“Risk management and insurance: a missing link in marketing thought and practice”

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| **AUTHORS** | Odo Cosmas Ogobuchi |
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Odo Cosmas Ogobuchi (Nigeria)

# Risk management and insurance: a missing link in marketing thought and practice


### Abstract

The paper canvasses the view that since marketing is intertwined with risks the absence of risk management in marketing thought and practice is a critical missing link. It not only reviews concepts of risks and their classification but explores the diverse nature of marketing risks. The paper also discusses the risk management process with a highlight of insurance as a tool for managing risks. Various insurance products, that marketers can access, are identified. The paper concludes by emphasizing what marketing stakeholders stand to gain if a risk-conscious culture is cultivated in marketing.


**Keywords:** risk, uncertainty, marketing, insurance and risk management.

## Introduction

It is the observation of the author that only a casual reference is sometimes made to the subject of risk management and insurance, and its relevance in marketing literature. This is, however, not to deny the fact that some of the marketing strategies, followed by marketing managers, are in essence risk-reducing in effect (Sturdivant et al., 1970). This, even, does no harm to the view expressed above. The fact, that my illiterate late farmer-dad combined several crops simultaneously, on the same plot of farm land, was a policy followed more by force of tradition and what land scarcity in Obuoffia[1] dictates than a deliberate practice of risk management via diversification. No crystallized risk management thought could be figured as basis for his observable farming practice. The same holds for marketers, whose actions may, in practice, embody elements of risk management. For instance, the pursuit of a multi-product policy by firms may on the surface seem driven by a profit motive but which translates to risk reduction in substance. This is so even as poor business results in one or more products could be made up by superior performance in some others. So, the marketer's action should be seen more as serendipity than anything else.

Not assigning a visibility status to risk management and insurance in marketing thought is, in the view of this paper, a critical missing link, which fortunately provides a foundation for this discussion. Our concern about this lacuna stems from what one presumes is a general knowledge, namely, that all aspects of marketing are embedded in risks, thus, providing a self-evident case for the practice of risk management. This has not been the case.

This paper, therefore, argues that effective marketing is feasible only if the risks in marketing are identified, measured and managed. This further will require a recognition of and elevation of risk management and insurance as a marketing tool to be placed in rank (if not higher) as research and product development.

To cut a path into what remains of our assignment, the paper is organized as follows. Section 1 looks at the general concepts of risk and risk classification. Section 2 considers the nature of marketing and the risks associated thereto. Section 3 explores the risk management model open to marketing, while the last Section concludes the paper.

## 1. General concepts of risk and risk classification

**1.1. Concepts of risk.** Risk is a universal phenomenon. No race of human society is shielded from its ubiquity. Only recently, the global community woke up to the rude shock of the incidence of the worst case of earthquake in the history of Haiti (Sun, 2010). Again, and had providence not prevented the bombing attempt of a U.S. bound air craft on December 25, 2009 by Mutalab Jr. (Akande, 2010), the world could have witnessed a brutal dramatization of one of the risks in undertaking a journey by air. Just at the home front, a religious violence was reported in Jos, Nigeria, in which hundreds of human beings were killed and properties worth millions of Naira lost (Chukwulaka, and Aleshinloye-Agboola, 2010). Many instances of risk could be cited but these three serve to lend credence to its all pervading presence (Houston, 1968). What then is risk?

There exists a plethora of definitions of risk in literature. As a multi-dimensional concept the drive for a single definition that captures its many-sidedness remains elusive. This section of the paper attempts a presentation of the common definitions found in literature.

Risk may refer to a situation, where there is uncertainty about what outcome will be (Harrington and Niehaus, 1999, p. 3). Ortendahl (2007) holds that risk is a multiplication of threat and vulnerability, and vulnerability itself is seen as the manifestation of the inherent states of a system (e.g., physical, technical, organizational, cultural that can be exploited to adversely affect (i.e., cause harm or damage to that system). Risk is further regarded as a combination of probability and something adverse or dangerous (Jacobs, 2000). Both Mordi (1990) and Gabriel (2010)

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[1] Obuoffia is a small town in Enugu State, South East of Nigeria.

agree that an investor (a marketer), who is a speculator, opens himself to any of three possible outcomes, namely: gain (profit), loss and break-even. Profit motive remains the dominant economic rationale for undertaking a business venture. The businessman is, however, aware that he might lose his stake instead of making a profit or that he just recovers what he has ploughed into the venture and no more, i.e., break-even position. What, therefore, the marketer-investor fears is the prospects of losing his stake (loss). From this another definition of risk emerges, the probability of an unwanted outcome (Hanson, 2007). Death, accidents, fire, loss of wealth, etc. constitute cases of unwanted outcomes for both individuals and business. Hensel (2010) rather sees risk as the likelihood of an adverse effect in an organization, system or a subpopulation on exposure to a substance or situation under specific conditions. Irukwu (1991, p. 1) rather offers a dictionary rendering of risk as "hazard, chance of loss, or chance of bad consequences or exposure to mischance." Kaplan and Garrick, 1981, p. 13 in Hensel (2010) defines risk as a set of triplets, involving:

- a scenario;
- the likelihood of the scenario;
- the scale of damage in the scenario.

The above could be summarized in a mathematical shorthand, thus:

$R = \{[\, s, p^i, x^i \,]\}, i = 1, 2, \ldots N,$

where $s$ describes a scenario; $p$ indicates the likelihood of the scenario; $x$ indicates the scale of damage in the scenario.

Hence, risk could be defined as the sum of consequences examined along with their likelihood and scale.

It seems that the common thread, that runs through the definitions, overtly or covertly, is the element of uncertainty. Uncertainty, some argue, exists because of lack of knowledge or insufficient knowledge (Giarini, 1999). Already Kostor and Lugard (2010) opine that the environment of marketing is characterized by uncertainty. They added that in sheer uncertainty economic action is impossible without a vision of the world, an idea about its structure. Perhaps, this quest for knowledge might be the notion that undergirds the elusive goal for science of achieving complete knowledge of man and his environment, so that in the end insurance becomes unnecessary. This is what defines the mind-set of deterministic philosophers (Giarini, 1999). The counterpoise to this school is the in-deterministic philosophy, where essentially lack of information and uncertainty are inevitable and incomprehensible part of any living system, simply due to the fact that the future is open and not necessarily determined (Giarini, 1999).

And to this agrees the viewpoint of Redlick (1968), who states that uncertainty is like a fluid that surrounds us, our habitat and our creations both material and immaterial.

Further, he argues that uncertainty results from unpredictability or imperfect knowledge, concerning the future.

The whole argument comes to this: man and business are embedded in uncertainty (which defines the character of risk) and he cannot know the future perfectly. He, then, constantly deals with uncertainty since most of the consequences (outcomes) of present business decisions are hidden in the folds of the future. Some of these outcomes may be against his interest, this, therefore, creates the need for risk management. This is to be discussed later.

Knight (1921), as quoted in Hubbard (2007), categorized uncertainty into two namely, measurable and unmeasurable uncertainty. Those that can be studied statistically, i.e., measure them in terms of their outcomes and associated probabilities are called risk, while those that are incapable of statistical investigation are called true uncertainty.

**1.2. Risk classification.** Risks, classified according to their origin, may be subsumed under two broad categories: man and nature.

Fundamental risk is an aspect of risks of nature or natural risks (sometimes called "Acts of God"). These refer to those events which arise out of natural causes with no human intervention, and which could not have been prevented by foresight or reasonable care (FAO, 1988). They relate to those events whose origin is impersonal and associated impact socially widespread, if not cataclysmic (Rahim, 2010). They are termed fundamental because they arise out of the nature of the society we have. For example, war, inflation, changing custom or some form of physical occurrence beyond the control of man like typhoon, tidal waves.

The second category takes care of those risks that come into being as a consequence of man's active interaction with his socio-economic and physical environments. They include particular risks, pure risks and speculative risks.

Particular risk has its origin in individual events and its impact is restricted or locally felt (Rahim, 2010). A good example could be the loss of huge sum of money by a business firm through embezzlement. On the one hand, a pure risk will be something bad if it happens to one or an entity, where there is no corresponding good other than its absence (Gabriel, 2010). An accidental destruction of a business premises by fire illustrates a pure risk. Generally, only pure risks are insurable, though some aspects of speculative risks could be insured. For example, profit losses through business interruptions, occasioned by accidental fire, say, could be insured against through purchase of consequential loss insurance.

Speculative risk is regarded as a gamble one knowingly takes that has both, potential bad outcomes and potential good outcomes (Ibid). Investments (all types) by their nature generate speculative risks with three possible outcomes, namely, gain, loss or break-even, i.e. no-gain no-loss situation.

Businesses, including marketing, are exposed to an array of risks, coming from any of these risk classes. Concern about risks stems from the fact that they do result in reductions in business value (Harrington and Niehaus, 1999, p. 4). This is why, in part, the paper argues that effective marketing commences only if the risks in marketing are identified, measured and managed. These issues engage the mind in the balance of the paper.

## 2. Marketing and its associated risks

It takes one or two definitions of marketing to validate the notion that marketing is deeply embedded in risks. Consider the following definitions as we probe this point.

Kotler (1988, p. 3) holds that marketing is a social and managerial process by which individuals and groups obtain what they need and want through creating and exchanging products and value with others. Andoh (2010) states that marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individuals and organizational objectives.

Taken together both definitions essentially paint a picture of a marketer as an investor who in the pursuit of wealth-maximizing role in society creates products or values that could be exchanged between parties to satisfy the needs of a target market. This is basically the economic path that has transformed global economy from its rudimentary cottage industrial base with few assets to large industrial giants with assets worth billions of naira and whose activities or operations can trigger unintended events (risks) of immense consequence. The said unintended actions of marketing, as a poignant dramatization of risks of marketing, can sometimes assume frightening cost dimension. For instance, Pfizer international incorporated, a multinational pharmaceutical giant, was compelled to pay in compensation a total sum of $75m in judgment debt to Kano[1] victims of its failed illegal drug tests (Sun, 2010; Muanya, 2010).

The facts of the case are as follows. In 1996, there was an outbreak of meningitis epidemic in Kano. Pfizer, as part of its clinical trial, administered untested drug, Travafloxavin (Trovan), without authorization, to more than 200 infected children. 11 children died and the rest were incapacitated. Civil and criminal proceedings were instituted against Pfizer. An out of court settlement was reached in which the company had to pay $75m. This, indeed, is illustrative of an aspect of risks in marketing. That is product failure risk. One aspect of risks, embodied in marketing as made bare in the definitions, cited above, is the risk element that long-lived assets entail.

Take Innoson Plastic factory located at Emene Industrial Estate in Enugu, for instance. This giant-sized factory has several product lines including tables and chairs, water storage tanks, domestic utensils such as plates, water filter, hand operated mops, gift items, tricycles, etc.

To manufacture these items, there were installed heavy machinery that are managed by expatriates and local staff. The ware houses are stocked full with array of company products. Since risk is concerned with what could go wrong, an inquiry into its operations gives a bird's eye view of the nature of risks, a marketing organization is exposed too. They include, but not limited to the following risks, accidental fire that could damage machinery and products, death or injury to factory workers, embezzlement of firm's funds and theft of other assets of company, kidnap of firm directors and other key men with the associated ransom, possible unintentional breach of statutory provisions that could attract sanction from appropriate government agency. Others may relate to third party accidental cases and loss of products following breakdown of trucks.

As Andoh (2010) observed that conduct of international marketing throws up, yet, other forms of marketing risk namely, financial and political. According to him, financial risks relate to commercial, political, exchange rate risks and inflation-related risks, whereas political risks embrace any changes in the political environment that may adversely affect the value of a firm's business activities through expropriation, confiscation or domestication, interference with the firm's operation through changes in laws, environmental standards, tax codes, terrorism, armed insurrection or wars, etc. and transfer risks.

Others could be functional risk, which is associated failure of products to live up to expectation (Sturdivant et al., 1970, p. 171).

In addition, marketing is held to contribute to environmental deterioration, a phenomenon now regarded as a growing risk of global dimension. Three major causes are identified as being instrumental to the phenomenon, namely, extravagant consumption (marketing) by affluent countries, economic development without heed to the environment in developing countries and poverty (Inatomi, 1993).

[1] Kano is one of the states in the northern part of Nigeria.

Any reader conversant with marketing concept's emphasis easily connects extravagant consumption with environmental risks. Or perhaps, one needs no better evidence than to walk through the city of Enugu, at worst of times, to confront stench from decomposing domestic wastes. In Nigeria, no marketing organization is held to account for such. One hopes that in the future marketers could be held accountable for these risks.

What is done above may not have highlighted all conceivable elements of risks in marketing. Rather, primary intention is to spotlight the presence of risks at all levels of the marketing process and to encourage risk-consciousness and risk-thinking among marketers. This will produce the beneficial effect of enthronement of risk-management culture at all levels of the marketing process. The visible benefit of the risk-thinking and risk management culture is loss minimization and improved profitability for business. This largely agrees with Manning (2010), who observes that risk management enables marketing opportunity to improve business with greater quality, resilience and predictability across marketing enterprise.

## 3. The risk management process

Risk management has taken the front burner in most fields, including engineering (all aspects), banking, medicine, and legal practice. The only exception remains marketing theory and practice. This piece seeks to promote the idea in marketing.

The broad based interest, shown in risk management, has generated several definitions to elucidate its meaning and relevance to society. With regards to its societal relevance Kloman (1992) observes that risk management is to enable individuals and business to live with uncertainty productively and prudently.

Irukwu (1991) describes risk management as the principles or techniques devised in order to promote and ensure effective management of risk. This will include procedures devised to minimize the adverse effects of possible financial loss.

As could be deduced, risk characteristically operates to inflict losses on individuals and businesses (Odo, 2003, p. 19). This is why effort is made to anticipate, reduce or eliminate risks, if possible.

Managing risk is a process. Kloman (1992) identifies key elements of risk management as risk identification and assessment, risk control and risk financing. As Mordi (1990) observed, risk identification involves locating all units in the business that are exposed to risk. To be comprehensive, a check list is prepared that captures all the business assets that are exposed to risk. It entails not only the itemization of business assets but spotlighting the business processes that could malfunction. As Kaplan and Garrick (1981), as quoted in Kloman (1992), pointed out, the risk analyst seeks to provide answers to three questions, namely: what can go wrong; what is the likelihood that it would go wrong; and what are the consequences? Clearly, answers to these questions help the analyst to identify, measure, quantify and evaluate their consequences and impacts. In other words, these answers will present the risks in terms of severity of losses and their probabilities. Risk management process builds on risk assessment by providing answers to another set of three questions: what can be done; what options are available and what are their associated trades-offs in terms of all costs, benefits and risks; and what are the impacts of current management decisions on future options (Haimes, 1992)? Answers to these three later set of questions broadly discuss issues involved in risk treatment or risk handling. This agrees with (Jardine et al., 2007) who postulate that the practical purpose of risk assessment is to provide information which can then be used to manage identified potential risks to avoid their occurrence or minimize their influence.

Risk treatment (risk control and risk financing) decomposes into four elements namely, risk avoidance, risk reduction (or risk control), risk retention (or risk absorption) and risk transfer.

Risk is transferred when either the risk or the activity, causing the risks, is transferred to some other entity or it may mean the transfer of the financial losses, associated with the risk.

It is important to note that we have both, insurance and non-insurance transfer of risk. It is an insurance transfer when an investor buys a protection from an insurer duly registered and, who for the premium paid to him by the investor, assumes the financial responsibility of indemnifying him should the perils occur. On the other hand, it is a non-insurance transfer of risk when no insurer is involved, rather we may transfer the activity that causes the risk to some one else. One of the ways this can happen is by sub-contracting out some aspects of a job that is considered too risky to somebody else, who is now held responsible for the risks and losses associated thereto.

**3.1. Insurance as a tool of risk management.** In the previous sections insurance is presented as a risk transfer mechanism. And being a risk transfer mechanism it is a risk management tool. That is, that insurance is one way, among several others, by which a business owner can use to manage his risks.

What then is insurance? What types of insurance are available to aid marketers in the management of their risks? These are the questions that will be tackled in this segment of the paper.

**3.2. What is insurance?** There are several views of insurance. It is viewed as a collective system or social device for pooling of risks and sharing of losses. A legal view of insurance exists. As a contract, it is an agreement between two parties, the insurer and the insured, whereby the insurer agrees to indemnify the insured on the happening of a specified event, say fire, provided that the insured pays a service charge called premium in exchange for promised indemnity.

As could be inferred from the above, insurance being a risk transfer mechanism merely allows the insured to transfer the financial consequences of business operations to the insurer, while he retains control of his business operations.

There are several insurance products that a marketer can buy depending on the nature of risks he faces. They include whole life assurance, endowment assurance, product liability insurance, term assurance, workmen compensation insurance, public liability insurance, goods-in-transit insurance, cash-in-transit insurance, fidelity guarantee insurance and so on and so forth.

## Conclusion

The paper has shown that in practice marketing cannot fulfill its role of meeting consumer needs without investment in long-lived capital assets. And being a commercial activity, marketers are obliged to have some judgment about the future. The moment planning stretches into the future, one deals with the unknown risks. This is what investment in long-lived capital assets entails.

With long-lived capital assets, judgments about the market had to cover the entire future economic life of the capital goods. The risks of obsolescence in both the capital goods and product line because of pressure from competitors, forecasts of interest rates and other financing costs, the risks of possible losses from fire and theft, and inevitably, the impact of government and fluctuations in general levels of business activity (Bernstein, 1999). Evidently marketing is intertwined with risks. Marketing management, therefore, ought to recognize this fact and, thus, promote a culture of risk consciousness. This could be followed by the establishment of risk management as a functional area of business activity to be placed on cognate status as finance, operation, and accounting. With the enthronement of risk management culture, business losses are better anticipated, planned for and/or kept at the minimum. This will be in the best interest of all marketing stakeholders.

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