MANAGERS EFFECTS OF SPECIFIC RISK MANAGEMENT ON FIRM'S

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Abstract
The study examine the purpose and benefits of risk management in business organization, the impact of effective risk management on the organization and how managers/ owners become biased because of their private benefit from the organization. This may induce managers to misreport information and even avoid risky project with positive NPV that can yield more profit for shareholder to increase their value instead. The study identified factors that can possibly influence managers' attitude towards managing the firm's specific risk that are within his control. Examination of different types of managers and /owners shows that managers/and owners become more risk taking once they observe a positive relationship between risky project and their income and vice versa.
Keywords: Management, Risk, Firm's, Organization.

Introduction
The purpose of this paper is to study the rationale behind risk management practices in the business organization and how different types of managers - /owners take decision towards managing the firm's specific risk. The decisions taken by different types of managers, their attitude towards risk, and how their personal interests affect the actions and decisions they take as regards risk management. Therefore, the following questions can be raised: why manage risk in business? Are actions taken by management aim at achieving the purpose of risk management in the organization? In some cases, the managers act as agents of their shareholders (principal), so the interest here is to examine the behaviour of different types of managers and to ascertain if really they act for the benefit of the shareholders or other factors influence the decisions they take towards managing the firm's specific risk. However it indicates that risk management decision by managers does not really reflect the interest of shareholders.

What is firm's specific risk
The interest of this paper is on the firm's specific risk, in this regard, therefore unsystematic/commercial/specific risk/ can be define as the probability of the occurrence of any negative or positive future outcome unique to the organization which can be influenced or controlled by managers (Servaes et al 2009, Aven 2010, Aven 2012). The Firm's specific risks are those risks that can be managed through diversification, hedging, insurance, etc. (Smithson. et al.. 2007). These are internal sources of risk that are associated with the firm's profit, losses, opportunities, etc which are within the control of the management. In this respect, it is possible to say that risk has concern about the outcomes in the future of the business organization.

Enterprise Risk Management
Risk management is regarded as all the activities, methods and strategies put in place to control, influence or manage the future outcomes that can bring about loss or benefit to the organization (Aven. 2008). It is all about taking advantage of the opportunities open to the organization, which has the potential to create profit or loss (Aven and Vennem 2007, Aven. 2012). Enterprise risk management has gone beyond this by coordinating different risk management functions that add value to the organization. It identifies various risks as well as assessing their dependence and applies holistic approach in handling each risk according to the organization risk profile and appetite to achieve it goals. Having known what risk management is, let see how this create impact on the organization that practice it.

Why Organizations Manage Firm's Specific Risk

The answer to the question on why business organizations manage risk depends on what they stand to benefit in practicing risk management. It helps an organization to put in places tools that will direct their activities towards achieving the corporate objectives and goals. A risk management function is usually put in place in an organization to assist in implementing policies and evaluating the risk associated with business plan and activity before any execution is carried out. In this respect therefore, an organization that maintain an effective risk management function will be able to effectively take decision on which investment to undertake (investment policy), how much of the total risk to retain or transfer (risk management policy), how much of the company's capital makeup equity, shares, retained earnings and what proportion of it should be used (financing policy), how much working capital - / economic capital (buffer) to be maintained for short term and long term investment (cash management policy) (Beneplanc and Rochet 2011).
Additionally, organizations that practice effective risk management function will have direction in their day to day activities. Besides assisting companies implement their policies, the other benefits an organization stand to gain in managing risk include:

1. Reducing likelihood/cost of financial distress/likelihood of bankruptcy: risk management can reduce the likelihood of bankruptcy and the direct and indirect cost associated with it like destruction of the intangible asset value (goodwill and reputation) (Hatchet et al 2010, Servaes. et al..2009).
2. Help to avoiding the corporate underinvestment problem: by strictly monitoring risky activities assist in limiting the company's from the underinvestment activities of managers.
3. Help to reduce tax payments by stabilizing income: risk management can reduce the income volatility and as a result lower taxation costs.
4. help to reduce risk, increase value of the firm through effective management design: effective risk management function in an organization facilitates decision concerning pricing, profitability measures, capital structure and allocation of resources as well as designing performance system and job description that focus on actualizing overall objectives(Hatchet et al 2010).
5. improves company's reputation: risk management reduce earnings volatility and improve credit rating as a result lower a company's cost of capital(Hatchet et al 2010, Smithson. et al 2007)
6. Help prevents organizations from loss of profits/cost of borrowing: external capital raising is more expensive than utilizing the retained earnings because of asymmetric information as well as frictional cost associated with borrowing outside.
7. prevents asymmetric information, help to Reflect financial price risk in stock price movement, help to communicating information to investors through risk management activities (Chavas 2004, Servaes. et al 2009),
8. Help prevent any form of negative externalities: with effective risk management in organization help to communicate some level of possible future outcome that can adversely affect the company.

Individual Risk Preferences

There are three basic groups of peoples as regards risk preferences, the risk averse, risk neutral and the risk loving individual (Jenson and Meckling 1976). The risk averse person will be willing to accept any certain outcome instead of a risky one that has more benefit if it became a positive one, the risk loving individual will rather accept or gamble the more profitable uncertain outcome by risking his finances, and the risk neutral person will decide not to risk his finance nor accept certain outcome. In this paper we will identify if managers and shareholders fall under any of these categories.

Outside Shareholders Attitude towards Risk

Shareholders are the part-owners of the business that also raised the initial capital to set up the business even though companies raise fund from retained earnings and debt. They are the owners who employ the managers to run the day to day activities of the business with the sole aim of creating wealth through profit maximization. Therefore shareholders expect the managers to act on

their behalf for the aim of maximizing profit. Thus, the risk taking attitude of the shareholders will influence his action towards the success of the organization.

With this thought in mind to make profit, Shareholders will prefer managers to engage in more risky projects or involve in effective risk management activities that can add value and create more wealth for themselves. The shareholders are not directly in control of their business, but they have voting rights in the company's board, and as well apply motivational policies to influence the behaviour of their managers towards the success of the organization. The government of some countries has made it compulsory for CEO and CFO to sign their financial statements published so as to hold them responsible if any failure occur. The regulators in country like the U.S. government act on behalf of shareholders by passing the Sarbanes and Oxley Act which stipulate that managers should be held liable for mismanagement of company they manage (Beneplanc and Rochet 2011). Beneplanc and Rochet also explained instances where company directors were sued by shareholders and millions of dollars were paid to them as settlement.

On the other hand, the shareholders have the voting right, but their rights are limited to voting and selling of shares. The managers have all the information about risk associated with each project, so they are to decide which business to undertake that will yield more profit or which risk to management strategies to put in place to prevent loss. Findings have shown that the shareholders earnings does not have any relationship with risk management activities in the company they own (Tufano 1996). A corporation is a legal entity separate from its owners, but the manager is the brain behind that business because he acts on behalf of the owners. Therefore the shareholders have no power over their business except a sole proprietorship or partnership where ownership is not separate from management. The regulators in U.S that protect their shareholders right in organizations are limited to corporations within their country. The influence of shareholders on risk management decisions has to be viewed from global point of view, so looking at it from a unit will be misleading.

The Agency Problem in the Business Organization

Business practices have observed a conflict between the role of managers and the interest of the shareholders some decades ago, this has been a concern to organization. Firstly, managers who are agent of the shareholders cannot behave or act exactly the way shareholder will act towards the business, their interest seems to conflict (Burkart and Panunzi 2006, Desai and Goolsbee 2004, Eisenhardt 1989, Jenson and Meckling 1976, Brealey et al 2013), because the desired goals of these two parties differ. Agency cost come to play when managers deviate from maximizing the firm value and shareholders start to spend additional money in monitoring and trying to limit their actions (Jensen and Meckling 1976, Eisenhardt 1989, Brealey et al 2013). Secondly, there is a problem of risk sharing because the both of them (principal and agent) have different attitudes towards risk (Gonzalez et al..2013, Jensen 2005, Jensen and Meckling, 1976). Thirdly, managers have all the necessary information about the business but they seem to conceal/misreport this from shareholders/board (Prison and Turnbull 2011, Esisendardt 1989). In this regards, there is bound to be a disagreement between shareholders and their business managers. The attitude of managers are now more focused on their selfish interest, they have shifted from the main objective to enrich their own private pocket or involving in luxury/perquisites with the company's money.

In other to provide solution to this problem, most companies shifted their company managers Pay from cash to stock and stock option to align the manager's interest with shareholders (Nikolov and Whited 2014) to encourage management effectiveness. These executive compensation incentives plans were introduced to encourage managers to take more risky project with positive NPV to generate more profit (Cain and McKeon 2014). Examining risk taking attitude of managers with stock options, studies have shown that even executive pay can also motivate risk averse/greedy managers(Haynes et al 2014) as well as discourage risk seeking managers depending on the type of pay and the market trends (Campello and Graham 2013, Holmes et al 2011). Managers become risk averse whenever changes occur in the stock prices which will make their stock options higher than exercise prices. Likewise higher incentive pay targets reviewing may also influence manager to be more risk seeking (Holmes et al 2011). The prospect theory by Holmes et al tries to depict relationship between probability and the decision weights and how different levels of decision

weight affect the organization risk attitude (2000). On the other hand, Geppert et al argues that the agency problem seems not to exist in multinational corporations because of institutional differences in difference countries 2013.

In light of my earlier discussions, as managers becomes co-owners through stock and stock options as compensation, they become very sensitive towards information they know about the organization activities on whether to disclose or misinterpret it to outside shareholders. Campbell et al 2014, Eling and Marek 2013 also assumes that SEC mandatory Risk Factor Disclosure of firms to submit details of specific risk the firm is exposed to in their business activities (SEC 2010) and Europe changing from GAAP to IFRS as this has been able to communicate meaningful formation about risk financial statues of firms. On this note Campbell et al argue that managers provide reasonable level of risk factor that will help investors/shareholder stake decision. Recent literature has shown how managers misinterpret or conceal risk-related problem that has led to the failure of firms because of their selfish interest. Example is the bankruptcy of Lehman Brothers due to manager (CFO)-O'Meara's refusal to pass risk-related information the firm faced for 3-months period to board directors, and instead reported edited standard chart for each board meeting, so the board/shareholders were misinformed (asymmetric) about the company's excessive risk taking(Prison and Turnbull 2011).It is therefore hard to stop managers from involving in perquisites as their activities are difficult to monitor (Eisenhardt 1989, Brealy et al 2013).

Managers/Manager-Owners Attitude towards Risk

The manager's attitude towards risk greatly has impact on the success or failure of the business. Managers who are risk averse seems to undertake less risky projects that will generate little profit, which conflicted with the objective of maximize the value of the firm. On the contrary, managers that are risk seeking will create wealth for the shareholder through risky projects that bring more profit to the business.

However, managers who have become co-owners of the organization they manage involve in more risky projects with positive NPV and less expensive risk management activities than those who only act as agent (La Porta et al 1998,). Similarly, firms controlled by managers-shareholders who strangely diversified their wealth will always want to engage in riskier projects and vice versa (Faccio et al 2011, Chen and Steiner 1999). Previous literature has shown that any increase or decrease in their portfolio diversification will respond to a corresponding increase or decreased in their risk taking behavior (Faccio. et al 2011). Faccio et al provided evidence in their findings that there is a positive relationship between portfolio diversification of managers and their corporate risk taking behavior. Dybvig et al 2013 assumes that spending more money to reduce risk only benefit the large shareholders at the expense of those who's wealth are fully diversified. The managers whose pays are closely related to the company's accounting profit seems to engage in less risky projects than managers whose pay are related to the company's overall performance. Most Executive or managers engage in wasteful Merger and Acquisition(Jensen 2005) as a corporate risk measure and spend less in Research and Development which can be a riskier strategy for firms in changing technology because each risk measure also have its own consequences (Christensen et al 2014). The managers benefit more from M&A since bigger company attract higher pay but at the expense of the shareholders wealth. Christen et al also argues with evidence that tax avoidance is a riskier measure as it also exposes the firm to reputational and financial risk in the future if caught. Again, managers who own stock options become more risk-seeking than those who are stock owners because their income is strongly related with risk taking decision in the firm (Tufano. 1996, Faccio. et al.. 2011). In contrast, Compensation with stock option may not be effective in multinational organizations as accounting profits of various divisions are used to evaluate performance.

In addition, the managers tenure/succession in office also influence their cooperate risk taking attitude because changes in risk taking attitude occur once there is a succession in management. New managers in the system sometimes perform better than those who have been for long term. They see this as a golden opportunity to impress people or show their skills in management of the business. Shareholders are far away from their managers, so sometimes stock options are over used to pay managers, executives and employees but in case these managers tenure become shorter it

will have adverse effect on the company (Kaplan and Mikes 2012).). Companies owned and managed by families does better(La porta et al 199) around the world compared to other corporations because the agency cost and borrowing is reduced to minimum but reverse is the case when family act as a board member due to higher risk aversion (Gonzalez et al 2013). On the other hand, changes occur in risk taking when there is a successions or heir takes over (Gonzelo et al 2013, Faccio et al 2011) because of fear of losing control.

Conclusion

Management studies and scholars have contributed greatly to proffer solution to this conflict in interest between managers and shareholders on who benefits more from the organization. Despite the contribution and suggestions from different levels of study, there is still a gap between the problem and its solution that need to be addressed. However, the more shareholders become sensitive to their business, the more the managers become aware. Therefore the managers' risk taking attitude towards the business is not a matter to shy away from.

In summary, organizations should have active risk management committee/risk monitoring unit(Prison and Turnbull 2011) headed by a Chief Risk Officer (CFO) who is among the top five officials to handle their risk related activities. Furthermore, increasing debt leverage (Gonzalez et al 2013, Truong and Heaney 2013, Vu and Qin 2013) encourages raters/outsider monitoring, and strictly tying management compensation to the firm's overall performance will reduce managerial inefficiency because managers seems to engage in more value enhancing projects (Marek and Eling 2013) since their pay is depending on the firms performance (Geppert et al 2013). Truong and Heaney also suggest that the insider ownership approach and increasing of debt as a source of agency control (2013). Finally, implementing equity incentive, avoiding any form of fixed pay to managers, and application of the enlightened value maximization (Jensen 2010) since it take account of other stakeholders but still focus on the main objective of maximizing the firms value/shareholders wealth.

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