Value and Actuation

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Abstract

The term "enterprise" is used here to refer to the firm as a whole. In order for enterprise risk management (ERM) to support the worthwhile goals of insurance firms, an appropriate conception of "value" is needed. Risk will then be seen, properly, in relation to this conception of value rather than as an inherent property. The purpose of this paper is to outline a framework that measures *decision* and to argue that such a measure is the rightful focus of the enterprise. A central motivating theme is that relatively holistic approaches to valuation should supplant the more traditional methods that set value and assess risk in isolation. The paper develops the principle of maximizing expected utility (PMEU) as a normative decision theory from its philosophical roots in order to motivate its proper usage (i.e., to the enterprise's *ultimate good*). It interprets and applies PMEU in a way that surmounts objections that have been made to it in the form of paradoxes. The theory is then developed mathematically by the direct construction of the general utility function using the concept of a decision lattice. The paper then addresses the misconception that the choice of utility function is hopelessly subjective by establishing rational and objective criteria for its selection. The actuarial community, through the establishment of reliable probability models, is seen as the key intermediary in transforming a subjective view of value and risk into one that can be objectified. Finally, the paper indicates how PMEU can be employed in actuarial activity and insurance company management as the principal measure of a firm's value. Risk mitigation efforts can then be judged in accordance to how they would add to that value.