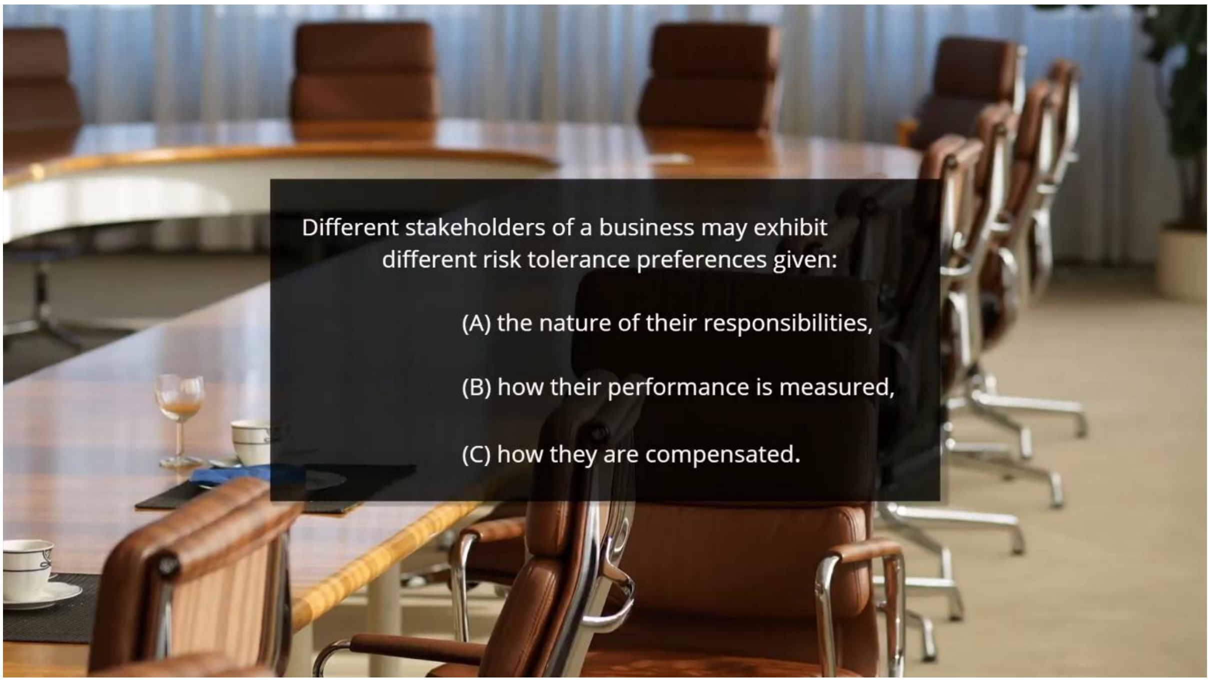
M4L16. Risk Tolerance in Organizations

Slide #1

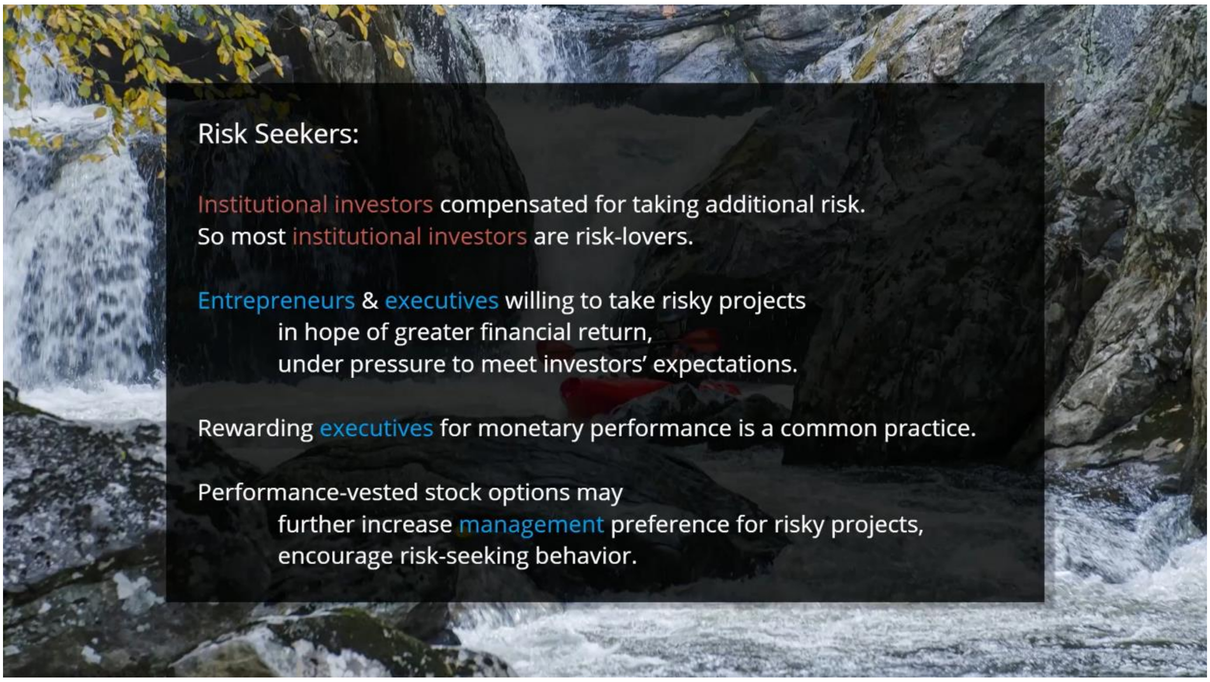
In this topic, we will discuss the different risk tolerances of the different stakeholders in an organization.

Slide #2



Different stakeholders of a business may exhibit different risk tolerance preferences given the nature of their responsibilities, how their performance is measured, and how they are compensated.

Slide #3



As most institutional investors expect to be compensated for taking on additional risks, they may acquire investments of higher risk.

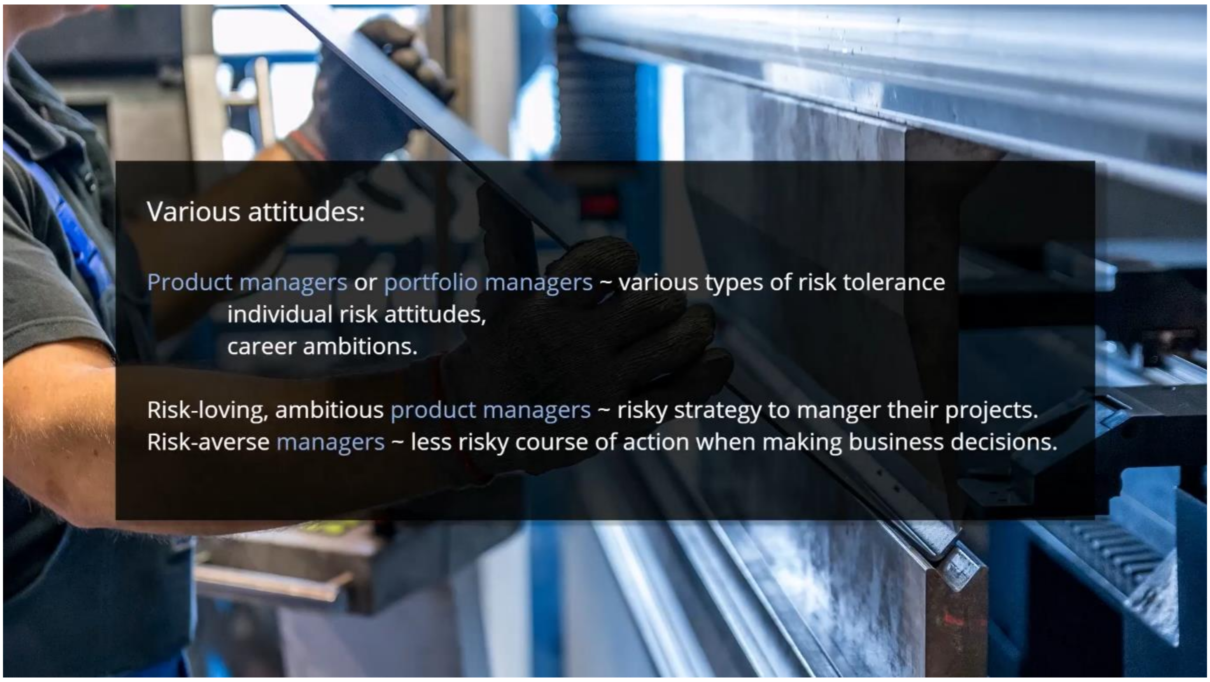
So most of the institutional investors are risk lovers.

Risk seeking may also describe entrepreneurs and executives who are willing to take risky projects in hopes of a greater financial return as they are under pressure to meet investors expectations.

Also, rewarding executives for monetary performance is a common practice in the corporate governance code.

The performance vested stock options may further increase management preference for risky projects and encourage risk seeking behavior.

Slide #4



Product managers or portfolio managers exhibit various types of risk tolerance behaviors depending on individual risk attitudes and career ambitions.

Risk loving, ambitious product managers prefer risky strategies to manage their projects, while risk averse managers take a less risky course of action when making business decisions.

Slide #5

Most employees are risk averse as they seek long-term job security.

The tendency is more obvious in the stable industry, such as oil or gas, healthcare, and so on.

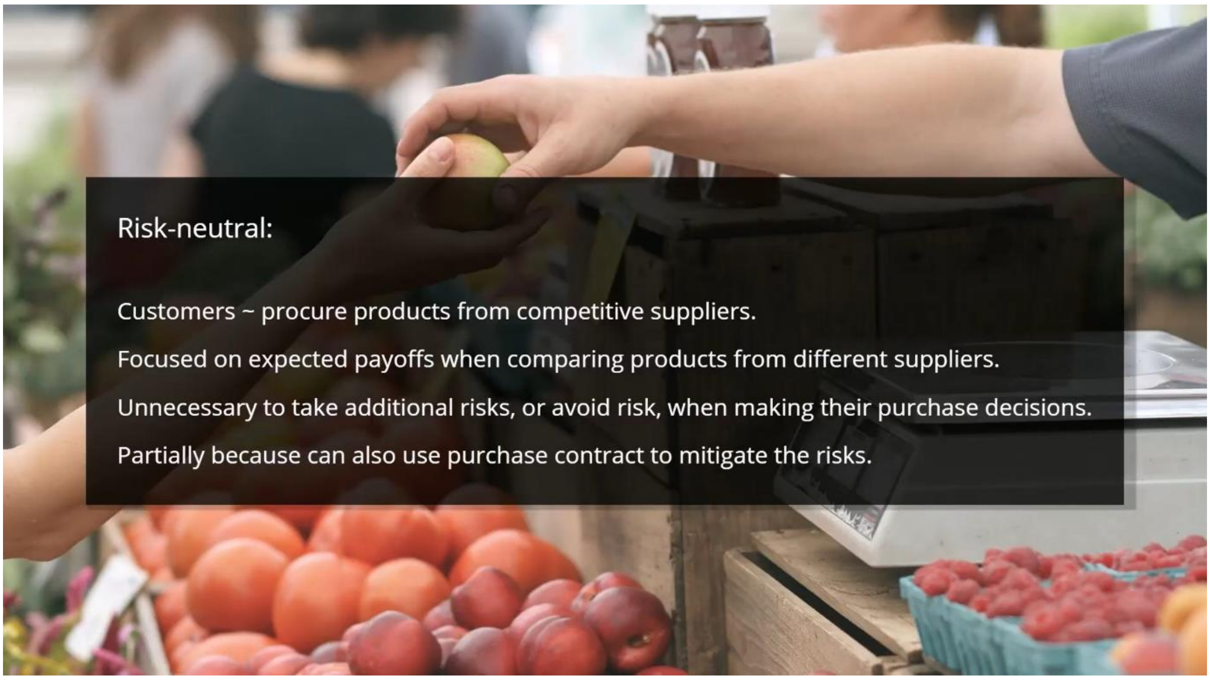
But people in growing industries such as high tech or financial fields may have the incentive to take more risks.

Suppliers on the product value chain tend to be risk averse as they need to deliver promises.

They follow the principle of promise low and deliver high.

Suppliers would avoid the decisions that put them at the risk of not meeting customers' expectations.

Slide #6

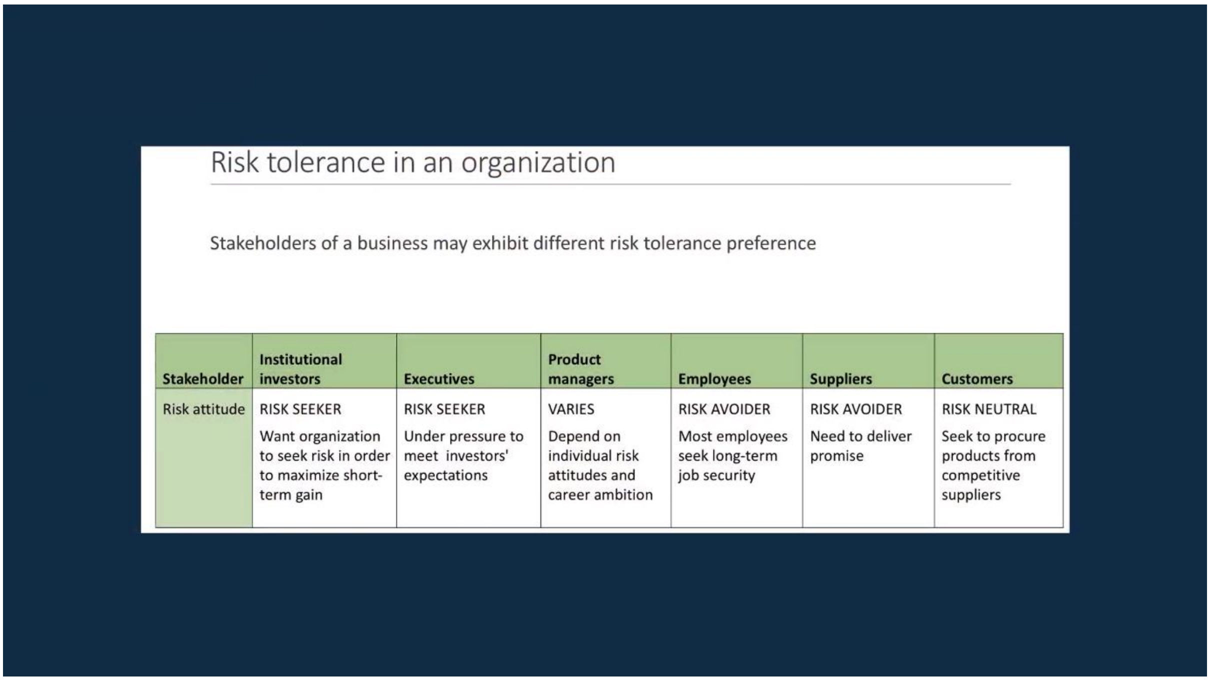


Customers are risk neutral by seeking to procure products from competitive suppliers.

Customers are focused on the expected payoffs when comparing products from different suppliers.

It is unnecessary for customers to take additional risk or avoid risk by making their purchase decisions, partially because they can also use the purchase contract to mitigate the risks.

Slide #7



Risk tolerance in an organization

Stakeholders of a business may exhibit different risk tolerance preference

Stakeholder	**Institutional investors**	**Executives**	**Product managers**	**Employees**	**Suppliers**	**Customers**
Risk attitude	RISK SEEKER Want organization to seek risk in order to maximize short-term gain	RISK SEEKER Under pressure to meet investors' expectations	VARIES Depend on individual risk attitudes and career ambition	RISK AVOIDER Most employees seek long-term job security	RISK AVOIDER Need to deliver promise	RISK NEUTRAL Seek to procure products from competitive suppliers

This table summarizes the various risk attitudes of the various stakeholders of an organization.