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RISK AND CORPORATE ACTIVITY: THE DEFINITION

Klochkova Nataliya Vladimirovna, Dr. Sc. (Econ.), Prof.
Koltsova Elena Aleksandrovna, Cand. Sc. (Filology), Assoc. Prof.

Ivanovo State Power Engineering University named after V.I. Lenin, Rabfakovskaya st., 34, Ivanovo, Russia, 153003, e-mail: nklochkova@mail.ru; elena.a.koltsova@gmail.com

Purpose: article is devoted to problem of risk and corporate activity and their definition. *Discussion*: the term risk management does not yield to simple definition. The terms risk and management offer some clues on content, although without prior knowledge, few would accurately guess the subject matter from the title. Certainly risk management is more specific than the title would have us believe; only some risks will be managed under our subject umbrella. *Results*: we proved that the class of risks does have distinguishing characteristics that set it apart from other forms of corporate risk, although in trying to achieve precise definitions, researchers find many poorly fitting cases. Despite these difficulties in formalizing a definition for our subject matter, authors have captured its general flavour.

Keywords: risk management, pure risk, corporative activity.

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1. Introduction

Many activities undertaken by an individual or a firm do not have a predictable outcome, e.g. the return from investing in a stock, the wages resulting from labor contract negotiations, the outcome of an auction for a government contract, the future demand for a newly marketed product, the outcome of research in new products, etc. At best, they can identify a range of outcomes for such events and give some indication of the likelihood or probability of each possible outcome.

The lack of predictability of outcomes may be termed risk. We hold the view that Risk, in this sense, does not imply that outcomes are adverse, only that they are not known in advance. Thus, risk includes the possibility that the result may provide a pleasant surprise; e.g. an investment may yield a higher than expected return.

2. Results

From such a working definition of risk, it is apparent that corporate activity is replete with risk and that risky activity can be classified:

1. Marketing risk. The demand for a firm’s products depends on many

factors that may or may not be within the control of the firm, e.g. product design, promotion, general income levels, price, price of competing and complementary products, consumer tastes, changes in government regulation of trade in the firm's products, etc. Such influences combine to cast a thick veil of uncertainty about a firm's future demand [3].

2. Financial risk. The cost of providing and maintaining capital for a firm is subject to capital market fluctuations. In recent years, both debt and equity costs have been subject to considerable fluctuation [6]. Financial risk may be modified by particular corporate decisions; for example, an increase in corporate debt will often increase the default risk on old debt and enhance the variability of stockholders' returns [9].

3. Resource management risk. In the production process, the firm brings together specific resources. The productivity of these resources is subject to risks of varying nature. The cost of resources is subject to changes in price, resources may be withdrawn from the production process (as in strikes), resources may be subject to sudden physical impairment or destruction (such as fire, explosion, etc.), and resource use may be beneficially or adversely affected by technological change, etc. [1].

4. Environmental risk. Risk may arise from the incidental interactions between a firm and its environment. For example, corporate operations, such as ownership of property and operation of vehicles, may expose the public to certain dangers for which the firm has a statutory or common-law liability. Also, government regulation other than that having a specific product or industry basis, such as zoning laws, may impose contingent costs on the firm or result in unexpected benefits, etc [4].

So, this classification of risk is, perhaps, arbitrary and the types of risk defined are neither mutually exclusive nor exhaustive. It serves merely to suggest that typically a firm is subjected to a wide variety of risks [2].

In monitoring the total performance of a firm, the collective effect of these various risks is important. In its continuing activity, the firm hopefully earns a profit for its owners.

Against the backdrop of diverse corporate risks, risk management writers have sought to isolate a particular class of risks that is the object of their attention. Perhaps the most enduring classification was given by Mowbray (1930):

Speculative risks are those that offer the firm a chance of gain or loss. Such activities are usually undertaken in the hope of gain, although the range of possible outcomes inc1udes those that will register to the owner an economic loss. Pure risks are those that offer only the prospect of loss. Thus the possible outcomes from activities or events exhibiting pure risk range from zero to negative [8].

From the examples of corporate risk given earlier, risks can be identified as either of a speculative or of a pure nature. Marketing risks are usually speculative. The marketing of products or services is an indispensable ingredient in the entrepreneurial process, since the firm is in business to make a profit. Demand changes can either decrease or increase corporate earnings. Similarly, changes in the regulatory posture adopted by the government can either increase corporate earnings (by shielding the firm from competition) or decrease them (by removing impediments to competition). Another example of speculative risk is the capital gains or losses the firm experiences on its holdings of physical or financial assets.

So, the terminology pure risk is quite unfortunate because it does have normative overtones. Indeed, one might reflect on the curious paradox that such purity of risk often leads to moral hazard. No doubt, the intended connotation is that risk is generally understood to be adverse in quality and that pure risks concentrate on adverse events [5]. While the definition of pure risk does capture the 'flavour' of risk management risks, the definition is not very tight. Two borderline examples have been noted by Dennenberg and Ferrari (1966). Credit risk refers to the prospect of bad debts on the firm's credit accounts [2]. Certainly, a bad debt is a loss to the firm. However, if the activity giving rise to the risk of bad debts is defined to be the extension of credit, such activity may be said to exhibit speculative risk [7]. The extension of credit is used as a marketing device to stimulate product demand. Thus, liberal credit may lead both to higher sales and more bad debts. A second borderline example is the prospect of a strike. Although a strike usually results in financial loss to the firm, this may not always be the case. During a period of excess capacity, a firm can possibly achieve more effective cost savings through a strike than trough layoffs [10].

In conclusion, risk management does have well-defined responsibilities in the areas: the protection of corporate property; the safety of employees, customers and third parties. Often, risk management is also defined to include other employee benefits, such as life insurance and health insurance.

So, the concept of pure risk gives a rough guide to the content of risk management. Our feeling for the subject matter might be enhanced by describing the evaluation of the subject.

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РИСК И КОРПОРАТИВНАЯ ДЕЯТЕЛЬНОСТЬ: ОПРЕДЕЛЕНИЕ

Клочкова Наталия Владимировна, д-р экон. наук, проф.
Кольцова Елена Александровна, канд. филол. наук, доц.

Ивановский государственный энергетический университет им. В.И. Ленина, ул. Рабфаковская, 34, Иваново, Россия, 153003; e-mail: nklochkova@mail.ru; elena.a.koltsova@gmail.com

Цель: статья посвящена определению понятий «риск» и «корпоративная деятельность». *Обсуждение*: категория «управление рисками» многопланова и не поддается однозначному определению. Отдельно взятые понятия «риск» и «управление» позволяют составить лишь поверхностное представление о сути рассматриваемой категории, понимание которой невозможно без детального изучения проблемы. Термин «управление рисками» весьма специфичен и, соответственно, предпринятый авторами подход к исследованию затрагивает лишь некоторые аспекты рисков, оставляя за рамками изучения систематические риски и их последствия. *Результаты*: авторам удалось доказать, что класс рассматриваемых рисков имеет ряд отличительных свойств от иных предпринимательских рисков. Несмотря на трудности, связанные с определением ключевого понятия нашего исследования, авторам удалось обобщить категориальный аппарат.

Ключевые слова: управление рисками, чистый риск, корпоративная активность.

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