

The risk associated with business: a review of literature essay sample



Being an entrepreneur and operating a business involves accepting risk. Business Owners are exposed to two primary kinds of risks: Financial risk and Business risk (Oscar Guzman). Financial risk, as defined by chron. com is the chance that a business does not generate enough revenue to pay creditors and meet other financial obligations, depends on the amount of debt the business owes. Business risk is independent of a company's' debt level and relates to the business operations themselves. Oscar Guzman further points out that business risk negatively impacts value. Thus, for two otherwise identical businesses, one with a higher level of risk will always be worth less than one with less exposure.

Managing risk therefore becomes paramount to maximising your business value. Guzman iterates the fact that business must continually evaluate its exposure, identify its sources and develop strategies for minimising that exposure. Although there is little small business owners can do to decrease their exposure to the market and sector-wide systematic risks, these risks are widely studied and there are plenty of resources available to entrepreneurs that can help predict downturns and other regularly occurring events. Risk is defined many different ways depending on the discipline being queried for its meaning. On a general level, risk is defined as the probability of variance in an expected outcome (Spekman and Davis 2004).

According to Spekman and Davis (2004) for example, if a person expects a certain outcome or result from an activity and the results fall short, risk deals with the consequence of this outcome. For most part, risk is seen as a reactive consequence since the inference is the downside effects of an outcome. Chilles and McMach (1996) observed that the notion of economic

<https://assignbuster.com/the-risk-associated-with-business-a-review-of-literature-essay-sample/>

loss more closely reflects Manager's perspective of risk. Philip A. Wickham looks at business risk from a different angle.

He accesses risk from the standpoint of the strategist and in so doing begs the question "What do strategists mean when they talk about risk?" which incidentally happens to be the title of his article. Modern economic psychology has developed a broad and rich picture of risk, not just as a technical concept, but as something that influences the ways in which strategists think and make decisions about risk and act within their risky world (Philip A. Wickham 2008).

Philip A. Wickham in his article explores eight perspectives on risk and invites strategic managers to think about risk in a fuller way. After a (brief) account of risk as it appears in finance and economics, Philip A. Wickham (2008) considers risk as something that enters the strategic managers' debates as something that influences strategic choice, as something that influences managerial behaviour, as a factor in position and status (for individuals and organisations), as something that affects the ways strategic managers think about and deal with information and finally, as something that like a resource, is shared between the organisation and its shareholders.

Heavey and Murphy (2012), in their article "Proposed cooperation framework for organisation and their leaders" refer to risk in business life as a ubiquitous phenomenon. According to Heavey and Murphy (2012), if for instance the likelihood of an event occurring is less than 100 per cent and it has the potential to have a positive or negative impact on the business, then a risk exists. He elucidates further that risk is an area that all leaders have to

deal with inside the organisational environment. Heavey and Murphy (2012) makes reference to Conchie and Burns (2008) acknowledgement of Hillson's (2002) classification by contending that risk can be categorised into positive and negative risk.

In that reference, Conchie and Burns (2008) explains that positive risk have a positive impact on the business where as negative risk have a negative impact on the business. Heavey and Murphy (2012) note in their finding that the proposed framework has utility for organisation and their leaders and informs us that trust has the potential to reduce risk and increase cooperation. Investopedia defines business risk as an uncertainty in the profits or danger of loss and the events that could pose a risk due to some unforeseen in future which causes business to fail. Business risk can be classified by the influence by two major risks: Internal risks and External risk (business. gov. in, " Influencing types of business risk").

Internal risks can arise from factors (endogenous variables, which can be controlled) such as human factors (talent management, strikes), technological factors (emerging technologies), physical factors (failure of machine, fire or theft), operational factors (access to credit, cost cutting, advertisement). External risk arise from factors (exogenous variables, which cannot be controlled) such as economic factors (market risks, pricing pressure), nature factors (floods, earthquakes), political (compliance and regulations of government) Miles D. Anthony (2011). Jolly Adams (2003), classifies business risk in a manner that is largely consistent with that of Miles D. Anthony (2011).

Business risk can be classified into strategic risk, financial risk, operational risk, legal risk and a fifth category that encapsulate natural disaster (floods and quakes) and others depending upon the nature and scale of the industry. In the paper titled " Small business failure and external risk factors", Everett and Watson (1998) discuss business risk as it relates to small business failure. Rather than look at all the risk factors (Internal and External) that could cause small business failure, Everett and Watson highlights external risk factors as a major cause of small business failure. When starting a small business, Everett and Watson (1998) explain that owners accept three categories of risk that all together ultimately determine the success or otherwise of their business.

Firstly, there is the risk associated with the economy in which the business is located (). This is referred to as economy based risk (Everett and Watson, 1998). Secondly, there is the risk associated with the industry in which the business is operating... this is referred to as industry based risk (Everett and Watson, 1998). Thirdly, there is the risk unique to the business itself which Everett and Watson (1998) referred to as firm based risk. To a large extent, there is little individual business owners can do to influence the economy in which they operate and Everett and Watson (1998) make reference to Fredland and Morris (1976, p. 9) who noted that during " cyclical downturns, the marginal firm is more likely to fail".

Fredland and Morris (1979) takes further steps to explain how government policy could be used as a mitigating measure. For instance Fredland and Morris (1979) explains, if the underlying cause of small business failure are predominantly Internal (endogenous), then government policy would be best
<https://assignbuster.com/the-risk-associated-with-business-a-review-of-literature-essay-sample/>

directed at the level of the firm; for example by providing training and education programs and support Agencies. If the underlying causes of failure are predominantly external (exogenous), the government policy would be best directed at changing the economic environment within which small businesses operates (Fredland and Morris, 1976).

Understanding the factors that affect small business performance “ would enable public policymakers and small business advisors to better serve the small business sector” (Gaskill and Van Auken, 1993, p. 18). What Everett and Watson does is to model the relationship between small business failure rates and the aggregate level of internal and external risk to determine the relative importance of each of these sources of risk to small business mortality and secondly, unlike much of previous literature which has generally focused on internal risk factors, their study is aimed to explore the impact of various key macro-economic variables on small business failure rates. Business risk management is extensively discussed in literature.

The influence of external organisations and the pressures on business risk management practices has hitherto been examined through the influences of state regulating regimes on business (Hutter and Jones, 2006) In “ Business risk management practices: the influence of state regulatory agencies and non-state sources”, Hutter and Jones (2006) “ explore the different external pressures upon business risk management...” A broader objective is to throw some further light onto the debate about regulation within and beyond state. Looking at the External influences on business risk management beyond the state, a number a number of factors are identified

which may encourage or limit the role of the law as a risk management tool – although seldom is research framed in that way.

Typically the focus is more on issues of legal compliance (Hutter and Jones, 2006). Research indicate the need for sanctions and state influence though law appears as a necessary but not sufficient influence upon business risk management (Gunningham and Kagan 2005; Hutter 2001). There has been a growing recognition that the state is not the only influence on business risk management practices (Hutter and Jones, 2006).

Indeed, there is increasing acknowledgement of regulation beyond the state, where regulatory space is occupied by the state and other non-state players and where there is a move to outsource public management functions (Hancher and Moran 1989, Osborne and Gaebler 1992, Scott 2001). Hutter and Jones analytically examines also, the external influences on business risk management in relation to the economic sector and civil society. In analysing the complex, Hutter and Jones notes that some market participants sell risk management products and risk management advice, for example, insurance companies and consultancies. Others may exercise influence through their investment or consumer choices (Hutter and Jones 2006).

REFERENCED ARTICLES AND JOURNALS

Conchie, S. M. and Burns, C. (2008), “ Trust and risk communication in high-risk organizations: a test of principles from social risk research”, Risk Analysis, Vol. 28 No. 1, pp. 141-9.

Chiles, T. and McMackin, J. (1996), “ Integrating variable risk preferences, trust, and transaction cost economics”, Academy of Management Review, <https://assignbuster.com/the-risk-associated-with-business-a-review-of-literature-essay-sample/>

Vol. 21 No. 1, pp. 73-100. Everett, J. E and Watson, J. , 1998, ' Defining Small Business Failure', International Small Business Journal 11(3), 35-48.

Fredland, E. J. and C. E. Morris, 1976, ' A Cross Section Analysis of Small Business Failure', American Journal of Small Business 1 (July), 7-18.

Gaskill, L. R. and H. E. Van Auken, 1993, ' A Factor Analytic Study of the Perceived Causes of Small Business Failure', Journal of Small Business Management 31(4), 18-31.

Gunningham, N. and Kagan, R. A. (2005) ' Regulation and business behaviour', Law & Policy 27 (2).

Guzman, O. (2012). What is Business Risk? , Retrieved from