The insurer did not pay any compensation for the loss because the proximate cause of loss was delay in unloading and not any accident during voyage.

INTEXT QUESTIONS 10.4

Fill in the blanks using appropriate word(s).

i. The principle of utmost good faith is based on ____________ between insurer and insured.

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ii. In life insurance contract the insurer must have insurable interest at the time of ____________.

iii. The purpose behind the principle of ____________ is that, the insured is not allowed to make profit from the insurance contract.

iv. If there are two or more insurers and the insurance claim is paid by one of them, other insurers have to contribute _________ to the insurer who has paid the claim.

WHAT YOU HAVE LEARNT

- Risk is the possibility of loss or damage due to causes over which we have little or no control. All business activities have to face the risks of loss or damage due to uncertain events or happenings.
- Insurance is a means by which the risks of loss or damage can be shifted to another party (the insurer) on payment of a charge known as premium. The party whose risk is shifted to the insurer is known as the insured.
- Insurance is based on a contract between the insurer and insured whereby the insurer, in exchange for a fixed sum (premium), undertakes to pay the insured a specified amount on the happening of a certain event (like the insured reaching old age), or pay the amount of actual loss when it takes place due to the risk insured.
- **Importance of Insurance:** Insurance is a simple means of sharing the burden of loss or damage among many people. It plays a significant role in business in view of the large-scale production and distribution of goods in national and international markets. It is an aid to both commercial and industrial enterprises. It enables the insurance company to invest the premium received from the various policy holders into securities which is ultimately used for national development. Insurance is also a source of employment for many people.
- **Types:** Insurance as a service activity may be classified into four broad types:

Life Insurance	:	Whole-life policy, Endowment policy
Fire Insurance	:	Time policy
Marine Insurance	:	Voyage policy, Mixed policy, Floating policy
Others Kinds of Insurance	:	Motor-vehicles insurance, Burglary insurance, Fidelity insurance, Personal accident and sickness Insurance, Liability Insurance, Property Insurance.

TERMINAL EXERCISE

1. What is meant by 'business risk'?
2. Define Insurance.
3. Why is insurance considered important? List any two reasons.
4. What does 'Endowment' life policy mean?
5. What is a 'Voyage Policy'?
6. What is meant by 'Hull' insurance?
7. How insurance is important as an aid to trade and industry? Explain.
8. How does whole life policy differ from endowment life policy? Why is life insurance also called life assurance?
9. Explain the types of risks which are covered by (i) Motor Vehicles insurance; (ii) Fidelity insurance.
10. What purpose does Marine Insurance Policy serve? Explain the different types of marine policies, which may be of use to exporters and importers.
11. A person suffering from cancer did not disclose this fact while taking a life insurance policy. Name the principle he violated and explain it about 50 words.
12. At what time there should be insurable interest in, a) Life insurance; b) fire insurance; and c) Marine insurance.

ANSWER TO INTEXT QUESTIONS

10.1	i. True,	ii. False,	iii. False,	iv. True,
	v. True,	vi. True		
10.2	i. Loss,	ii. Secured,	iii. Securities,	iv. Industry
10.3	i. False,	ii. True,	iii. True,	iv. False,
	v. True,	vi. True,	vii. True,	viii. True

10.4	i. Mutual trust and confidence,	ii. Contract,
	iii. Indemnity,	iv. Proportionately

ACTIVITIES FOR YOU

- Students may be prepared to make enquiry about the number of shopkeepers in their localities who have got insurance cover against loss by fire.
- Students may be required to enquire from the neighbours about the number of persons who have taken life insurance policy whether whole-life or endowment policies.