Module 3

"Risk Management & Business Law"

Contents

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Introduction

The third educational module is «Risk Management and Business Law». The entrepreneur must have a good understanding of business law in terms of its significance for sales and purchasing, the legality of contracts, debt recovery and consumer protection legislation. In the free market, the entrepreneur's activities are ensured by legislation such as patents and copyrights. The importance of data protection has also increased significantly and entrepreneurs can no longer afford to neglect data security issues.

Purpose

The purpose of this module is to define the meaning of risk management as well as to address the business risks and methods of risk management. In addition, it tries to provide a holistic aspect of the subject that refers to insurance, trying to indicate the significance of it for the firms as well as entering the readers to the meaning of a contract, its validity and the debt recovery process.

Learning Outcomes

- *<u>In terms of knowledge:</u>*

After finishing the module, the participants will know

- *The different types of business risks*
- *that risk management means being aware of risks and being prepared to face them through different methods*
- *that risk management begins with the identification and recognition of risks*
- *the importance of the insurance*
- *that risk management is implemented through the firm's daily activities by avoiding, minimizing, carrying or transferring risk*
- *the different methods of risk management*
- *the contents of business contracts*
- *the debt recovery process*

- *In terms of skills*

After finishing the module, the participants will understand

- *the legal and binding issues behind different risks*
- *the different procedures for concluding an agreement*
- *the different terms of agreements*

- *In terms of competences*

After finishing the module, the participants will be able to

- *assess and manage business risks*
- *properly prepare business contracts*
- *prepare the terms of agreement*
- *organize the debt recovery process*

Keywords

- Risk management
- Business risks
- Insurance
- Agreement
- debt recovery

3.1. Risk management

"**Risk management means being aware of risks and being prepared to face them through different methods**". Business is risky. There are risks in every part of a business environment ranging from the firm's production processes, markets for goods and services and financial markets. The goal of risk management is to overcome risks through planning and directing the operations of a business so that the probability of risks is diminished and that their potential damages are minimized.

Risk in itself is not bad; risk is essential to progress, and failure is often a key part of learning. However, we must learn to balance the possible negative consequences of risk against the potential benefits of its associated opportunity. (Van Scoy, 1992)

The following video could help you to obtain an even more holistic view about what exactly is enterprise risk management.

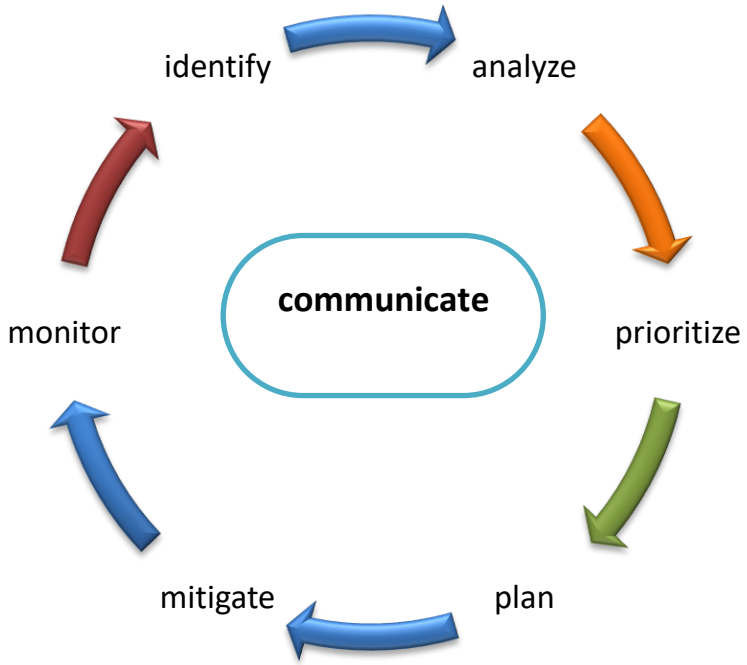
video

3.2. Risk management in practice

Risk management begins with the identification and recognition of risks. The next step is to evaluate risks, to estimate how serious the consequences of certain risks are and how they can be managed. It is important for a firm to assess its risks, the potential losses that can be caused by the risks as well as the costs of risk management relative to potential losses.

Risk management is implemented through the firm's daily activities by **avoiding, minimizing, carrying or transferring risk.** Insurance is one of the most common methods of risk management. The ***risk management process*** can be broken down into two interrelated phases, risk assessment and risk control, as outlined in Figure 1. These phases are further broken down. Risk assessment involves risk identification, risk analysis, and risk prioritization. Risk control involves risk planning, risk mitigation, and risk monitoring (Boehm, 1989).

Figure 1. The Risk Management Cycle[1]

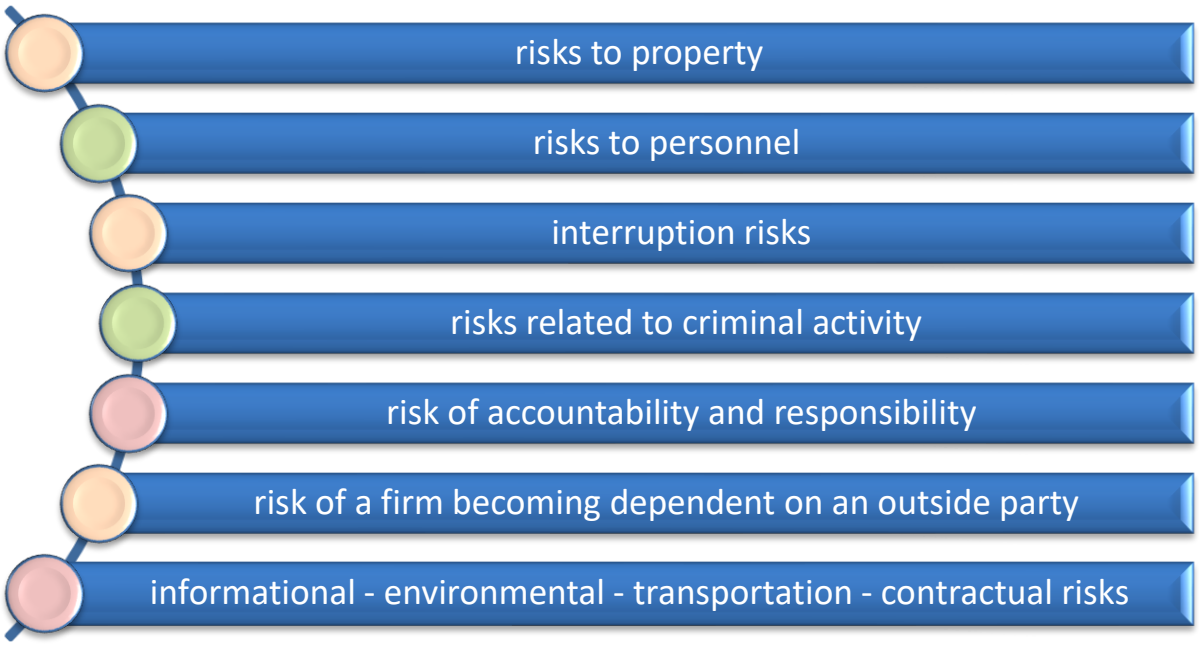


3.3. Business risks

A firm is faced with various risks. Business activities always involve risk as entrepreneur invests his or her capital and time into the firm with no guarantee of profits. In addition to the entrepreneurial or contractor's risk the firm can, for example, fail in its recruitment, machinery or equipment can break down or changes in legislation can be economically damaging.

[1] http://agile.csc.ncsu.edu/SEMaterials/RiskManagement.pdf

Risks are caused by three factors: the lack of control, the lack of information and the lack of time. The entrepreneur can never fully control the firm's environment. Business risks include:



3.4. Methods of risk management

Risk can be managed by these methods:

Avoiding risk	Avoiding risk is based on pre-emptive deterrent action such as the training of personnel, work safety and the careful preparation of supplier contracts.
Minimizing risks	A firm seeks to diminish risks that it cannot transfer or eliminate. Risks are minimized by either sharing the risk, grouping risks or through damage prevention. By sharing risks, the firm aims to reduce one-sided risks. Sharing risks requires the exchange of information in real-time with the relevant parties.
Transferring Risks	Transferring risks refers to the transfer of risk through a contract to another party. The transfer can be done through an insurance contract, rental agreement or a contract of sale. Insurance is one of the most common methods of transferring risk.

Carrying risk under one' s own liability	Being liable for the damages of a risk can also be a method of risk management. In such a situation, the firm is liable for any consequences of realized risks. This method of risk management is relevant for a firm when the probability of a risk is low and the costs of managing the risk otherwise are high.

3.5. Insurance

Insurance is one of the most important methods by which to transfer risk. Insurance refers to the situation when an accident occurs and the insurance company covers the economic damages incurred due to the accident according to the conditions of the insurance policy. However, an insurance policy does not mean that a firm should not use other methods of risk management. In some circumstances, the insurance policy itself demands that the firm engage in some sort of damage prevention activities.

3.5.1. The insurer and the insurant

The insurer, such as an insurance company, is the party that assumes liability for paying for the damage incurred in the event of an accident. The party that transfers risk is called the insurant or the insured. The insurant always has the right to dissolve the insurance policy if they see that the conditions of the contract have not been executed in the agreed manner.

3.5.2. Over-insurance and under-insurance

It is important to be able to assess the potential economic damages associated with a risk. Over-insurance refers to when the amount of the insurance surpasses the economic value of the risk's damage. Conversely, when the amount of the insurance is less than the real value of the risk the situation is referred to as under-insurance. Both of these situations present a problem for the insurant. In the case of over-insurance, the insurance premiums will be unnecessarily high while in the case of under-insurance the firm will not recover the full cost of the damages in the case of an accident.

3.5.3. Business insurance

A business' insurance policies can include personnel, property, real estate, contents and insurance of operations. The need for different types of insurance varies between companies. Therefore, the evaluation of a firm's risks is a good place to start when planning for insurance.

More information about insurance and insurance policies is available through various insurance company websites or by meeting with an insurance agent.

Click the link below and watch the video in order to learn business insurance tips

https://www.youtube.com/watch?v=hLSFGQVPJMI

3.6. Entering into a contract

"A contract is a two-party legal act requiring two concordant declarations, an offer and its acceptance".

The following section will cover the process of preparing contracts according to legal regulations. However, it is important to keep in mind that the following is a simplified description rather than a legal, instructional guide. In today's information society contracts are created by various means. A contract always raises the issue of the trust between parties. Contracts are often the result of a process involving many stages of negotiation throughout which it is difficult to define when the final offer will come about and when it is accepted. Many contracts are also entered into through everyday actions without the parties making or accepting offers.

3.6.1. Procedure for Concluding an Agreement

The conclusion of the agreement involves placing a proposal (offer) and accepting it (acceptance) or assuming other measures that stand as sufficient proof of the agreement between the parties. As soon as the parties reach an agreement on all the basic conditions, the agreement comes into effect, although the agreement regarding secondary conditions has been delayed. The parties are required to practice honest behaviour even at the moment of pre-contractual relations. The parties are entitled to initiate and maintain negotiations and are not held liable for a failed attempt to reaching an agreement. The party that begins negotiations for the conclusion of the agreement or is involved in dishonest negotiations shall compensate the other party for incurred losses. It is deemed that negotiations begin or seem to be dishonest, when the party engaged in negotiations has no intentions to enter into an agreement and acts contrary to honest principles.

The parties shall disclose to each other all the information they have to their knowledge deemed to be crucial to the conclusion of the agreement. If one of the parties provides the other party with confidential information during the negotiation process, the other party that is aware of and in possession of such information shall not reveal it and use it to its interests contrary to law, regardless of the fact whether the agreement has been concluded or not. When this obligation is violated, the party in breach shall compensate the other party for inflicted losses.

3.7. Freedom of contract

The freedom of contract means that both natural and legal or juristic persons can freely enter into legally binding contracts. Contracts between parties are generally non-mandatory by nature and by law. These conditions, however, can be adapted if the parties so choose. The freedom of contract is sometimes limited by certain regulations that are binding to the contractual parties. Typically, these types of regulations are intended to protect the weaker party in the contract.

3.7.1. Preliminary Agreement

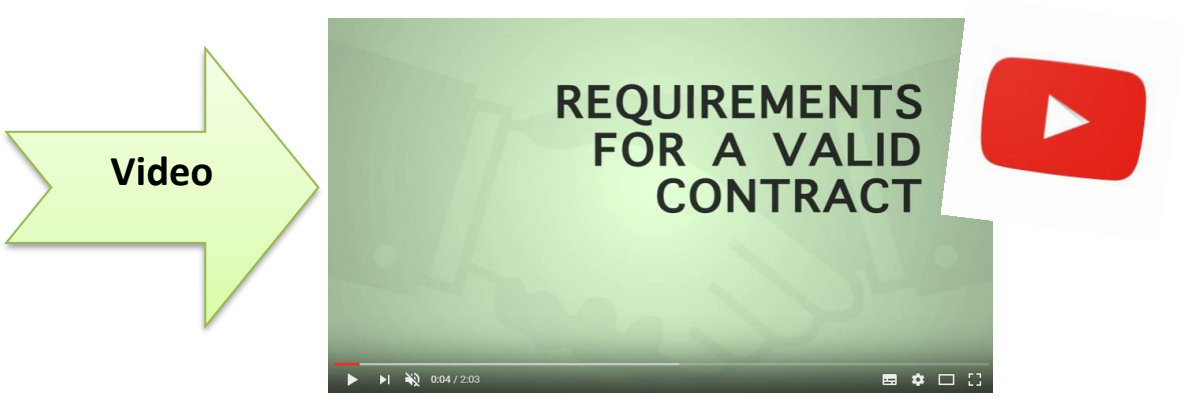
A preliminary agreement is an agreement between the parties according to which the parties undertake to enter into the basic agreement in the future under its discussed conditions. A preliminary agreement is **concluded in writing**. If the parties do not adhere to the requirements imposed on its form, the agreement is considered to be invalid. A preliminary agreement shall include the term for the conclusion of the basic agreement. If the term is not indicated, the basic agreement shall be concluded within a year from the moment a preliminary agreement is concluded. In case the party that entered into a preliminary agreement avoids or refrains from concluding the basic agreement without a reasonable basis, it shall compensate the other party for incurred losses. If the parties fail to sign the basic agreement within the period specified in a preliminary agreement, the obligation to enter into this agreement ceases to exist.

3.8. Validity of contracts

A contract binds its contractual parties. The declaration preceding the contract, either the offer or the acceptance, binds the party as soon as the other party becomes aware of it. A misplaced or lost letter of an offer therefore does not bind the party making the offer. A cancellation of an offer also will nullify the offer providing that the receiving party receives the cancellation at the same time or before the offer.

The validity of a contract is also weakened when it includes something unreasonable. Some contractual stipulations can, at the request of the parties, be negotiated at a later date.

Click into the picture below and follow the link in order to watch the video to learn more about the requirements you need for a Valid Contract.



3.9. Offer and acceptance

A proposal that is placed to conclude an agreement is deemed to be an offer, providing it has an adequate description and expresses the offerer's intention to be bound and obliged under the agreement in the case of the acceptance. **The offer is intended to a specific person or an unspecified number of persons (public offer)**. The offer becomes valid as soon as it is received by the acceptor. The offerer can cancel the offer (even when it is irrevocable), if the addressee is informed about its cancelation prior to the receipt of the offer or together with it. When there is no conclusion of the agreement, it is possible to revoke the offer, providing the acceptor is notified about its revocation before sending the acceptance. However, revocation is impossible, if: 1) a certain term is indicated in the offer for its acceptance or it is specified in any other way that it is irrevocable; 2) there was a reasonable basis for the acceptor to assume that the offer was irrevocable, which caused him/her to take respective actions. The offer becomes invalid, when the offerer receives a decline to accept it or does not receive any response within the specified period.

The acceptor's assertion or any other behaviour that asserts the acceptance of the offer is regarded as the acceptance. Silence or inaction by itself is not deemed as the acceptance. The acceptance leads to legal consequences from the moment the offerer receives it.

If the offer includes the possibility to accept it without informing the offerer about it (by silence or concluding actions) or such conclusion is reached in consideration of relations or customs that exist between the parties, the acceptance leads to legal consequences depending on the acceptor' s respective actions that express his will. The offer shall be accepted within the term indicated by the offerer and in case the term is absent, it shall be accepted within a reasonable period by taking into account specific circumstances, including possible means of communication used between the parties. A verbal offer shall be accepted immediately, if there is no basis for reaching any other conclusion in relation to specific circumstances. The acceptance ceases to be valid, if the offerer receives the notification about its revocation beforehand or at the moment the acceptance becomes valid.

3.10. Terms of agreement

Terms of agreement are generally a pre-printed part of the contract. The standardized terms of agreement add reliability and facilitate parties entering into a contract. However, ***the parties to the contract must always remember to read the contract they are entering into.*** The regulations regarding consumer protection are especially concerned with terms of agreement.

The Moment and Place of Agreement Conclusion	Registering terms of agreement (an example)
1. An agreement has been concluded at the moment the offerer receives the acceptance, unless the agreement provides otherwise. 2. The place of agreement conclusion is the offerer's place of residence or business, unless the law or agreement prescribes otherwise. **3.** The agreement has not been concluded until the parties reach an agreement on these conditions or execute the agreement in a proper manner.	1. **Date** 2. Information about of the **offeror** 3. Information about **the offeree** 4. **Product** – it is important to note the exact product description, serial number or a reference to a customer's possible sample, model or brochure 5. **Price** – specify what the price includes (e.g. transportation, applicable taxes, etc.) 6. **Terms of payment** – including possible interest, penalty interest, payment due dates 7. **Terms of delivery** 8. **The validity of the offer** 9. **Other possible terms** – (reference to the general terms of agreement, the guarantee or warranty, a clause regarding the place and process for the settlement of disputes, etc.) 10. **Signatures**

3.11. The debt recovery process

"In the practice of business, a firm may find itself in a situation where the contract's other party, for some reason, does not pay their obligations. Before a debt recovery process begins, the creditor has made several unsuccessful attempts at collecting the payment. The creditor's last resort is to launch into the debt recovery process."

The debt recovery process can be divided into the following stages:

- The application for implementation
- Foreclosure
- Conversion of assets into money
- The distribution of funds

If the creditor must engage in a forcible collection, the firm must first provide a document noting the grounds for the implementation of the debt recovery so that the debt's execution authority can rule that the demand is legal. The most common implementation of the process is through a magistrate court's ruling. However, this ruling is not necessary when recovering tax arrears.

Debt recovery	Debt recovery implies a set of the following procedures as the whole: searching for a debtor and his/her assets, analysing debtor' s financial status, filing claims, negotiating, recovering debts on a pre-trial and judicial basis, writing off irredeemable debts, purchasing debts and etc. The main purpose of all these procedures is to retrieve debts within the shortest period with the least expenditure by making use of all possible mean.
Pre-trial Debt Recovery	Pre-trial debt collection occurs when in accordance with the court decision there is no debt adjudgment
Judicial Debt Recovery	Judicial debt collection involves preparation of all necessary procedural documents and their submission to the court, representation in the court and execution process control, and when required, initiation of a bankruptcy case and pre-trial investigation.
Writing off Irredeemable Debts	The process of writing off irredeemable debts involves proving the presence of the irredeemable debt or its portion and previous efforts invested in the debt retrieval

Selling of Debts	Selling of debts (claim rights) can occur when a company has an insolvent debtor and sells its claim right to the debt to another person.
Administration of Debts	By acquiring this service, you transfer all concerns about payment control to your service provider. The organization will notify your customers (debtors) of payment terms that are about to expire, reach them by phone, send notices about delayed payments, urge them to pay late payment charges (interests) and informing them about legal consequences arising from the noncompliance with their obligations.

Learning Activities

TASK 1

After reading the module three, please read the sentences below and circle the right answer.

1. **Risk management means**
   a. That the entrepreneur is being aware of risks
   b. that there is no risk in business
   c. that there is no loss in business
2. **Business risks include:**
   a. risks to personnel but not to property
   b. risk of accountability and responsibility
   c. informational risks but not environmental risks
   d. transportation risks every 1 year
3. **Methods of risk management**
   a. Are 10 in number
   b. Aren't necessary for an entrepreneur
   c. Can include avoiding risk
   d. Include only transferring risks

3. The risk management process

a. involves risk identification but no risk analysis,
b. involves administration of debts
c. provide investments
d. can be broken down into two interrelated phases, risk assessment and risk control

4. Insurance

a. refers to the situation when an accident occurs and the insurance company covers the economic damages
b. does not transfer risk.
c. means that a firm should not use other methods of risk management
d. isn't necessary for a firm

5. A preliminary agreement

a. is an agreement between the parties who undertake to enter into the basic agreement in the future under its discussed conditions
b. is concluded in oral
c. Does not need to include the term for the conclusion of the basic agreement.
d. includes business risks

6. Registering terms of agreement

a. isn't necessary to include information about product and price
b. includes signatures
c. dates of meetings with investors
d. includes transfer risk
e. economic indexes

7. In Debt recovery:

a. one of the factors that implies is negotiating
b. debts are retrieved within the longest period of time
c. organizations send notices about delayed payments,
d. urge customers to pay late payment charges (interests)

TASK 2

Indicate a method of managing risk and describe how it is implemented.

Summary

This educational module aimed to enter the readers to «Risk Management and Business Law». Nowadays it is obvious that entrepreneurs have to obtain a good understanding of business law in terms of its significance for sales and purchasing, the legality of contracts, debt recovery and consumer protection legislation.

According to the contexts of the module, the readers will obtain an integrated and thoroughly knowledge of the main aspects which refer to business risks and methods of risk management and so on.

Completing the module, trainees will be able to assess and manage business risks, preparing business contracts, terms of agreement and organize the dept recovery processes.

In the free market, the entrepreneur's activities are ensured by legislation such as patents and copyrights. The importance of data protection has also increased significantly and entrepreneurs can no longer afford to neglect data security issues.

Generally speaking, risk management is the process of identifying, assessing and controlling threats to an organization's or firm's or business's or company's capital and earnings, for all these reasons, it is essential, risk management to be taken into account by the entrepreneurs.