Çevik V. A. (2020). The concept of key person risk in enterprises. Gümüşhane Üniversitesi Sosyal Bilimler Enstitüsü Elektronik Dergisi, 11(Ek), 27-33.

The Concept of Key Person Risk in Enterprises[1]

İşletmelerde Kilit Kişi Riski Kavramı

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Abstract

Until today, being a key employee in organizations was very well received. Even in personal development books and marketing books were described how to become a key person. However, in the recent years, the problems that emerged after the key employees' getting in to trouble or leaving their jobs have been financially difficult for the enterprises. In this context, the investigation of the risk of key persons has become important since there has been little research on this issue in the literature and many enterprises are exposed to the risk of key people. In this study, the smallest number of literature and companies' recent crisis in the last days were researched and key risk factors were analyzed. This study has been investigated with case study method and it has been revealed that the extraordinary movements of the senior managers or other important employees of the enterprises or their separation from the enterprises affect the enterprises.

Keywords: *Key Person Risk, Key Employee*

Öz

Günümüze kadar organizasyonlarda kilit çalışan olmak çok iyi karşılanmakta idi. Hatta kişisel gelişim kitapları ve pazarlama kitapları nasıl kilit kişi olunuru anlatıyordu. Ancak son yıllarda kilit çalışanlarının başlarına kötü durumlar gelmesi veya işten ayrılmasının ardından ortaya çıkan problemler işletmeleri finansal açıdan oldukça zora sokmuştur. Bu bağlamda kilit kişi riskinin araştırılması, literatürde daha önce bu konu hakkında çok az araştırma yapılmış olması ve çok sayıda işletmenin kilit kişi riskine maruz kalması nedeniyle önemli hale gelmiştir. Bu çalışmada az sayıdaki literatür ve şirketlerin son günlerde kilit yöneticilerinden kaynaklı yaşadıkları krizler araştırılarak kilit kişi riskleri analiz edilmiştir. Bu çalışma vaka inceleme yöntemi ile araştırılmış olup, işletmelerin üst düzey yöneticilerinin veya diğer önemli çalışanlarının olağandışı hareketlerinin veya işletmeden ayrılmalarının işletmeleri etkilediği ortaya çıkartılmıştır.

Anahtar Kelimeler: *Kilit Kişi Riski, Kilit Çalışan*

Araştırma Makalesi [Research Paper]

JEL: *L20, M10, M54*

Submitted: 28 / 01 / 2020
Accepted: 31 / 12 / 2020

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Introduction

Whether small or large, every company has some risks. One of these risks is the key-person risk that is seen more and more in recent years. Today, with the development of media and communication, the movements and remarks of the managers or senior staff of the companies can be monitored more easily. These companies are important for businesses, resigned unexpectedly, bad business-like bad jobs that will affect the reputation of the business, such as the loss of life to make extraordinary developments affect companies financially. The latest example of the global business world, Carlos Ghosn, CEO of the Renault-Nissan-Mitsubishi partnership, has been arrested in Japan on charges of showing his personal use of the firm's earnings and of lying about his income. In the process of changing economic conditions and business cycles, management quality is ensured by the intervention of internal and external corporate governance mechanisms. Supervision of the board of directors, intervention of major shareholders, discipline from debt markets, competitive pressure in product markets and management behavior. In the first weeks of 2011, Apple's CEO, Steve Jobs, again, after obtaining a sick leave, Apple's stock prices fell by 8.4%, and this has reduced the value of the company billions of dollars. At the same time, TRYG share price rose by 4% in the hours following the resignation announcement by Stine Bosse, CEO of the Danish pension fund, TRYG. As it can be understood from these experiences, it is seen that CEOs affect the valuation of public companies and that having right or wrong CEO can make billions of value differences (Egholm & Nordström, 2011).

1. Literature Review

In the past, there has not been much research on key person risk. In the literature, the relationship between the chief executive officer (CEO) change and firm performance has been studied extensively (Parrino, 1997; Puffer & Weintrop, 1991). Denis and Denis (1995) researched the causes and impacts of the CEO's change, and showed that, compared to traditional retirement, the CEO's change was typically caused by low firm performance. Dherment-Férère and Renneboog (2000) analyzed the share price responses to changes in senior management in their work. Cools and Praag (2003) researched the impact of the forced impeachment of senior management on the company and found that the separation of CEOs had a negative impact on current and future firm performance. Ardiphine (2015) analyzed the risk of enterprises in case of loss of key persons. Jaitly (2016) in his book of Operational Situation Determination of Mutual Funds gave information about key person risk in investment funds, disaster recovery and business continuity. Key person insurance has attracted increasing attention all over the world, as the death of a significant person or a major accident will cause considerable damage to the company. The key man insurance, also called key person insurance, is an important form of business insurance. It is an insurance policy that is applied by an enterprise to protect from the loss of material that may be caused by the death or limited capacity of a very important member of the business (Nie et al., 2018). Key person insurance is required if a sudden loss of a key manager has a significant negative impact on a company's operations. In recent years, a significant number of insurance companies have begun to offer key person insurance policies. This key person may be a manager, a researcher working in a laboratory, a "nose" working for a perfumer or a footballer (Axa, 2018).

2. Method

Case study methodology was used to examine the effects of key person risk on companies. Since the natural form of case study research is the most appropriate method to study the role of contextual variables (Dhanesh & Sriramesh, 2018). Gillham (2000) explained that case analysis can be performed in the following cases;

Must be a humanitarian activity associated with real life,

Be able to study and understand only one subject,

Must be present in the current environment and time zone,

It should be difficult to draw the exact boundaries as it is in its own state,

The case analysis method is a comprehensive research strategy that is particularly relevant in the emerging research areas when asked "how" and "why" questions about current events. (Yin, 2017, p. 44).

The research questions are;

What is the key person risk?

How does key personality risk arise?

In this study, the examples of companies that face key person risk in recent years have been analyzed and ways of reducing these risks have been investigated.

3. Concept of Key Person Risk

Intellectual capital (also intangible assets or information assets) consists of employees' competencies, the institution's relationships with customers and other partners, its culture, values, image and management operations (Jääskeläinen, 2011).

According to Kucharčíková (2011), human capital is the human factor in the institution; combined intelligence, skills and expertise that give the organization its distinctive character.

The meaning of the key person in the dictionary is the individual whose knowledge, creativity, source of inspiration, reputation and / or skills is critical for the survival or growth of an organization and the company is damaged if it is lost (Businessdictionary, 2019). Key people are defined as managers and / or employees who are critical to ensuring the success of the enterprise and the continuity of the enterprise (Hassett, Reynolds, & Sandberg, 2018). Key human risk arises when an individual's presence, absence or behavior adversely affects a firm's value (The Economist, 2019). This risk arises when someone in the office is the only intellectual capital and the only one who has knowledge or is the owner of key organizational relationships (Hall, 2019). Keeping key employees has also emerged as an important and related dimension of the procurement process. As the technologies, capabilities and expertise of the purchased companies depend on key individuals, managers have repeatedly emphasized the importance of holding key person (Ranft & Lord, 2002). The risk of key person often arises when companies go public (Hill, 2015). Business continuity begins with key human risk issues - disease, injury, incapacity, death, resignation of key people, and how each core business function works (Jaitly, 2016).

The key man risk is not only applicable to the manager's senior employees. It also extends to other people who may be solely responsible for certain critical functions, for example, as the head of software development in computerized trading systems, some funding sources may be CEOs and in some cases may be CFO or general manager (COO). China's technology giant Huawei's global finance officer (CFO) reduced Huawei's stock indexes in China and Hong Kong following its arrest for alleged infringements of US sanctions (Sin, 2018). A Canadian cryptographic currency exchange said that after the CEO died suddenly, he would not pay back at least $ 250 million to his customers. Quadriga CX told the court that C.E.O. was the only person who knew the security keys and passwords needed to access the funds (Zraick, 2019).

3.1. Recognition Of Key Person Risk

The success of a company depends on many areas. All areas must be active for the entire company to be successful. Employees are important resources in the company's activities. Prediction and management of personnel-related risks is an important part of business activities. Personnel risks refer to threats that may be to employees of a company. These risks may arise from the company or from external sources. On the other hand, personnel also pose a risk for a company.

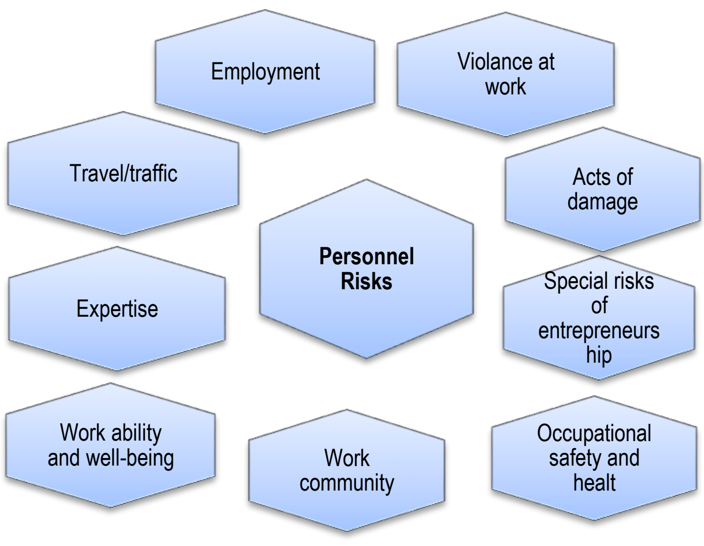

Figure 1. Personnel Risk Factors Source: (iosh,2002)

Personnel risks cover large areas, so managers need to have in-depth knowledge (Figure 1).

According to Institution of Occupational Safety and Health (2002) and Jääskeläinen (2011), key employees consists of the following factors:

Competencies

- Knowledge and skills, expertise, professional skills or training
- Ownership, financing
- Customer, purchasing or subcontracting contacts
- Knowledge and experience of the use of machines, devices, working methods or software

Person-specific properties

- Long-term experience
- Managerial and leadership skills
- Negotiation and sales skills
- Language skills
- Co-operation and group work skills
- Social skills
- Creativity
- Motivation
- Proactiveness
- İnitiative

The news of the death of Steve Jobs has dropped the Apple stock price in Frankfurt by more than 5% in 2011(Kollewe, 2011). The company's shares were down 9% after Snap's CEO announced the resignation after only eight months after taking office (Kelleher, 2019). Tesla stocks dropped 9 % after CEO Elon Musk drank in a weird video of marijuana and whiskey, and two high-level executives suddenly announced they had left the company (Eisenstein, 2018). Renault of France's stock price fell almost 10% after news Carlos Ghosn, CEO of the company established by Renault-Nissan-Mitsubishi, was arrested in Japan over suspected financial violations (Winton, 2018). Twenty most valuable firms in the world including Amazon, Berkshire Hathaway and JP Morgan Chase, are considered to have key person risk. It is estimated that 66% of the firms in S&P 500 will suffer economic damage if an unexpected event occurs to their general manager or other top executives (The Economist, 2019).

When assessing whether a company has a key person risk, the following six areas can be analyzed (Harter, 2017; Pratt, 2009):

3.2. Management and Leadership Skills

In order to determine the existence and importance of the key person risk level, human resources experts aim to measure the impact of the key employee on the company by performing performance assessments and interviews with key employee and other employees in the company.

3.3. Suppliers

Business relations with suppliers can sometimes be linked to one person. A key employee can obtain lower prices or more specific products than the market. More appropriate supplier terms provide a company with a lower input cost that positively affects a company's profitability. Relations with suppliers can be largely dependent on a person. A key person can obtain extremely cheap or more specific products from suppliers. More appropriate supplier terms provide a company with a lower input cost that positively affects a company's profitability.

3.4. Customers

Communication with customers in organizations can be largely dependent on a person. Customers can only buy goods or services from a company because they have a personal relationship with one person in the company. The company's customer portfolio can be on one person's list.

3.5. Innovation

A person in the company may have a unique ability to innovate in the products to be produced. For companies in the technology sector or other sectors of significant technological innovation, a key person to understand the direction of movement of industry or products can be important.

3.6. To Obtain Debt or Equity

Employees with a unique ability to find loans or equity can be present. In some cases, a person within a company may have the ability to increase additional equity through a large potential investor network. Similarly, if a person is responsible for collecting debts and cannot be changed, the risk of a key person may be exposed to the company's ability to continue.

3.7. Employee Engagement

Employees who are important to the company's operations may be loyal to a particular person. If the key person leaves, loyal employees can leave. In some smaller companies, there may be a strong loyalty between a company founder or leader and other employees. This loyalty can cause a large number of employees to leave if the founder or leader leaves the company. The effect of losing a key person, profitability, response time, productivity, image, reputation and trust can be felt in all success factors. As the remaining personnel need to spend more time to grasp the consequences that the key person can do instinctively, the deteriorating process will increase the correction times. Because of their inexperience, they will make preventable mistakes and reputation, image and trust may be bad as a result. It is inevitable to lose key people. He can get a new job, retire, get a long-term disease, or die unexpectedly. However, businesses may take steps to prevent them from being exposed to this risk before the crisis begins (Jones, 2013). Key human risk is manifested in three ways (The Economist, 2019);

The most risky is that a defective individual gains absolute power because he controls the voting rights in the management of a company. As in the case of Facebook, Mark Zuckerberg's size, but more effective than the subordinates or a reliable board to assign a bad situation has emerged. Since July, the share price has fallen by 37%, investors have felt insecure. The second risky situation, even if it is stated that the management of a firm is very complex, only one person can continue to do the work. As in the case of Renault, Nissan and Mitsubishi, the company could suffer damage to the CEO. The most hidden key person risk is, when a boss is perfect in his job. Apple's CEO Steve Jobs lost his life worried investors.

Conclusion

The leaving of a key employee from work does not only mean the loss of the work itself, but also a loss of sales, credit and growth opportunities. When an employee leaves the job temporarily because of illness, injury, family problems or military duty, the important tasks of the enterprise become even more complicated (Ardiphine, 2015). Businesses are successful according to the degree of employee engagement and dominance of the company. However, the fact that the employees are on the brink of being indispensable may have negative consequences for the company in the following years. Key man can be the founder of a company and are therefore most likely defined as managers who may be more integrated into their value; thought leaders in their industries; key strategic knowledge and importance; or have the ability to create a proven value. Asset managers, software companies, and large-capital banks are the sectors with the highest key risk, given the intensity of high-value CEO's considered to be very important for their business (Green, 2018).

Employees are an important success factor for many modern organizations. However, employees' personal accomplishments or productivity typically do not belong to an organization. As a result, separation of key employees can have negative effects on intellectual capital, which can affect an organization's productivity.

One way to overcome the risk of key people is to ensure that more than one person in your office has the necessary skills to do any task, including any secret emergency information needed to do the job. Cross-training gives your organization a back-up plan in case of any problems or long-term depth. In addition, cross-training is a critical aspect of successive planning, such that when an organization rises in its ranks, it must have a broader vision of the organization. Cross-training can help to create knowledge and vision (Hall, 2019).

If the key person risk management is done correctly, the continuity and smooth transition of the company's activities will be ensured. The most important risks of the enterprise should be determined in order to minimize the risk of key persons. The key solution to the risk of human addiction is to identify and document the critical information of the organization. Organizations need to focus on cross-training and sequential planning to enable other employees to perform and perform the same tasks as a key official. No employee should be indispensable. A well-managed company never depends on one or several people's performance.

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