

INSURANCE - A RISK COVERING STRATEGY FOR HOSPITALITY INDUSTRY IN ROMANIA

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Abstract:

Insurance industry in Romania is facing for a few years a continuous decreasing in Gross Written Premium. The negative trend may be caused by the effects of financial crises for companies and also for individuals. In order to keep their market share, insurance companies must identify new opportunities to increase their's GWP. Among these new market niches hospitality industry may represent an option to be followed. In this paper, we will analyze the types of insurance policies available for hospitality industry (except mandatory motors' third party liability and motors' own vehicle insurance). The conclusion represents solution both for insurance companies and for hotel as a part of their's risk financing process.

Key words: Insurance, Hospitality Industry, Risk, Property, Liability.

JEL classification: G 22

1. INTRODUCTION

Hospitality industry in Romania is a very active sector in the last years. Among the development of regional or national hotels/guest houses /resorts, there are also international corporations in the market with many years of experience in this field. Beside this, new businesses (some of them just family owned) developed using EU financing programs or new international investors in hospitality industry, entered in this market. All these participants invested significant financial resources, so their business need to be protected by different types of risks.

The most common techniq to protect a business is represented by insurance contracts. This easiest sollution may not be always the chapest one. Before choosing insurance as a solution of risk transfer towards a third party, risk managers from the hospitality industry need to established a professional risk managemnt plan.

Risk management plas will be structured in two major parts: controlling the risks and financing the risk. For both cases, there is a need of statistical events for all type of losses that ocured for the hospitality company (in case there is a new company, they can not rely on these). Analyzing carefully the losses (type of losses and severity) risk managers need to decide what risks to be held inside the company and which to transfer to the insurance industry.

Insurance industry in Romania offers different types of insurance policies in order to cover the risk exposures of hospitality industry. In the last years, Insurance industry in Romania recorded a continuous decreasing. Based on the official records of Romanian Financial Supervising Authority (A.S.F):

- Insurance companies recorded at the end of the first quarter in 2014, a level of Gross Written Premium (GWP) of 2.053.671.545 lei, this represents a decrease of 3,43% compared to the same period of 2013 (2.126.749.907 lei)
- In case of non-life insurance the decrease of GWP for the same compared period is of 2,09% - at the level of 1.671.387.716 lei from the level of 1.707.087.760 lei

As long as there are a lot of small, medium and large companies involved in hospitality industry, all of them are exposed to different types of risk. All these companies may be interested in different strategies in protecting theirs' business. As mentioned – a very important solution is offered by insurance companies as insurance contracts.

Insurance companies must try to offer pertinent and fair solution to this industry, at a competitive price. By offering insurance policies to them, there may be recorded even an increasing in the insurance companies business and maybe even in the entire insurance market and also protection for hospitality industry.

2. METHODS

In order to analyze the types of insurance contracts for hospitality industry we made a practical research in different insurance companies (subscribing methodology at insurance companies), or even using theirs' websites. The research emphasis on the types of policies:

- Property insurance
- Third party liability (hospitality industry specific only)
- Employees

Also, the research followed the process of risk control techniques available for hospitality industry. These companies have different attitudes:

- Some of them simply to have insurance for all / a part of risks
- Some of them are not interested in insurance as risk control strategy
- Some of the do not know that insurance may represent a way to protect theirs' businesses in hospitality industry

3. RESULTS AND DISCUSSION

Insurance contracts in Romania evolved a lot in the last years. This evolution is a result of developing the insurance industry (insurance companies updated their products to the ones that exist in most developed European countries). Another reason for this changings is the new risk exposures of the companies. Businesses became more complex and a specific attention must have been focused on the new risks.

Hospitality industry evolved in the same ascending trend of facing new risks, so insurance contracts for this business are now more specific and with more risks that in the past (5 or 10 years ago).

3.1. Property Insurance for Hospitality Industry

In case of resorts, hotels, pensions, guesthouses the property insurance refers to the building itself and to content. Insurance for a building needs a high level of expertizes from the insurance agent and also from the manager of that business. A very important aspect refers to evaluation of the building – this takes into account different types of prices per squared meter. This price can be obtained:

- Using insurance companies' evaluation prices – these takes into account: type of structure, materials for resistance, quality of interior finishes, number of quality stars
- Using an ANEVAR (Romanian National Association of Experts in Evaluation) report that will officially prove that price

Some of the buildings in hospitality industry were built using European Funds. In this case, the normative from E.U. request a mandatory insurance for the building for a mentioned period (full insurance coverage for all risks related to the building). In this case the properties' risks are transferred to the insurance company. The owners of that hospitality facility have no other option but to buy this mandatory contract.

Some resorts, new hotels and pensions were financed from the bank in order to build or to extend their properties. The same, in this case the bank will ask for a property insurance (that cover 100% of all risks). The owners must have this insurance contract signed and all the rights within it are ceded to the bank. This means that in case of a total loss, the bank will receive the insured sum in order to clear the entire credit. In case of a partial loss, insurance companies compensations will be used to repair the effects of incurred loss.

In this last case the problems appear: usually the bank ask for an advance from the investor in the hospitality industry. When they analyze the business plan, the bank asks for a percent (for example of 20-30% from the entire project) from the investors' money. The bank will not finance itself the entire project. So, if a bank gives a credit of 75% from the total business plan, they will ask for insurance that equals the level of credit.

Following this principle, after building the facility, investors must insure it for the amount asked from the bank. Contrary, when they ask for insurance to an insurance company, they will find out that the value they must insure is the entire value of the building (not only the part requested from the bank).

Insurance companies follow a proportional principle of compensation in case of a loss.

$$C = L \times \frac{I.S.}{R.V.} \times 100$$

Where: C. – compensation in case of a loss

L. - loss

I.S. – Insured Sum of the property

R.V. – Real Value of the property

If we assume a hospitality entity that is about to start a new investment of 3 million Euro and they have an advance of 0.75 mil. Euro, they need a credit for the rest of 2.25 mil. Euro. So, the bank will ask for an insurance at that level. In case of insuring only the amount that equals the level of the credit, the owners of the new hospitality facility will be underinsured, in our case only 75%. Problems appear in case of a loss: each loss will be paid by insurance company in the same percent of 75. The remaining 25% will be covered by the owner.

If a potential loss is about 200,000 Eur – after a fire occurrence, the insurance company reimbursement will be:

$$C = 200,000 \times \frac{2,250,000}{3,000,000} \times 100 = 150,000 \text{Eur}$$

In fact this percent may not be very annoying in case of a minor partial loss, but in case of a total loss the bank receive all the money and the investor will have nothing from his own invested financial resources. There are three parts of discussion:

- The problem is that some times, insurance agents do not explain clearly or at all how this principle works, this is why investors do not know about the benefits of insuring theirs' properties at the real value (instead the amount requested by the bank).
- Other way, in case insurance agents reflects these benefits, investors simply do not care about this (having a wrong judgment – “this is not going to happened to me”), more the insurance premium will be with 25% higher.
- Third situation – the normal one – investors understand the importance of being insured to the real/entire value of the building, and they pay the insurance premium for full value

Beside this issue related to the insured sum of the building, a special attention must be given to other buildings' contents. These particularities of insurance contracts may cause the most delicate problems.

When comparing the prices from different offers, major differences in the insurance premiums appear from an offer to other. At a glance, all covered risks seem to be the same. But studying carefully all these risks, we can notice that also there are significant differences between coverings. For example an insurance company covers a risk on the basis contract (having a higher insurance premium) and another is covering the same risk as additional on a special clause (in this last case, initial offer is a lower price one, but when adding the supplementary premium for that clause the total price will be different).

In this case, the risk managers (or similar persons in medium or small hospitality entities) need to analyze all risks that they need coverage against, and to pay only for the desired exposure.

Among the risks that may cause damages and have a medium frequency of occurrence and make the object of special clauses (that usually are not included in the basic policy) we mention:

- Risks related to the pipes (water pipes, heating system) – this risk occurs very often and the losses are of a medium level in severity (need to replace the pipes, need to repair the building, the floor and all other damaged special features of the hotel/pension)
- Risks related to breakable assets – such as lobby mirrors, stained walls/windows, luxury chandeliers and all other similar decoration fixed assets
- Risks related to cleaning costs in case of an insured event – in case a risk occurs, the costs of cleaning the space may be quite impressive sometime because it is unexpected and cleaning need to be done quickly and without major inconvenience for existing visitors
- Risks related to business interruption – in case of a medium severity loss, the hospitality entity may not offer its services to the clients (partial or total), so they will have a loss in revenues for the entire period of repairing the damages

Once all risk exposures are analyzed by specialized managers, the hospitality entity will have a clear map of what they need insurance for, so they will be able to buy the insurance policy that suits better for their needs at an adequate insurance premium.

Beside the insurance for the buildings companies involved into hospitality industry have the possibility to insure the fixed assets – furniture (from the lobby area, from rooms), electronic equipment, elevators and so on. Risk managers will have their own decision about adding this insurance to the one for the building. The major risks that may occur are fire, explosions, pipes defection or earthquakes (in the specific areas only).

In order to have these assets insured together with the building, insurance companies offer a low quotation (most of cases they will use the same quota as for the building). For these assets, insured sum is very simple established - it will be used the statements from the accounting.

3.2 Third party liability insurance - hospitality industry specific

A very common insurance policy designed and implemented only for hospitality industry refers to the third party liability. Each activity developed by a hospitality company (resort, hotel, pension, restaurant etc.) generates an exposure towards third parties. Judging after the clients that have each hospitality facility, risk managers must adopt a very prudential attitude towards these exposures.

The specific of this insurance is focused on:

- Number of stars – reflecting the quality offered by the hospitality entity
- Number of rooms
- Number of tables/chairs for restaurants as individual or as a facility inside a resort/hotel
- Variety of facility: night clubs, gym, pools, sauna, outside sport activities

- Parking

Beside the common risks (inside' facility possible guilty) the above mentioned risks will substantially raise the insurance costs. Insurance managers must take into consideration these possible exposures, clients that may suffer injuries during usage of these facilities may ask for high compensation.

A delicate problem related to this third party liability insurance refers to the insured sum of the contract. Insurance companies offers two choices:

- A total insured some for the contract – this sum has the advantage that in case of one or more insured events, its level it is decreasing once with compensations paid by the insurance company – this is an expensive insurance contract because there is no mention about the events or about the group of risks that may lead to a compensation
- There are more insured sum – one for the entire contract and the others are the first one divided by different events (2 or three events during the contract) or by different groups o risks (injuries, restaurants, belongings of visitors) – this is a cheaper insurance than the first one

The disadvantages of the second choice may be that the insured sum may be not enough in case of a major event. The exceeding will be paid by the owner of hospitality facility. For example we have a total insured sum of 1 million Euro, divided in 2 events o 500,000 euro. More, each individual event has 2 limits of 250,000 one for injuries and other for rest of possible risks. In case a guest suffer an accident because a wet floor, and ask for a compensation of 300,000 Euro, insurance company will reimburse only 250,000 euro and the rest of 50,000 will remain on behalf of the company from the hospitality industry. In case if there would have been the first choice of insured sum, all the compensation it would have been on insurance company behalf.

In order to decrease the level of this exposure, managers of these hospitality entities may have specialized employees that will coordinate it. Also, they can use a signed form by the client about the risk that may occur while having an extra activity (in this situation the they will be protected against complaints from the clients that suffered injuries during sport/gym or even from sauna/gym if they already had a bad health condition or they did not respected the recommendation of the supervisor/trainer).

Beside this some resorts/luxury hotels have specialized doctors that make a simple investigation/questionnaire for the people that use the extra facility. Then doctors will allow or forbid some activities (sport/sauna/gym). Once this form is signed by the clients, the risks that may occur are on behalf of the clients.

The conclusion about these very delicate risks is that hospitality entities need to take a special attention. Some of them can be transferred to insurance industry and others may be retained inside the company by having additional strategies influenced by the complexity of the business.

3.3 Insurance for employees

For example, in USA each company before starting the business must provide a workers' compensation insurance contract. Unfortunately, in Romania this type of insurance is much prohibited one for companies. Hospitality entities have at their choices:

- Insurance for employees – related to injuries during working hours (in this case insurance companies will offer a compensation that takes into account the injured part of the human body) and also for demise
- Health insurance for employees – this type of insurance is more common and more use than the first one – in this case employees have included some basic analysis during the contract, and also supplementary investigation in case they need (in this cases, the costs of analyses are higher than usual and a deductible may be applied by insurance companies)

- Private pension for employees – it is used by the management of hospitality entities only for the employees involved in middle-upper management and/or for employees with a long activity inside the same company

Anyway, these types of insurances reflect a supplementary cost in the business plan of the hospitality entities. Some of them are offered as reward for different individuals. They are mostly used by the international hospitality investors in Romania in order to offer a supplement in the annual pack of benefits, beside the salary.

Once the hospitality industry will grow and the persons will be more specialized, the managers of these entities will try to keep them inside the company by offering these types of insurance.

Beside this, insurance companies must take into account the fact that in this moment the hospitality business cannot afford to pay higher insurance premiums for these coverings. So, a lower insurance may represent both an incentive for those companies and also a premise for insurance companies to increase their revenues.

4. CONCLUSIONS

Hospitality industry is a very active field in Romania. They are facing specific types of exposures, related to the specific of this business. In order to have their business protected, insurance represents an efficient measure to reach that purpose.

Risk managers of these hospitality facilities must analyze all types of exposures and to choose insurance for the most pressing ones. In case they do not have sufficient expertise, they may choose for an insurance broker that besides presenting the offers, will choose also the best strategy for risk transfer.

Hotels and the rest of hospitality entities that decide to buy insurance in order to protect their business may have chosen the correct way. They decided to pay for insurance having a supplementary cost, but in case of a loss occurrence they will be reimbursed – without affecting their business.

Anyway, the costs of insurance must be carefully followed in order not to increase overall costs of the company. The analysis must be continuous and permanently improved in order to include or to exclude different type of insurable risks – statistic proved over a period of years.

Insurance companies may accord a special attention to the hospitality industry. The ones that will offer competitive insurance prices efficient risk coverage may increase their revenues and also may increase their quota share.

This attitude for hospitality industry may be a positive one, if we think of motors' insurances (motors' own insurance and motors' third party liability) – insurances that were not analyzed during this research – if an hospitality entity choose to have the most expensive insurance to a certain insurance company, for sure the vehicles ones will go to the same insurance company.

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