

Assignment Proposal

TASK DESCRIPTION

Analysis of Contemporary Transformation on Organisational Management Practice: Solutions for Management Challenge

Word count: 7500 words

Topic :

“The Effect of Risk Management Practices on Financial Stability of General Insurance Firms in Sri Lanka.”

Background

As we all live in a risk-prone world, insurance has emerged as a global phenomenon that plays a critical role in risk management. When insurance becomes one of the key components of risk assessment, it underscores the fact that risk assessment is the foundational concept of insurance. According to Francoise’s novel perspective, risk is a neologism of insurance (Ewald, 1991).

This assignment specifically focuses on the Sri Lankan General (Non-Life) insurance market. The Sri Lankan insurance sector faces significant pressure from various factors, including natural disasters, volatility in macroeconomic conditions, inflationary pressures, and regulatory reforms (Weerasinghe & Weerasinghe, 2022). As a developing country, Sri Lanka is particularly vulnerable to natural disasters (Silva & Kawasaki, 2022), which has led to an increase in insurance claims.

Several peer-reviewed studies and policy papers document the frequent occurrence of floods and landslides in Sri Lanka, the resulting economic losses, and the country’s reliance on public and macro-level insurance mechanisms to manage disaster risk (Silva & Kawasaki, 2022). As a member of the International Association of Insurance Supervisors (IAIS), Sri Lanka’s insurance

regulator has introduced reforms to align industry practices with international standards, particularly in risk management indicators (Oxford Business Group, 2025).

Consequently, risk management practices in underwriting, technical provisions, reinsurance, and actuarial functions directly impact the financial profitability and stability of insurance companies (Sooriyaarachchi & Buddhika, 2024). Therefore, Sri Lankan insurers must identify these gaps and implement appropriate risk management strategies.

Aim

The aim of this research is to investigate how effective risk management practices influence the financial stability and performance of general insurance firms operating in Sri Lanka. The study conducts:

- A **comparative analysis** of current vs. potentially more effective risk management strategies.
- Linking **ERM implementation** to measurable financial outcomes (e.g., ROA, ROE, solvency ratios).
- Evaluating how **external pressures** (natural disasters, macroeconomic volatility, regulatory changes) affect the success of risk management frameworks.
- Offering **context-specific recommendations** for Sri Lankan insurers to enhance resilience and profitability.

Objectives

1. **To identify and categorize** the key risk management practices adopted by general insurance companies in Sri Lanka, in the focus of underwriting, operational, investment, liquidity, and reinsurance strategies.
2. **To evaluate** the level of implementation and effectiveness of risk management practices, emphasizing how consistently and rigorously insurers apply in Enterprise Risk Management (ERM) frameworks in underwriting, risk rate analysis, policy formulation, and procedural adherence complied with the regulator.

3. **To analyze** the relationship between risk management practices and the financial stability of general insurance companies, using indicators such as solvency ratios, return on assets (ROA), return on equity (ROE), and liquidity metrics.
4. **To examine** the influence of macroeconomic volatility, regulatory reforms, and natural disasters on the effectiveness of risk management practices within the sector.
5. **To propose** strategic recommendations for enhancing risk management frameworks aimed at improving financial stability, profitability, and stakeholder confidence in Sri Lanka's general insurance industry.

Research Gap

Despite the growing importance of risk management in the general insurance industry, limited factual research has been conducted on how risk management practices specifically influence **financial stability and performance** in the **Sri Lankan general (non-life) insurance market**.

The existing literature tends to more focus on:

- **Global or Asian regional frameworks** without tailoring to Sri Lanka's unique risk landscape (e.g., frequent natural disasters, inflation, regulatory volatility).
- **Descriptive overviews** of risk management practices, rather than **comparative analysis** of their effectiveness.
- **Solvency and profitability metrics** in isolation, without linking them to specific risk management strategies such as underwriting, reinsurance, or liquidity controls.
- **Limited integration of external factors** (macroeconomic shocks, regulatory reforms, climate-related risks) into the evaluation of risk management effectiveness and the financial stability of the insurance company.

Currently / Commonly used Management Theories in Risk Management Practice

These theories support existing risk management frameworks commonly used by Sri Lankan General insurers:

1. Enterprise Risk Management (ERM) Framework

- Based on **Contingency Theory**: Organizations adapt risk strategies based on environmental uncertainty (Otley, 2016).
- Applied through risk registers, internal controls, and compliance protocols.
- Focuses on integrating risk across departments (underwriting, claims, finance).

2. Agency Theory

- Addresses conflicts between shareholders and managers. (Park & Lee, 2021)
- Encourages transparency and accountability in risk decisions (e.g., reinsurance purchases, investment strategies).

3. Stakeholder Theory

- Recognizes the importance of balancing interests of policyholders, regulators, investors, and employees (Gawsalya & Ekanayake, 2024).
- Drives ethical risk practices and sustainable underwriting.

4. Systems Theory

- Views the insurance firm as an interconnected system (Sooriyaarachchi & Buddhika, 2024).
- Helps in modeling risk propagation across functions (e.g., how underwriting affects liquidity).

Recommended Theories for Enhanced Risk Management

Below theories are recommended to offer a foundation for more adaptive, resilient, and forward-looking strategies for more effective risk management practices and to simultaneously perform in healthy and financial stability:

1. Dynamic Capabilities Theory

- Encourages insurers to build flexible, responsive risk systems.

- Supports innovation in catastrophe modeling, digital claims processing, and climate risk adaptation.

2. Institutional Theory

- Explains how regulatory pressures and global standards (e.g., IAIS guidelines) shape risk practices.
- Useful for aligning Sri Lankan insurers with international solvency and governance norms.

3. Behavioral Risk Theory

- Highlights cognitive biases in risk perception and decision-making.
- Can improve underwriting accuracy and policyholder engagement through behavioral insights.

4. Resilience Theory

- Focuses on the ability to absorb shocks and recover.
- Especially relevant for disaster-prone contexts like Sri Lanka, guiding insurers to design robust reinsurance and liquidity buffers.

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