Appropriate Risk Behaviour for Rapid Growth Entrepreneurs

Dr Lionel Boxer, Adjunct Research Fellow
Royal Melbourne Institute of Technology
Centre for Management Quality Research, Business Faculty, 112-3-21, Melbourne, Victoria, 3000, Australia
Tel: +61-3-9925 1406 email: lionel.boxer@rmit.edu.au

Track: Developing Entrepreneurial Behaviours

Type of Paper: Refereed Research Paper

ABSTRACT

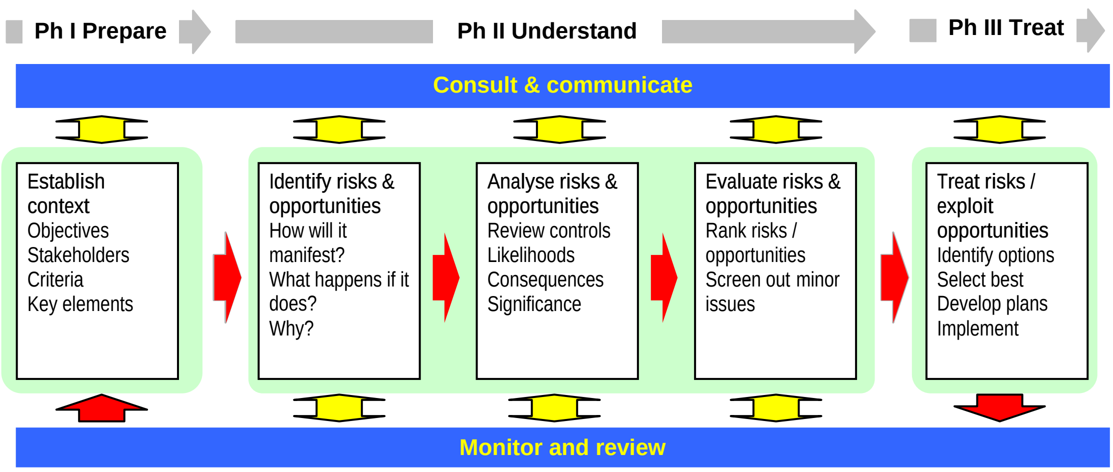
Regardless of whether a small and medium enterprise (SME) is public, private, or other, risk is inherent in any undertaking. Blombäck and Wiklund (1999) have shown that rapid growth entrepreneurs engage in specific risks and avoid others. That is, rapid growth entrepreneurs are selective at what risks they accept. The challenge then is to be able to effectively manage these risks.

All organizations – even multinational corporations – are ultimately composed of elements that may be viewed as SMEs. Hence, the approaches used by large organizations to manage risk might well apply equally to smaller organizations. This concept is explored and it is suggested that once the specific context of a SME is understood, risk management becomes a matter of applying a common formula.

This paper is written for those entrepreneurs interested in optimizing the risk they accept while pursuing rapid growth. By understanding the process at the core of the pursuit, context will become apparent, risks easy to define, analyze and quantify, and measures commensurate with those risks will naturally follow to efficiently and effectively manage risk.

Keywords: Risk, prevention, control, management

Free
Risk Management Primer
http://intergon.net/RiskMgtPrimer.pdf
(click)



INTRODUCTION

This paper explores the challenge of managing risk in a small and medium enterprise (SME), particularly in a rapid growth phase. It then proposes a process to effectively manage risk in an efficient and effective way suitable to a SME in a rapid growth phase.

Risk is defined by Standards Australia (2004) as: “the possibility of something happening that impacts on your objectives”. It is the chance to either make a gain or a loss. It is measured in terms of likelihood and consequence.

Regardless of whether a SME is public, private, or other, risk is inherent in any undertaking. Blombäck and Wiklund (1999) have shown that rapid growth entrepreneurs engage in specific risks and avoid others. That is, rapid growth entrepreneurs are selective about what risks they accept. The challenge then is to be able to effectively manage these risks.

All organizations – even multinational corporations – are ultimately composed of elements that may be viewed as SMEs. Hence, the approaches used by large organizations to manage risk might well apply equally to smaller organizations. This concept is explored and it is suggested that once the specific context of a SME is understood, risk management becomes a matter of applying a common formula.

This paper is written for those entrepreneurs interested in optimizing the risk they accept while pursuing rapid growth. By understanding the process at the core of the pursuit, context will become apparent, risks easy to define, analyze and quantify, and measures commensurate with those risks will naturally follow to efficiently and effectively manage risk.

OVERVIEW OF THIS RESEARCH

A general understanding of dealing with risk management has been developed by the author through the development of business management systems for a wide variety of organizations ranging from family business to multinational corporations. To augment this, literature has been reviewed and SMEs have been observed to determine a generic process. There is also a degree of anecdotal reflection to enable the paper to flow and convey ideas in a meaningful and thought provoking way.

In subsequent sections, the risk related issues present in SMEs will be explored. This will be followed by a discussion of various approaches taken. Finally, a generic process for managing risk will be explained.

RISKS TAKING BY A RAPID GROWTH SME

Blombäck and Wiklund (1999) have found that rapid growth SMEs (RGSME) take different risks than other firms. These are summarised in the following sub sections. The common factor appears to be the entrepreneur’s perception of being in control of the risk.

Avoid Uncontrollable Pure Financial Risk

There is a reluctance to take pure financial risks. That is, the entrepreneur uses liquidity at their disposal for investment in the RGSME or leaves it poised to be rapidly applied to an opportunity that arises. Rather than purchasing opportunity specific resources as long-term assets, such direct process related requirements are leased as a short-term expense related to the opportunity. Perhaps the fear of losing control of cash flow motivates this behaviour.

Accept Controllable Strategic Risk

It appears that a RGSME entrepreneur prefers risk related to existing or known situations. There is reluctance to go in dramatic new directions with a preference for acquisitions, diversification and geographical expansion. Establishing joint ventures with those experienced in the area, while ensuring majority-ownership enables the RGSME entrepreneur to explore less certain opportunities. The less certain they are about new directions the less likely they appear to be to invest financially. That is they prefer alternate arrangements.

Accept Controllable Operational Risk

Rapid growth creates rapid demand for key personnel and key resources. SMEs by nature have limited resources, but a RGSME is faced with an additional risk that their expansion will put pressure on a few individuals. These key players may realise alternate employment opportunities with less stress, equipment may breakdown, or material may become scarce. As such, alternate and short term capacity of people, equipment and materials needs to be sourced.

Avoid Social Risk

There appears to be a preference for long-term trust-based relationships with customers, suppliers and workforce over acceptance of social risks. This appears to be consistent with Ritchie and Brindley (2000), where it is suggested that there is an increasing tendency for building flexible alliances at speed, relying on what could be referred to as pre-established long-term and trust-based relationships. However, where necessary, RGSME entrepreneurs will reluctantly venture into new social situations to achieve their goals.

Limit of Aggregate Risks taken by a RGSME

When undertaking rapid growth, an entrepreneur will endeavour to remain in control of situations and avoid risks that are out of their control. However, if risk management is introduced to provide a greater range of control, the spectrum of risk that the RGSME may take could be expanded. In fact, informal risk management may be the cause of the reluctance to engage in pursuits that appear beyond what the RGSME is comfortably able to control. That is, how else would an entrepreneur determine a risk that should be avoided if there was not some sort of risk management taking place? However, how does informal risk management limit possibilities?

It is suggested here that an entrepreneur operating a RGSME may broaden the scope of risks taken if a formal risk management approach were undertaken. Such an approach would need to be robust to the degree that entrepreneurs would achieve confidence in their ability to control the expanded range and quantity of risks.

DISCUSSION OF APPROACHES TO LIFE AND OTHER PURSUITS – THE CASE FOR RISK MANAGEMENT

There is great variation in how people behave and approach their lives and pursuits. Two extremes of this continuum are explored in the following sub sections.

She'll Be Right Mate

The Australian colloquialism *she'll be right mate* implies that there is no need to plan, because some capability to resolve problems, an act of altruism, or even luck will neutralise all unforseen disasters effortlessly. It may be that Australian – and perhaps other – entrepreneurs are influenced by this philosophy. Some entrepreneurs find it necessary to challenge others, who may perceive it their right to career aimlessly to uncertainty (Boxer 2003).

Entering into a pursuit with no concern for, or awareness of, the variation of what will be received is a way of doing business for some people. One CEO commented after completing an internal quality auditor course, "Australia is the dumping ground for the rest of the world's mistakes because they know we do not understand variation". This CEO went on to surprise his international suppliers during a subsequent visit by auditing their processes and instituting and enforcing stricter specification. In short, this CEO developed an understanding of, and appreciation for, variation.

While Deming's (1986) insistence that variation requires control may be widely understood, what is far less prominent is Kinsey's observation that human variation is far wider than generally perceived and accepted (Khun 1954). Risk is caused by variation, not just in processes, but in people. It is foolish to assume an arbitrary authority that one can know with certainty what people are going to do; "human stupidity" (Cipolla 1987) can undermine one's progress. Sir William Slim (1957), then Australian Governor General explained to the Australian Institute of Management, "phenomenal expansion … holds perils as well as promises. Ill directed, it will either collapse in ruin on itself or, losing its way, bring more in human misery than in happiness" Slim recognised the need to lead people to avoid variation. It is suggested here that little changes in human nature; certainly there are many more recent publications about leadership and variation (just do an internet search on Motorola's Six Sigma), but people remain what they are.

Having no concern for variation creates either a sloppy product or an enormous amount of work for clerical and production staff. Often the massive effort that is undertaken by caring individuals is concealed by and costs offset by people being drawn in to help as a repayment of favours (likely the reciprocal to a previous disaster.) This is a hidden cost that is a manifestation of any risk. There must be a better way.

P.P.P.P.P.P.

The Australian Army colloquialism *pppppp* or *prior planning prevents pretty poor performance* reminds those who need reminding that failure to plan will result in failure to perform. It reinforces the message that superior planning will ensure superior performance, because the act of superior planning foresees risks that might occur and puts in place measures to prevent the occurrence of those risks or adverse manifestation if they do happen to occur. In many ways superior planning is what risk management is about.

Engaging in superior planning is the first part of the process, which is followed by superior execution. However, superior execution is facilitated by superior planning, because resources will have been identified and allocated at appropriate steps in the process. With these resources in place, plans are followed and outcomes emerge from the process in the form planned for. Of course, nonconformities do occur from time to time, but these can be reliably contained, resolved and their repeat prevented by the quality system (Standards Australia 2000) of the SME.

Being convinced that variation must be controlled to avoid manifestation of risks, it is necessary to determine what risks need to be controlled and the specific parameters (those varying factors that require control) relating to those risks identified. The following section presents a risk management approach.

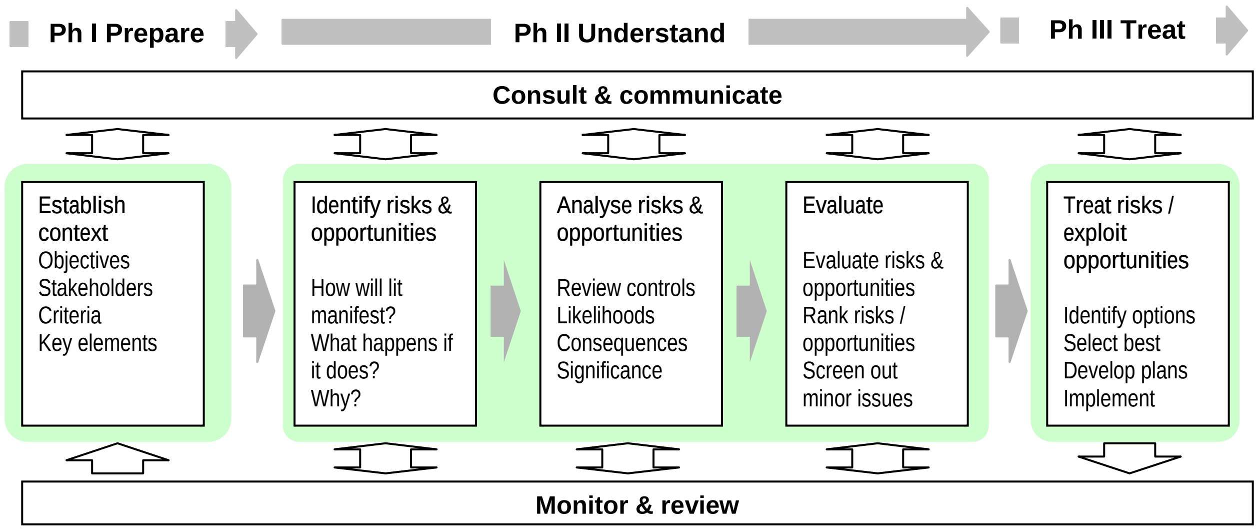
RISK MANAGEMENT APPROACH TO DEALING WITH RGSME RISKS

As in any pursuit, it is wise to manage the inherent risks (Standards Australia 2004) in the process of operating a RGSME. Before dealing with risks, first understand the context of the RGSME. This requires consideration of various issues and how they manifest themselves in the individual organization. From that, individual risks can be identified, analyzed and evaluated so that a treatment plan can be established, implemented and monitored. The full spectrum of risk management is beyond the scope of this paper, but the overview provided here will contribute to a better business management process. Kirytopoulos, Leopoulos and Malandrakis (2001) suggest that risk management enables a much more realistic view of what can be expected.

Intergon (2006) provides a risk management primer based on AS/NZ4360: 2004, which summarises the various steps to risk management. By exploring the approach specified in AS/NZ4360: 2004 and reflecting on the various steps, it becomes clear that robust risk management enables entrepreneurs to gain understanding over a broader range of risks. With that knowledge, entrepreneurs can better select which risks to take and then determine appropriate measures that will provide them with control over those risks taken.

Risk management is conducted following a process similar to that in Figure 1. There are three phases involving preparation, understanding and treating risks. This process is most effective with consultation and communication.

Figure 1. Risk Management Process as a Linear Activity



Ph I - Prepare

It is necessary to determine the context in which risks will be managed, that is what activities go on in the RGSME in which risk is being managed. As shown in Figure 1, you do risk assessment in the context of your goals. Identification and validation of your goals is done first.

Then understand your context (to which the risk management process is to be applied) in which your organization operates through a structured analysis of the process your organization undertakes. From this define the parameters within which the risks to your outputs are to be managed. Context needs to be understood in terms of these considerations:

- strategic
- organization and
- risk management

That is, the relationship between the organization its environment needs to be understood. Using a structure such as strength weakness opportunities threat (SWOT) analysis (Humphrey 2005) or strengths, opportunities, aspirations, results (SOAR) analysis (Stravos, Cooperrider and Kelly 2003) that need to be understood include:

- financial
- operational
- competitive
- political (public perceptions / image)
- social
- client
- cultural and
- legal

From the context determine the scope for risk management, which needs to provide understanding of:

- the organization
- its capability and goals
- objectives and
- strategies.

Ph II - Understand

Understanding risks involves three distinct steps, identification, analysis and evaluation.

Identify risks

Rigorously identify the risks most likely to impact your outputs and the **sources** and **impacts** of those outputs. Risk treatment strategies will be determined based on these sources and impacts.

Analyse risks

Identify those controls currently being used to deal with the risks identified in the previous step and assess effectiveness. With this assessment, use a risk analysis tool to analyse the risks in terms of likelihood and consequence. From this analysis determine the risk intensity.

Evaluate risks

As the entrepreneur (being the person who has respponsiblity for outcomes being achieved and the authority to install preventive measures), ask yourself whether or not current risks are acceptable or unacceptable. Document the record of how this decision was made and by who it was made. Acceptable risks are to be monitored and periodically reviewed to ensure it remains acceptable. Unacceptable risks are to be treated as determined in Ph III

Ph III - Treat

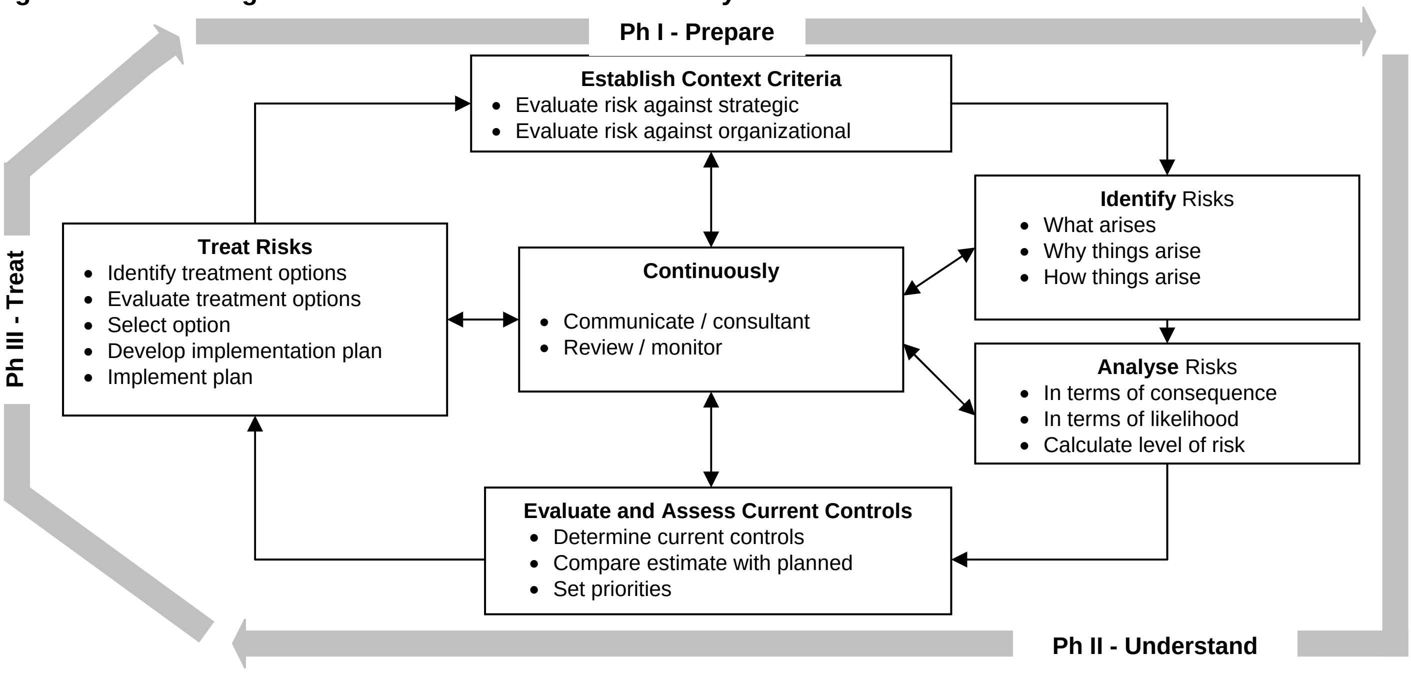
Determining an appropriate treatment involves preventing situations from occurring or correcting (or reacting to) situations that have occurred. **Sources** identified indicate the need for preventive treatments to take place, while **impacts** indicate reactive treatments.

The following categories of treatments can be applied:

- Discontinue the activity that generates the risk
- Reduce the likelihood of occurrence
- Reduce the consequence of occurrence
- Transfer the risk
- Retain the risk

With consideration of cost and effectiveness develop potential options according to the treatment strategy selected. Document the responsibilities, implementation timetable and monitoring for each strategy. Repeat the understanding phase for each option. As demonstrated in Figure 2, this is an iterative process that is repeated perhaps annually and whenever a new strategy is being considered.

Figure 2. Risk Management Process as an Iterative Activity



CONCLUSION

There is a continuum between superior planning and poor planning along which any enterprise will find itself. However, this paper shows that the complexities inherent in managing the operation of a RGSME require superior planning. Control is required on various fronts, and it should become clear that consideration about risk involving all people in a RGSME is most important if superior outcomes are to be produced.

With a clear risk management framework, communication about risk becomes more natural and the true nature of risks becomes clearer. Furthermore, with a clear understanding of risk, appropriate treatments become more apparent as does the ability of a RGSME to control these. With that, boosted confidence enables entrepreneurs engaging in RGSME to be more likely to entertain a broader range and quantity of risks.

REFERENCES

Boxer, LJ (2003) *The Sustainable Way*, Brolga, Melbourne

Blombäck, A and Wiklund, J (1999) “The Risk-Taking Behaviour of Rapid Growth SMEs”, Third International Stockholm Seminar on Risk Management, Jönköping International Business School, http://www.ihh.hj.se/eng/research/publications/wp/1999-10%20Blomback,%20Wiklund.pdf, Accessed 25 May 2006

Cipolla, CM (1987) “The Basic Laws Of Human Stupidity”, *Whole Earth Review*, Spring 1987, p. 2-7 http://www.mentalsoup.com/mentalsoup/basic.htm, Accessed 25 May 2006

Deming, WE (1986), *Out of the Crisis*, Massachusetts Institute of Technology, Center for Advanced Engineering Study, Cambridge

Humphrey, A (2005) “The Origin of SWOT Analysis”, *European Quality*, http://www.european-quality.co.uk/Frequently-Asked-Questions/Business-Improvement-definitions/The-origin-of-SWOT-Analysis/, Accessed 25 May 2006

Intergon (2006) “Risk Management Primer”, http://intergon.net/RiskMgtPrimer.pdf, Accessed 25 May 2006-05-26

Kirytopoulos, K, Leopoulos, V and Malandrakis, C (2001) “Risk Management: A powerful tool for improving efficiency of project oriented SMEs”, *Manufacturing Information Systems*, Proceedings of the Fourth SMESME International Conference, Aalborg University, Denmark

Khun, MH (1954) “Kinsey's View on Human Behavior”, *Social Problems*, Vol. 1, No. 4, April 1954, pp. 119-125

Ritchie, B and Brindley, C (2000), “Disintermediation, Disintegration and Risk in the SME Global Supply Chain”, *Management Decision*, Vol. 38, No. 8, pp. 575-583

Slim, W, “Leadership in Management”, *Australian Army Journal*, September 1957, pp. 5-13, delivered as the fourth Sir William Queale lecture to the Australian Institute of Management, 4 April 1957

Standards Australia, (2000) ISO9000:2000, *Quality Management Systems*

Standards Australia, (2004) AS/NZS 4360, *Risk Management*

Stravos, J Cooperrider, D and Kelly, DL (2003) “Appreciative Intent: Inspiration to SOAR: A new framework for strategic planning”, *AP Practitioner*, 11 Jan 2003, http://appreciativeinquiry.case.edu/uploads/Stavros%20-StrategicInquiryArt.doc, Accessed 25 May 2006