“Managing Risks” versus “Taking Risks”: Revisiting an Underestimated Distinction between Managers and Entrepreneurs

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Abstract

The catallactic functions within a firm are the same, irrespective of production scale or organization typology. That being said, an “entrepreneurial perspective” projected on inter-/multi-/transnational corporations is just as legitimate, although usually the entrepreneurial element is associated with the “small business” managed by the owner himself. The entrepreneur, having an unmistakable role in the structure of production (still marred by ambiguities in some parts of the business literature), has the same identification data, from “self-employed” (for tax purposes) to “joint stock” companies. Every enterprise has at its core the idea of human action based on resource ownership (the property function), carried out in time (the capitalist function) and subject to uncertainty (the entrepreneurial function). These functions are related to specific business projects that are managed in a monetarily calculated manner in order to acquire profits. This article revisits the basic framework of the enterprise / corporation, placing there the entrepreneurial compound, inextricably linked to risk-taking, to which managerial activity, including risk management, is a complement, not a substitute.

Keywords: entrepreneur, manager, enterprise, corporation, profit, loss, uncertainty, risk.

1.Introduction

Reality has repeatedly proved us that any human activity unfolds in conditions of absolutely unavoidable *uncertainty* and yet relatively manageable *risk*, if using the Knight-ian dialectic. These risks are more or less serious, more

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or less known, easier or harder to avoid. Insufficient knowledge and bounded rationality regarding risks, their imprecise or merely improper assessment, as well as the lack of adequate protection against them will directly affect the final outcome of activity. Risks are regarded as phenomena that arise from the circumstances for which the decision-maker is able to identify possible evolutions / events, and even the likelihood of their production / materialization, however without being able to accurately state which of these events will actually occur.

Assessing and addressing risks proved to be an important emerging driver for a successful business and almost all interest groups connected to modern organizations abundantly refer to it. The more and more complex package of risks with which an organization is confronted became a strategic concern, modelling the most important decisions to be adopted by every undertaking. The enterprise-wide approach forces businesses to take into consideration the potential impact of all types of risks upon all processes, activities, stakeholders, products and services as well. The implementation of a comprehensive approach may result not only in the organizational fears (the “downside of risk”), but also in taking advantage of what is referred as the “upside of risk”.

The present article investigates risk from a perspective that is not enough emphasized in the mainstream business literature: that risk-taking is the decisive feature of market *entrepreneurship* (besides other adjacent aspects such as coordination, innovation, arbitrage) and that un-confusingly understanding the decisive role of entrepreneurship (de-homogenized from other economic/catallactic features/functions) in economic life is the crux in clarifying the true versus false drivers of modern capitalism, especially in the aftermath of a crisis and the spectre of a threatening relapse.

Distinguishing the “ultimate risk-takers” in the economic landscape – the *entrepreneurs* –, via the variety of organizational formats they develop, expand, reduce and eventually foreclose – the *enterprises/firms/companies* –, while adopting economically-informed and monetarily-calculated decisions is of utmost importance in both principled and practical sense. We are living in an epoch where economic freedom is under assail due to invocations of “market failures” and “corrective measures” by governments that finally only exacerbate risk and expropriatedly distort prosperity creation.

The article is organized in four main parts:

- The first part is dedicated to a succinct literature review of risk approaches, identifying, among numerous definitions, the key-features of this

phenomenon: a danger which has a measurable probability of occurrence and, if surpassed, may generate solid gains.

- The second part focuses on what represents entrepreneur, in his unique quality of "creator of firms/enterprises": in the division of labour approach, he is the one receiving the profit, in the managerial approach – the one coordinating the factors of production, in the Schumpeter vision – the one that innovates, while in the praxeological line of thought, he is the one that finally bears the risks within the entrepreneurial project (enterprise) whose originator he is.

- In the third part, it is stressed out that the entrepreneur can delegate competences to the manager(s), for instance in terms of risk administration – managers who only perform technical operations (such as risk avoidance, acceptance, mitigation or transfer operations) –, while the burden of risk remains to be carried by the entrepreneur, who stands to lose his already made investment (own resources), not only future income (such as wage, rent, interest).

- In the fourth and last part, it is underlined that the entrepreneurial process is sometimes altered (with the consequence that the risks are poorly managed) by regulations: legislation that limits the powers of entrepreneurs in favour of managers, restrictions on share-holding, criminalization of insider-trading, antitrust legislation, constraints on mergers and acquisition, labour laws, subsidies, bail-outs, credit facilities, monopoly privileges, etc. – all these interventions in the "free order of markets" end up in generating social welfare decreases.

2. Risk theorizing: a condensed literature review

In the extremely vast economic literature devoted to this topic, various definitions of *risk* can be encountered, thus testifying for the complexity of this term (Markowitz, 1952; Allais, 1953; Kolmogorov, 1956; Tobin, 1958; Savage, 1961; Kahneman and Tversky, 1979; Kaplan and Garrick, 1981; Tversky and Wakker, 1995; Bernstein, 1996; Bewley, 2002; Holton, 2004; Hay-Gibson, 2008; Hurt, 2014; Green, 2016). For instance, the concept of risk is associated with two major streams: (a) a threat that can sometimes be accompanied by some opportunities; (b) an event whose achievement is marked by uncertainty. Still, there is some enduring controversy over the actions to be taken in order to limit the exposure to risk, the "practical philosophy", the principles and doctrines regarding right "risk management". Tightening the perspective, *economically speaking*, risk can be seen as companies' inability to efficiently adapt to the changing circumstances (of time and place).

Bernstein's study, *Against the Gods: The Remarkable Story of Risk* (1996), provides an impressive historical perspective on the evolutions of risk and risk management throughout history, as well as a plethora of definitions. For the limited purpose of the present study, the common sense of risk is much more important than erudite inventories of definitions. Still, much more important than the *specific differences* in definitional nuances is the fact that the *proximate gender* of risk points to a critical entrepreneurial feature. Risk speaks of (a) a danger, (b) accompanied by a probability of occurrence, (c) one that, once overcome, may entail substantial gains. So, risk does not always come along exclusively negative connotations, but, on the contrary, "taking" it might prove quite rewarding for the entrepreneurs who, as argued further on, are "specialized" within the broader societal "division of labour" in surmounting uncertainty and mastering (pure and speculative) risks.

A risk element is any element that has a measurable probability to deviate from the plan. This of course implies the existence of a project. Firm strategies, plans, and programs are elements that allow prefiguration of reality and then confront actual achievements with expected results. In order to achieve the objectives of the company it is necessary to carry out some sets of activities.

Also, the decisions meant to fulfil an envisaged plan are documented by a stock of information, of knowledge. In the spirit of the notorious delimitation proposed by Knight (1921) between the concepts of *risk* and *uncertainty*, the following classification of the (economic) decisions in relation to the degree of knowledge (regarding consumer tastes and production techniques) unfolds:

- *decisions under sure/certain conditions*, where available knowledge allows the decision-maker to determine the exact result of each action;
- *risk decisions* ("first degree uncertainty"), where the available information allows the decision maker to estimate the results for each decision due to the associated probabilities;
- *decisions under the conditions of uncertainty* ("second degree uncertainty"), in which the decision-maker is able, based on available knowledge, to establish, for each decisional alternative, possible outcomes, although no related probabilities;
- *decisions in conditions of ignorance* ("third degree uncertainty"), where the decision-maker has not sufficient knowledge to determine all possible outcomes of decisional variants.

An extremely important aspect for the follow-up of these brief considerations on risk is the fact that the (associated) *odds* / *probabilities* of the

undesired events to happen can be divided into two distinct categories (Mises, 1949): the *class probability* (or frequency) and the *case probability* (linked to the specific understanding from acting persons). The field of application of the former is that of *natural sciences* (governed by *deterministic* causality) and the field of application of the latter is that of the *human action / social sciences* (governed by the "ends-means" *teleological* dialectics).

All that goes beyond the mathematically-expressed class probability and remains in the spectre of probability (in terms of "casuistry") refers to the specific way of reasoning involved in the analysis of historical uniqueness or individuality. It is related, on the one hand, to that kind of understanding employed in *historical* sciences, and it is employed, on the other hand, in facing the *future* configurations of events (i.e., in markets) where non-mechanical understanding is the only appropriate way to address the pervasive uncertainty, which is the very domain of the *entrepreneur*.

3. Risk taking: entrepreneurs as creators of firms

There have been, in the history of economic thought, a variety of attempts to *identify* and *isolate* the role and place of the *entrepreneur* within the social nexus. More or less intuitively, theoreticians and practitioners alike understood that the entrepreneur and the enterprise (and the resources they transform) represent the engine (and the fuel) of the *market economy*.

One route of pointing to the entrepreneurial domain was that of decomposing of human action within the market (and within the division of labour) into a series of specific contributions (economic or catallactic functions), one of the ways of determining / materializing / circumscribing them being the type of income they receive: thus the *worker* bears the "disutility of work", being rewarded with the *wage*; the *capitalist* contributes with its "patience", being rewarded with *interest*; any *owner* of "lendable" goods is rewarded with *rent*; while the *entrepreneur* remains with the *profit*. In reality, the *pure functions* of the entrepreneur, owner and capitalist overlap. These blurred lines, contrasted to clear-cut work explain socialist hate to "parasitic" proletariat-exploiting, profit-making "capitalists".

Other economists argued in favour of the idea that the entrepreneur's task is to *coordinate* all the factors of production in the enterprise – "managerial vision" of enterprises and entrepreneurship, traced back to J.B. Say or J.B. Clark. Others pointed to *innovation* – emphasizing the resourceful role of technologies or ideas, here J. Schumpeter being the leading figure.

However, the most coherent and consistent route to search for the entrepreneurial function could be the one that adopted the *risk-taking* line. The reasons for this are plentiful and the contributions of the *praxeological* line of thought developed by the Austrian School are illuminating (Topan, 2013; Jora, 2013). Although the entrepreneur's contribution looks somehow "residual", it is actually the essence of the whole economic process. Without someone's willingness to bear the uncertainty / take the risks of an entrepreneurial project, the other factors of production remain idle. These are factors of production *for* the entrepreneur who fights the variation in prices between the moment of hiring the factors and the one of the proceeds from the sale of the final goods or services.

The specific offshoot of the entrepreneurial work is the *enterprise*, the *firm*. The fact is that the enterprise portrayed in mainstream economics textbooks is an extremely impersonal representation, an abstraction that removes the investigator from the intuitive reality of the firm – see the excellent collection of fundamental contribution to the theory of the firm edited by Langlois, Fu-Lai Yu and Robertson (2003). The enterprise from these textbooks is either a residue of the *neoclassical* representations (where firms are seen as production functions, each identical and each transforming homogeneous inputs into homogeneous outputs, depending on a certain technical "pattern" known to all), or a product of *neo-institutionalist* re-evaluations (where firms are the result of balancing transaction costs resulting from, on the one hand, outsourced operations in markets and, on the other hand, internalized ones into organizations).

Revisited in the logic of entrepreneurial action, the firm is basically the *project* of a capitalist as entrepreneur, a project where material resources owned by him as well as entrusted by simple capitalists/creditors (third-party relative to the project) are configured and combined calculatedly with services (employees' work) and used, under conditions of uncertainty/risk, for the attainment of ends whose common denominator is *profit*.

4. Risk tackling: the core managerial instruments

In the specialized literature, one can find many definitions for *risk management* (this being a star-concept within the contemporary *business economics*), to be grouped in some broad categories: (a) some definitions associate this process with the preparations undertaken by organizations with respect to responses available in relation to future events affecting the activity (Damodaran, 2010); (b) other ones focus on essential risk management operations, identifying the threat and/or opportunity, the evaluation of the effects

and the adoption of the proper methods to reduce the potential losses and fructify the chances (Bannister and Bawcutt, 1981; Rejda, 2001; Taylor, 2007); (c) other definitions emphasize the minimization of the risk-related costs from potential losses as well as the suitable methods for certain instances (Williamson, 2007; Zhang, 2009; Dionne, 2013); (d) finally, ISO Guide 73 links risks to the stated objectives exhibited by (business) organizations.

It is widely agreed that every managerial team needs to answer some essential questions such as: Which is the most appropriate method to differentiate between business risk and financial risk? Which is the most performing manner to reduce business risks? How to manage a business risk? How to perform the most relevant business risk assessment? Answering these questions is not a very simple task. One of the most sensitive challenges the manager needs to cope with is the typology of risks. Often, in practice, when faced with risks, managers do not simply blame and complain of the potential losses, but try to estimate probabilities of events and magnitudes of hardships, adopting an active position, pointing to the feasible solutions for their problems and choosing, hopefully, the optimal one from the perspective of the organization's objectives and resources. They can't afford to say that "risk management is rather magic than science"; they scientifically confront it (Attar, 2011).

However, in the proposed logic of the present article the focus is not on risk management, but on identifying the level where risk is ultimately assessed and addressed, detail with non-negligible consequences. The fact is that the expression "risk management" induces the idea that the phenomenology of risk belongs primarily to the managerial domain. But this is not quite true. *Teleologically* seen, the *entrepreneur* – the owner of resources and longer-time-preference investor-capitalist – is the ultimate stakeholder – being the true artisan of a business project, a business firm – and *bears* "strategically" the burden of risk (based on his risk appetite, tolerance, responsiveness). And he is only *technically delegating* – to the *managerial* class – the "tactical" or "operational" risk management (involving risk avoidance, acceptance, mitigation or transfer operations), the manager, as his "agent", administering, besides his own personal risks, the patrimonial risks of his "principal".

Therefore, prior to making the apology of "risk management", one should carefully understand the division of labour (for instance, in terms of dealing with risk) between the entrepreneur/capitalist and his mandated manager (Jora et al., 2015). Naturally, the entrepreneur cannot be omnipresent in his company's current activity if this exceeds a certain dimension and complexity. Thus, it

becomes necessary to delegate competences: by virtue of the principle of division of labour, he can improve the ratio between his invested effort and his acquired results, exchanging, in the logic of the comparative advantages, his own monetary resources obtained from the activities where he possesses the best skills for labour services third parties – i.e., the employees, amongst whom there are the (risk) managers. Thus, he can devote himself to "great tasks", without caring about the myriad of small operations. He ends up *bearing* the risks of his business, while *buying* pieces of risk protection.

5. Risk incorporation: division of labour and risk

The architecture of risk-taking and risk-tackling remains unchanged even in the perimeter of the *modern business corporation*, the most adapted business organization to the world-wide markets. Even at this level, affected by legal complicacies the simple dichotomy between the risking entrepreneur-capitalist and the manager-employee stays visible and has subtle societal consequences.

- The *corporate entrepreneurs* are the *shareholders*. They are the ultimate "owners" of the corporation (although in the legal person logic the corporate assets are owned by the incorporated entity itself); they are also "capitalists" because they have accepted to "wait" from the moment they bring in the capital to the one in which they collect dividends; they are the ones who bear the risk of losses (uncollected dividends or dropping value of shares) caused by the unfortunate twists of the markets. The shareholders are the only ones (or at least the first ones) to lose up to the entire capital invested, when the corporation goes bankrupt, not only losing "future gain opportunities" (like managers or the rest of employees that risk being laid-off).

By extending the "risk of loss test", we can see that the holders of privileged shares de-compact from the shareholders (they are not entrepreneurs, but only capitalists, standing closer to creditors), while the holders of non-voting shares are entrepreneurs (even if they are excluded from daily decision-making, they still bear the risks of losing invested capital).

- The *managers* remain the *corporate labour elite*, supplying leadership services (the directors) as well as various functional tasks (i.e., managing risks). Only to the extent they are being granted shares (as participatory incentive driver), they have the quality of entrepreneurs alongside with that of managers (but only in the quantum of their share-holding).

Also applying the "risk of loss test", even if managers are rewarded beyond fixed pay with quotas from earned profit, since losses do not have the same effect

on them in terms of capital exposure, they are not "entrepreneurs". Conversely, creditors that did not require collaterals to their lending act like entrepreneurs for the borrowing corporation.

The proper identification of the genuine risk-takers in the economic life, generally speaking, and in the organizational eco-systemic design is important for understanding the economic process. Those assuming risks facilitate, in their quality of producers of goods and services (complicated processes, affected by innumerable hardships), the living conditions of their fellow customers. Artificial add-ons to the "natural" range of risks (made of both anthropic and non-anthropic elements), for instance by means of erratic and unpredictable public policies or arbitrarily and discretionarily redistribution of risk-safeguards, distort and degenerate the link between the productive entrepreneurs and their suppliers and clients, hence leading to less prosperity in society.

Applied to the corporation, the negative consequences of the minimisation and marginalization of the crucial role of the *entrepreneurial-capitalistic risk-taking and prosperity-inducing* behaviours can be observed by scrutinizing both the intra- corporate and inter- and extra- corporations relationships (Jora and Iacob, 2012a; Jora and Iacob, 2012b).

- *Intra-corporation phenomena*. Given the "*property* - *control*" separation – that is installed by default in corporation between *shareholders* and *directors/managers/employees* –, when legislations are so set and enforced so as they limit the powers of the first category (as ultimate owners of the corporation's assets) to oversee and overrule the decisions of the second (as delegated operators of the corporate assets), an obvious bias insinuates into the organization: a relatively greater amount of relatively poorly managed risks tends to be taken by the second group at the expense of the first one. Finally, all this happens to the detriment of the social wealth, in a world where resources are scarce and need to be harnessed to the benefit of the consumers and not lost in careless undertakings. Imbalances in the relation between responsible risk-takers (shareholders) and their over-empowered delegates (managers), fuelling *moral hazard* behaviours in the corporate governance, are "legalized". Restrictions on share-holding, criminalization of insider-trading, antitrust legislation, constraints on mergers and acquisition, labour laws, etc. do end up in reckless rather than responsible risk-taking.

- *Extra-corporation phenomena*. As in the case of intra-corporation distortions, the interventions in the free competitive economic game through various legislative/policy drives create artificial "carrots" and "sticks" that end

up in misbehaviours also translatable in deviations in the risk assessment and, finally, risk management. Both the "infringements" against certain corporations (i.e., via regulations that establish standards, which, despite the fact that are nominally the same for all, are, in reality, asymmetrically costly) and the "inducements" for others (i.e., via subsidies, bail-outs, credit facilities, monopoly privileges) lead to misinterpretation of risks, to moral hazard, conducive to malinvestments that tend to become recurrent and to continuously erode the social stock of wealth.

6. Conclusions

In a free market economy, any individual can become an *entrepreneur* if he relies on his own ability to reasonably and informedly anticipate future market configurations better than his fellow citizens and if his attempts to act at his own risk and on his own responsibility are approved by consumers. The entrepreneurs are the *driving force* of the economy. By trying to maximize their own profit, the entrepreneurs try to anticipate the consumers' most urgent needs and strive to satisfy them.

In order to deliver their social mission, the entrepreneurs create firms or participate in the functioning of great corporations by adding their unique skill of *overcoming uncertainty* and *transforming risks into profits*. And in doing this, they take the ultimate residual risks, while hiring trained specialists in mastering the manageable dimension of risk. The dedicated managers instruct entrepreneurs how to use hedging, insurance and/or diversification as basic routes of risk management.

Misshaped interventions in the functioning of the market economy, by means of regulations that generate asymmetries among different categories of stakeholders, and induce moral hazard (reckless use of resources when costs are forcefully distributed to third parties while benefits are coercively appropriated by some), create a *perverted propensity*. On the one hand, there is the exaggerate risk-taking at the expense of others; on the other, exacerbated aversion of those "others".

Understanding the dynamic of risk in the market economy starts with recognizing the true character that confronts it – the *capitalist-entrepreneur* –, transforming threats into opportunities *for the benefit of the society as a whole*. The debates about risk management are secondary in documenting the phenomenology of risk, but nonetheless useful in an international economy

where globalization facilitates both prudent exposure to hazards as well as contagion of escalated liabilities.

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