

BUSINESS RISK - LIMITS AND COMPONENTS

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The MacMillan Economy Dictionary¹ incorporates the concept of business risk, which is somehow ambiguous, into the corporate risk, defined as the total risk occurred in an economical activity. It is further suggested that it is the matter of an agreed vision over the two major types of risk it comprises, i.e.: the financial risk, arising from financing by means of a loan and the economical risk, representing a fundamental risk of the current activity in a company. Another opinion is described in the Economy Dictionary², where the concept of business risk is referred to in close connection with the concept of profit³. Given the fact that under this vision the profit is viewed as a synthetic expression of the efficiency in the activity of any business entity, the major objective of such entities is connected with the profit maximization and the business risk is deduced to represent the risk of not obtaining and/or not maximizing the profit. According to the opinion of Hirschey and Pappas⁴, the business risk represents the "chance" of loosing, associated to a managerial decision and it is directly connected with the idea of product demand variation and under the conditions directly depending on the costs level. Moreover, Petru Prunea⁵ associates the business risk with the risk manifested in the organizational development process, in respect with quality increase, products and capacity diversification, or with the use of improved technologies, leading to a bigger profit. The Electronic Investments Encyclopaedia⁶ provides that the business risk is the risk for a company to not have the adequate cash-flow needed in order to meet the current expenses for the purpose of being operational; it is stipulated that there are two components, namely: the financial risk connected to the loans and the risk arising from the economical environment. McGladery⁷ - a Risk Consultancy Company uses a more general wording, describing the business risk as the event or action having adverse effects over the company's stability in its pursuit of meeting its objectives and strategies.

Although the few examples of approach use particular visions and wordings in order to describe the business risk, it is our opinion that such views have a number of commune features, which we are to synthesize in the following. In any company, the occurrence of a risk is a potential source of issues. An "issue" represents the difference between the recorded result and the intended one or, in other words, the distance between the effective result and the initial objective. To the extent in which it is accepted that obtaining, upholding and maximizing the profit is the implicit objective of the economical activity, the similitude can be noticed between the vision stated in the Economy Dictionary and the vision of the McGladrey consultancy company. No business entity will carry out its activity randomly: in order for its objectives to be achieved, the business entity needs coherent, functional and efficient strategies. In order to fulfill the said strategies, favorable conditions are needed and, most of all, they

¹ MacMillan Dictionary of Modern Economy (Romanian: Dictionarul MacMillan de economie moderna), Codex Publishing House, Bucharest, 1999, p. 354

² Economy Dictionary (Romanian: Dictionar de economie), coordinator Nita Dobrota, Economical Publishing House, 1999, p. 408

³ Economy Dictionary (Romanian: Dictionar de economie), coordinator Nita Dobrota, Economical Publishing House, 1999, p. 373-374

⁴ Hirschey, Pappas, idem, p. 729

⁵ Risk in the Economical Activity (Romanian: Riscul in activitatea economica), Prunea, Petru Economical Publishing House, Bucharest, 2003, p. 105

⁶ www.investopedia.com

⁷ www.mcgladery.com

need to be designed in accordance with the objectives (ability is needed for this scope). Therefore, between strategy and objectives an intrinsic relation exists and the business risk under the view of Hirschey and Pappas is somehow similar with the other two above mentioned opinions. The descriptions in the MacMillan Dictionary and the Electronic Encyclopedia actually suggest the same idea and if we agree that a company's activity is grounded on the universal engine which is the financial aspect, then we need to accept that the implementation and carrying out of the strategies and the achievement of the objectives are actions which cannot be performed without an adequate cash-flow. At last, the vision of Petru Prunea provides us with several company general strategies and objectives, either depending on conjunctures or permanent and is also in line with the general opinion on the business risk.

As it can be noticed, it has not been our intention to emphasize that the approaches of various authors are incomplete, and we have not stressed the differences between their visions. The fact that their opinion proved to be convergent has nothing to do with the fact that they are not identical. In order to describe the business risk, it is essential the *idea of aggregation, of total risk undertaken by the company and such aspect should be a disturbing one*. In order to discuss this risk, we need to have a view on the risk assessment, and the correctness in quantifying an agreed measure is such a difficult matter, that the identification of small semantic differences between the descriptions of the business risk made by various authors could be at the most as important as some insignificant gossips.

Therefore, it is more than necessary to sort the components which are to be analyzed, and such separation shall be performed upon the terms already mentioned in the descriptions above. Thus, we operate a distinction between a risk regarding the internal activity of the company and a risk of financial nature, which are to be referred to in the following. It is important to underline from the very beginning that we attempt to create a limit as strict as possible between the two said risk categories, because in view of the aggregate model to be set up, we become interested in ensuring - to the possible extent - that the occurrence and implications of the events in the two categories are independent. Of course we cannot certainly assert that in the functioning of an organization there are phenomena which are entirely independent of one another, but we can establish a limit between the phenomena which are strongly connected or very strongly connected and those which are insignificantly connected to each other. We felt the need of making such clarification because the investments made by an organization are grounded on initiatives, decisions, in short on internal activities, whilst the risks that might occur are of financial nature. Also, the assessment of the demand is an organizational activity, and by overestimating it losses may be generated from the expected incomes, hence financial damages can arise. However, in the following limitation the two aspects are to be described distinctly. We need to establish a series of risks which represent a cause for each of the two major categories generating business risk, and the fact that we will attempt each time to express the results in money is only an initiative aimed to help in setting up the model for assessing the total risk.

1. The risk regarding the specific activity of the organization

Regardless whether the organization provides goods, services or information, its activity is grounded on general elements which in the economic sciences are referred to the same, notwithstanding the nature of the products. These elements are demand, offer, a process of making the offer - irrespective whether it is a matter of actual production or of creating it by methods which do not imply equipments, assembly plants, a used technology, a selling process etc. Therefore, we are to include in this first risk category all those events which can generate problems in respect with achieving the objectives set out by the organization under this specific activity.

Potential problems might be encountered in this regard in attracting and appointing human resources, in establishing the offer, in assessing the demand,

in deciding upon the utilization of the technologies, in the relations with the competitors or in obtaining the intended sales level. There can also be included here the problems which might occur in result of the questionable quality of the product or consequent to the price fluctuations, as well as many other situations or events that might influence the obtaining, maintenance and maximization of the profit. In other words, we have described enough possibilities in order to persuade that a more clear distinction should be made. *Unless we make a clear distinction between the cause, means of manifestation and effects of the risk affecting the profit, the initiative of identifying such risks, as well as any ulterior attempt of measuring them, will be undoubtedly unsuccessful* Let us take an example and discuss the implications of a potential "risk for the raw materials suppliers to not fulfill their contractual obligations in due time".

The causes for such situation could be separated into three major types:

a) Regarding the supplier directly:

- > Unreliability;
- > Accidents during the transportation;
- > Damage of the raw materials and of the materials in the supplier's deposits, caused by irresponsible conduct of the employees.

b) Regarding the relationship between the supplier and the producer:

- > Breach by the producer of one or more contractual clauses, which might free the supplier of its obligation of fulfilling the contractual terms or might lead to the termination of the contract;
- > Refusal from the producer to receive raw materials or materials of inappropriate quality etc.

c) Independent of both the supplier and the producer:

- > The raw materials or materials are stolen;
- > The raw materials or materials are damaged due to accidental causes: fire, earth quake, floods, landslips etc.

Regarding the means of manifestation, apparently there is nothing to discuss, because it is a clear matter: the raw materials and materials do not reach the producer upon the contractual term. However, there can be taken into account several possibilities, on which the effects of the occurred issue will be dependant. The distinction will be made in this case upon the delay period, namely:

- > A small delay compared to the date established by means of the contract
- > A great delay compared to the said date
- > A very large delay, or the raw materials and materials not reaching the producer at all

It is the producer's decision how small, great or very large it considers the delay to be, depending on the effects it estimates, which can be as follows:

- > Insignificant delay in the production process, not effecting in losses;
- > Significant delay in the production process, generating significant losses which can exceed or not the level of the organizational affordability;
- > Ceasing of the production process and record of major losses.

We can take the analysis even further and, depending on the context, the nature of the losses can be discussed, which can be monetary or non-monetary and so on. Thus, only by listing the causes there result seven potential risks - and our aim was not to undertake a complete study. If we do not take into consideration the overall effect, which is "the impact over the production process", the relation with the supplier can lead the producer's existence towards a network of risks which can be left out even from a description, moreover from an evaluation.

When we refer to the risk regarding the specific activity of the organization we only take into consideration the "effects", and not the number of the causes. The last mentioned ones are very important, and therefore they are established - as well as the forms of expression - for each situation, because each organization is capable of detecting the potential sources of certain events. In respect with our purposes, we are interested in presenting a few categories of

events which can affect any economical entity and we are to focus our attention on the following types of risk:

I.A) Market risk

The activity of any organization implies direct contact with the customers, through the marketed product. Regardless whether the distribution is performed directly or by means of intermediary, the product reaches the users and represents a part of the evaluation process, and potentially of the selling process. Even if the company is "alone" on the market, the question always exists whether it will sell everything it produces. All the more in a competitive environment, the consumers' preferences and their possibilities, interests and options, the price of the product and the actions of the competitors are unpredictable. The instability of the demand, price and sale volume generate permanent risk factors in the organization's life. Therefore, we agree to set out that in our opinion the market risk refers to the possibility of not selling the entire produced quantity or of not selling it in the planned terms.

I.B) Operational risk

Regarding the operational risk, also referred to by some authors as exploitation risk, Irina Cismasu¹ said that it manifested consequent to the lack of correlation between the exploitation activity's results and the components of such activity, as well as to the lack of perfect anticipation of such. The said risk is to be further detailed in the next chapter. For the time being, it is our intention to underline that one effect - namely the non-fulfilment of the rentability level - can be reached both as a result of the market risk and of the operational risk; therefore, we need to reassert the fact that only a concrete analysis over the company's situation can reveal to what extent the two mentioned risks act independently or not.

I.C) Technological risk

In order to avoid any misunderstanding, it must be mentioned that this risk does not refer to the existence and use of a certain technology, because such aspect is a matter of the operational risk. We are referring herein to the decision of keeping or replacing an existent technology, being of common knowledge the fact that the technological development can have both a positive and negative impact over an organization - depending on its ability of foreseeing the evolution of the phenomena. A rapid adaptation to change, choosing the correct direction, can generate great advantages, whilst hesitations, delays or focusing to a wrong direction can seriously endanger the organization's position on the market. We are not including here the risk afferent to the decision of investing in technology, which will be naturally included in the risks of financial nature, but only those risks regarding the quality of the products, their costs, their ability of being competitive, features directly taken into account from the stand point of the results which can be obtained by the producer by using one technology or another.

Of course that the above description of the three types of risk specific to the organizational activity is a brief one, but our objective is to regard them in an aggregated manner, and not to detail them. Each of these types of risk can make the object of a consistent

¹ Cismasu, Irina Daniela - *The Risk, an Element of Decision Making (Romanian: Riscul, element in fundamentularea deciziei)*. Economical Publishing House, Bucharest, 2003, p. 71.

independent paper, and the specialized literature provides vast information in this area. In the forth chapter we are to present our own contribution to the thoroughgoing study of such. Thus, we move forward to a brief foray in the aspects regarding the financial risks which can be faced by an organization throughout its activity.

2. Financial risk

It is understood that without appropriate financial support no organization can carry out its activity according to the demands arising from its intent of achieving the organizational objectives. A good financial position grants the business owner with the comfort of having alternatives for making and diversifying investments and avoids to some extent the effects of shocks that might occur in its activity. On the contrary, a weak financial position obstructs even the elementary processes within an organization, generating uncomfortable threats to the organization. In the area of risk of financial nature, we are to undertake several specific risk typologies. However, first of all it must be noted that our intent is maintained for the risk categories resulted to correspond to less connected events.

2. A) Market risk (from the stand point of the investment portfolio) This is of course a different interpretation than the one provided under I.A. This time the term refers to the risk for the investment portfolio owned by the organization to not evolve as intended, or for the decision of modifying the portfolio structure to lead to losses. In the following we are to further detail this risk category, given the fact that the investment related aspect of the organizational activity is of extreme importance.

2. B) Inflation risk

The possibility of an increase in the general level of the price represents a real threat to the results of any commitment made on legal grounds and which imply fix, established payments to be further performed. The matter is more severe given the fact that the possibility of foreseeing such modifications of the price is most times relatively small and it can actually be out of the business owner's control. The inflation risk affects a great number of components in the organizational activity, having a direct impact over the financial results.

2. Q Interest ratio risk

The modifications in the interest level can severely affect the value of an organization's investments, irrespective whether such modifications refer to increases or decreases of the interest ratio. In view of the aggregate model, we need those fluctuations not resulting from inflation in order to keep as much as possible the independence between the types of risk. It is difficult to estimate which is the influence of the inflation over the modification of the interest ratio; however, it is not impossible to view separately the influence factors and one may hope in the possibility of distinguishing between such factors.

2. D) Loan related risk

The detailed approach of this sort of risk is usually made by the financial institutions. However, on an overall level the "loan" can be viewed as any contractual obligation implying the fulfilment of obligation undertaken by the parties and which can be monetary evaluated in the end. However, a strict distinction must be operated between the financial problems arising from an investment project made grounded on borrowed capital and those having an impact over the incomes in result of one contractual partner refusing to receive a weight from the organization's offer or refusing to pay the rent for a premise owned by the organization.

When the organization is incapable of making available financial assets or other types of investments it owns, upon the requested time and appropriate price, the lack of liquidity can generate severe issues in the carrying out of the activity or even the ceasing of such. Unfortunately, the liquidity risk cannot be regarded independently of the manifestation of other risks already described above and therefore it will be a matter at least delicate to include it in the aggregate model in respect with the co-variances occurring upon other manifestations.

Normally we could carry on describing the bankruptcy risk, which on one hand is included in the financial risk category, but on the other hand can be included as a direct effect of the operational risk, due to the fact that the last mentioned one was described as nonpayment of the expenses from the resulted incomes and, depending on the gravity of the gap between the two measures, the bankruptcy can be imminent.

From our description above several conclusions can be drawn, as it follows:

- > It can be extremely difficult, if not impossible, to make a distinction between the risks threatening the business, and to include them into independent categories;
- > One cannot describe the threats confronted by an organization without knowing and understanding the internal processes of the business;
- > The possible effects of a risk's manifestation are extremely diverse. It needs a lot of imagination in order to foresee them and a great ability of asses them, moreover given the fact that the same effect can be in the same time the result of more causes manifesting simultaneously and sometimes independently;
- > The complexity in the types of threats and of their potential effects, which are almost impossible to categorize and evaluate may generate chaos in the attempt of the business owner of managing the business risk. Therefore, methods of sorting the information, logical algorithms and formulae are necessary in order to have a model of the risk on an organizational level. Because the idea of "model" is often associated to a language difficult to be understood by the users, it is necessary for one to be permanently careful in using clear and accessible wording, and to create a bridge between the specialized theoreticians and the business owner.
- > Business risk is a complex one, which in order to be appropriately undertaken needs a general approach, an aggregate vision meant to ensure the mix of all the components viewed both theoretically and from a practical stand point. The lack of concordance between the theoretical model and the practical side would inevitably lead to initiative which might prove to be un-operational, same as any attempt of approaching the business risk without having a "pattern" would generate panic to the business owner aware of the complexity of the matters. An intuitive comprehension of the risk, grounded on experience and on common approaches can create a false sense of comfort, but obtaining good results in practice is grounded on more than intuitive approaches.

Grounded on the need of approaching the business risk as a whole, we are to attempt to suggest another point of view in the matter of dividing the areas threatened by business risk. It is our intent to pursue four major directions, namely:

- > The financial side, including all shares, promissory notes, term deposits, cash accounts, debts, loans etc.
- > The physical side, including buildings, lands and equipments.
- > The human resources side, including the abilities, knowledge (education), availabilities and limits of the employees.
 - > Non-tangible aspects, referring to the organizational reputation, brand, information. This matter is to be further detailed bellow, because the organizational image is an element more and more important for the business conduct. To the four approaches of the business risk should be added the time element, already discussed in the previous paragraphs, deciding that the rapid changes in the internal and external business environment make the study of real time risks necessary.

Therefore, we have made a distinction between four areas in which the potential risks can manifest and it is time to refer to several risk groups. We remind our intent of obtaining large categories of independent manifestations and in this respect we decide upon making the following distinction:

1. Business owners' (shareholders') risks

We comprise here the risks that correspond to purchasing, holding or renouncing of every type of capital hold by the organization. In this way we have included directly or indirectly what the specialists call the risks implied by holding the portfolio, by the portfolio's diversity, by investments projects regardless the nature of the used capital, by inflation, by interest rate, by loans etc.

2. Process risks

This category implies all the threats that may appear as a result of using the capital with the purpose of achieving the objectives appointed by the organization. Here we foresee an operational side with no connection to the category of risk formerly described so up to this point we can count on an acceptable autonomy of the risks from those two classes.

3. Behavioral risks

We shall take into consideration all the risks related to the attracting, keeping or renouncing of the human resources, but we shall not include those actions which may endanger the processes and which will be covered by the second category.

Therefore we have limited three risk groups which we hope to be independent enough in this category in order to not raise the issue of that global evaluation being damaged as a consequence of not taking into account the correlation between the random variables which we shall build up ulterior. There must be mentioned that every category described above includes risks that may be found in the activity of every economic entity and risks typical of every business. Therefore an even more detailed description of every mentioned group is needed and together with this activity maybe we shall obtain information about possible interdependence.

In the first category of risks confronted by business owners we shall have the following:

1.a.) Risks with external causes to the organization, which may damage the organization's activity and the desired objectives. We include here the demand's fluctuations, the competition, the settlements, the unfavorable modifications existing on the labor and financial market, modifications existing in technology, etc.

1.b.) Risks generated by ownership over the capital not including here the human resources. This time, the threats we shall take into account are of internal type, for example the bad usage of equipments, the theft, the depreciation of the capital etc. **1.e.) Accidental risks** also known as hazardous risks; here are included all those risks with natural causes (fire, earthquakes, floods, storms etc.) and the risks with insurance features as losses or disasters which may be generated unwittingly by man. It is a first group of risks which proves to be in close relation to another group, the group of process

risks and for the global evaluation of the risk on a business level it will be needed the estimation of the correlation between different specific events.

1.d.) Opportunity risks: it is a well known fact that in order for a business to function it takes the presence of a lot of decisions which the business owner wants them to be objective, rational and which eventually would lead to optimum results. It is advisable that at every decision's foundation to be a descriptive model to introduce the context, the endorsement and its implementation on an organizational level. There are many studies which prove that in reality organizational decisions are made less accurate than the classic theory recommends it, the decision makers are leaning towards approximate, suboptimal problems solutions. These methods are easier and sometimes faster but they can damage the logic of the decision and they can generate expenses. We shall name opportunity risk the cost of choosing one decisional variant different from the optimum one regarding the purchase and

the use of any type of capital. Here we can include the risk of choosing an inadequate capital or in an improper variant, its sale in an unfavorable moment, its keeping when in fact it should be dismissed etc. it is predictable that the opportunity risk is in close dependence to the behavioural risk and again it will have to be taken into account the declared co-variances in the aggregate model.

Regarding the **process risks** we can delimitate the following: 2.a.) **The accidental risks:** When we talked about the risks the business owners are exposed to, we had already met hazard and we had highlighted the fact that they are in close relation with the process risks category. Now it is obvious that the relation is established with the risks 1 .b., risks generated by the ownership over the capital. A very interesting process may be noticed, namely the process risks found as effect risks - in the event in which the external processes' elements affects the latter ones - and as cause effects when direct disturbances of the processes are reflected in capital owners' losses. 2.b.) **Risks generated by errors, omissions and delays:** the difference between these risks and the ones from group 2.a. consists in the nature of the causes that may generate them. If the causes in the situation mentioned above are purely accidental because they are not based on the bad usage of the equipments, on the lack of skill or on the lack of interest of the persons involved in the activity of the organization, this case is all about these things. Although those kinds of risks may appear as a result of some bad evaluations of the situations and operations, they must not be mistaken with the opportunity risk whose description makes the differences to be relevant.

2.c.) **The fraud risk:** it is the first risk from those presented above where the main characteristic is intentionality. Whether it is about a theft, property destructions, the organization's image destruction, threats addressed to clients or to the personal, the damages are the results of a mind and hand which work for this purpose, and the effects are felt at an organization level.

2.d.) **Risks of productivity loss:** We find in this group in close relation with the risks which aim at the behavior, all the threats that may be the result of a bad organization of the production process or of an inadequate control of the appropriate development of an activity. Here we can relate to the sub-usage of the productivity factors, to their inefficient allocation, to the lack of control actions, to the divergences between the objectives of the various departments etc.

Finally, we shall say a few words about **behavioral risks** in whose category we find the following:

3.a.) **Risks of productivity loss:** the productivity losses can be the result of the sub-usage of the equipment, of the raw material and of the materials, as well as of the human factor. A defective management, the favoritisms, the lack of discipline, the incorrect grounded managerial decisions, the personal conflicts may generate serious problems which are to be found on the list of risks from the mentioned group.

3.b.) **Opportunity risks:** Suboptimal decisions may be taken relatively even at the human chapter with all this chapter includes: humans, their knowledge, regarded from the purchasing or discharging point of view. The problem of the bad placement of the human resources is to be found in the risks area from the group 3.a., this second group including only the threats which result from hiring inadequate individuals or discharging those with abilities that are necessary for the good development of the organization's activity. We shall call the cost of such suboptimal decisions opportunity risk from the behavior point of view.

3.c.) **Risks of inadequate environment:** We shall include here all the threats that result from the existence of a work place that is burden with dysfunctions. We are marking the following two aspects: the problems that the employees may face as a result of dysfunctions and the problems which employees may create to the organization as a direct effect of the threats they suffer from. The

exaggerated, unrewarded stress, the religious, racial or sex discriminations, the trials, the violence at the work place are just a few examples of such risks.

Before we conclude this study, we find it necessary to refer especially to a risk that gets a major importance for any organization as very new changes in the economical and business environment keep on registering. Thus we must bring into discussion **the reputation risk** which refers to the intangible side of an organization's existence.

More or less admitted or stated, no economic actor contests the importance of the organizational reputation as a component or a business ingredient. Any prestigious institution can say without any doubt that the key to success is a good reputation, that through it credibility in business may be achieved and it is also the basis of sometimes surprising decisions and sometimes apparently in contradiction to the background objective of any organization - acquiring, maintaining and maximizing the profit.

Nevertheless, the biggest part of the financial or any other nature resources of a correct management of the risk in business is oriented towards directions we got used to meet them under the name of operational, financial, personnel management. Although accepted and acknowledged as a real threat, the reputation risk is too less involved in the organizations' concern regarding the assurance of achieving their own objectives.

In the life of each of us the idea of reputation appears early being associated to either the relation with parents, friends, and teachers, either - later - associated to the relation with society, partners, and employers. At any relation level the reputation is a complex and definitely subjective notion and it depends on the nature of the inter-human contacts and on the requests generated by the context. But it is associated in any case to the idea of trust and it reflects upon direct relations but also upon those established indirectly. In evaluating the reputation what we say and how we act counts equally but also the context and its changes which generate the perception upon our affirmations and behavior count. The complexity of this notion makes its interpretation in a particular context difficult, and the fact that an important side is related to the perception from an extern environment brings imprecision in its evaluation. Yet we like to think that reputation and implicitly the reputation risk are not only aspects acceptable in the life of an organization but also manageable aspects on solid theoretical bases.

Defined as a value which outruns the value of the physical actives, the reputation of an organization proves to be a more highly recommended direction for the application of a proper management. Under the circumstances in which the organization collects new various and not negligible threats day by day, and under the circumstances in which most of them have an insecure nature, the business owner must use his entire capital, tangible and intangible in order to ensure its existence in the desired parameters.

In its capacity of intangible capital, the reputation is the result of some difficult actions pointed towards winning the clients' and business partners' trust, under the circumstances of a continuously changing environment and of some humanity representatives who show clearly the most various wishes, opinions or who pursue goals that are many times in contradiction. If building up a reputation is a slow process, which takes efforts, to destroy it is very simple. There are many dangers and they may appear from unexpected directions. Here are some examples:

- **Economic dangers:** for example, when a sudden change of consumers' taste is recorded and when the organization is incapable to quickly adapt, it is perceived as being inadaptable to the new conditions and it losses credibility in the clients' eyes;
- **Natural dangers:** It is illustrative the situation in which a organization has a bad location, in floodable or predisposed to landslide areas. Over such a situation the suspicion of a bad management caused by choosing and maintaining in decisional positions of some inadequate persons hangs over.
- **Operational dangers** like the insufficient protection against work

accidents. Here also a bad management is being perceived and the organization's image is surely damaged.

- s **The pollution danger**, which appears in the case of existing of some inadequate methods (for example, throwing waste products at random) or in the case of using some polluting equipments. As long as pollution will affect the environment and people's health, the organizational reputation shall gradually deteriorate.
- s **The danger of incorrect practices**, results from the differences that may appear between the organization's published data regarding its activity and the reality.
- s **The danger of managing the organization** according to some questionable standards and ethics.
- / **The danger of the incorrect competition**, which is given by the fact that the organization may act in some manner that is not correlated to the official announced results of its activity.
- s **The danger generated by the human component**, which may aim at a voluntary side (the organization shows indifference to its employees) or at an involuntary side (the organization is in the position of facing the litigations resulted from some accidental events).

It becomes obvious that any danger which may threaten that good development of the business may also become at some point a threat to the organization's good reputation, in a context in which the economic environment records new and various modifications regarding the relations between the organizations but also the relations with the consumers. The unprecedented development of communications makes that the information regarding the most various events to spread with an amazing speed, the mass media being extremely inclined to mediating the news that may get commercial value, "the gossip", and the critics for which many individuals show a special interest. In this situation, any disorder and any event that basically is not a shock to the organization constitute themselves in a latent danger for the intangible capital named reputation.

Of course that the definition of reputation risk is simple at first sight, being any potential event that generated losses in the reputation of the organization. Such an approach is for sure a simplistic one because the description of the damage itself for an intangible active is a serious problem, the more so as this active is often sensitive and basically risky. Starting from the characterization made above it is clearly that the reputation of an organization may be affected by lots of factors. Basically we can divide them as being factors in relation with the preferences and opinions of business partners and consumers. Thus, we delimit here an objective component and a subjective one to the threats that aim to the reputation of an organization, and the subjective aspect does not in the least invite to relaxation.

We may characterize the risk of reputation as being any event whose manifestation may affect in a negative way the difference between the organization's market value and the value of the physical actives. Seen this way, the problem gets a quantifiable aspect - although incomplete yet - and the hope that there is a possibility of an approach based on more theoretical models raises. What is truly important and interesting in studying this risk is the fact that unlike the manifestation of other risky events which make immediate damages, the image risk may generate effects in process of time giving in this way the possibility of recovering in time without any powerful financial shocks. On the other hand, precisely this feature may turn into a real problem for the enterpriser because the lack of immediate perception upon the effects directs to a rather ex-post than ex-prior administration. Such an attitude may represent an additional threat for a small organization for which the loss of credibility in front of an important client for example, is more serious than the same situation faced by an organization well developed and with a diversified production.

To administrate ex-prior the reputation risk is a difficult initiative because this risk is fundamentally different from the other risks the organization is used to administrate. Its nature, more qualitative than quantitative, makes it

hard to estimate the proportion of subjectivity and the objective in this evaluation, many times being impossible to establish the real level of the reputation risk. That is the reason for which the construction of a more close to reality image for the concrete background of the manifestation of the risk is more than necessary. Therefore, a correct definition and a careful delimitation are needed for an entire ensemble called "Image risk" and for its particular categories of risk that it consists of.

We agree to the fact that the reputation risk manifests itself every time situations that threaten the material results of the organization appear as a result of business partners' and the public's from that institution lost of trust. Because we have already highlighted the importance of time factor in perceiving the effects, it comes only natural to emphasize the fact that the reputation risk may manifest itself in many ways.

1. Through damages of the organization's financial performance, whether these are made in a short or long period of time.
2. Through a negative impact upon the market value.
3. Through possible financial resources mobilization that are useful to an immediate measure meant to straighten some practices, products, models etc.

Thinking more in detail, these three manifestation ways correspond to some situations or types of distinct generating events. The first situation may be the result of some conjectural nuisance: the loss of a client, even an important client, is not necessarily a reason for image damage within the organization even though it brings financial losses. But if the organization's manager is under criminal investigation - for example - and this is tendentiously communicated through media, then the stock exchange quotation of the organization's stocks may decrease drastically without the receipts from selling the products to necessarily suffer. Therefore, the first way of manifestation aims at one or more components of the organization, the second one aims the whole organization, as for the third mentioned aspect, the financial resources mobilization to correct some internal elements, it is more connected to the market as a whole and, especially, to the competition's existent modifications.

Therefore it is time, apart from defining the reputation risk, to move on forward and to highlight three component categories which result naturally from those three effects categories mentioned above:

1. **The satisfaction risk** refers, as we can easily guess, to the possibility that a client or a business partner to feel unsatisfied by the quality of the organizations' services and to cause financial losses as a result of ceasing the collaboration with it. The satisfaction risk is surely immanent to the activity of any organization and it manifests itself in close relation to the operational risk.
2. **The risk of accepting the brand** aims at the perception of the entire organization, of the way the business is managed and promoted in the social, economical, cultural, legislative context. Typical of the activity development is, in a large extent, connected to the organization's capacity of perceiving the external environment, the operating and communication way in this environment.
3. **The risk of accommodation**, we describe it as being the result of some failures in implementing in the internal processes of the necessary elements so that the accommodation to the external environment to correspond with the organization's objectives. Legislative settlements, fiscal restrictions, the constraints of changes in the products' nature or structure are only a couple of causes which may lead to the third risk category manifestation.

A general look on these three categories show us the fact that they realize a mix between the internal and external environment of the organization, in the following way: the manifestation of the satisfaction risk is related to the way in which from the internal environment signals start towards the exterior and communication bridges are being established. Once the contact between the

two environments is established, the need of accommodation to exterior and then its inclusion in the internal processes of the business comes next, a complete circuit being therefore realized.

The brief browsing of the dangers that may affect an organization's reputation demonstrates us that the image and brand damage may be the cause of any risk's manifestation that the institution may be confronting, so the care for the reputation must be doubled by a proper management of the total risk at an organization level. The enterprisers must take this risk very seriously, because it is a known fact that an organization's impeccable reputation draws a series of unquestionable advantages, from which we highlight the following:

- sThe improvement of the relation with the business partners.

- sProducing a better environment for investments and for the access to the capital.

- fThe possibility of recruiting and keeping the best employees.

- / Drawing the best partners, from the base materials, equipments, technology suppliers

- as well as from the clients. jReducing the penetration and development barriers on the new market. / Guaranteeing the price level for goods and services.

- sMinimizing the threats of some possible litigation and of some severe settlements. 4Reducing the crisis potential.

- / Strengthening the organization's credibility and the partners' trust.

Of course that a good reputation has always been an element of interest for the enterpriser, even though a small dimension of the business couldn't have brought a huge fame by all means. Nowadays an unprecedented acceleration in spreading the information is recorded so that good and bad things are brought immediately to the public's attention. The dangers that once the organization might have considered as having effects on the properties, incomes or employed staff, have today a powerful rebound in the externals' perceiving of the organization's image and they draw after them potential losses from the elimination of at least one from the most profitable ones mentioned above.

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