RISK MANAGEMENT

"It's the little details that are vital. Little things make big things happen." – John Wooden

Building your business house in the swamp is difficult. You face potential hazards that can sink your business into the bog.

Risk management identifies factors that jeopardize the success of the company and includes a strategy to deal with those risks if they occur. The goal is to prevent adverse events from happening; but, if that isn't possible you want to minimize the damage and be in a position to resume profitable operations as soon as possible. Anticipating every possible risk probably is not possible. However, identifying and planning for as many risks is feasible and will increase your chances of surviving and succeeding in the swamp.

Here are sixteen business risks? Every business is different, so some of the risks discussed here may not apply to your business.

1. Hazard risk
2. Financial risk
3. Economic risk
4. Operations risk
5. Strategic risk: Competition
6. Strategic risk: Product Failure
7. Strategic risk: Obsolescence
8. Strategic risk: Seasonality
9. Strategic risk: Spoilage
10. Opportunity cost risk
11. Succession risk
12. Size risk
13. Employee risk
14. IT risk
15. Substitution risk
16. Customer Concentration

Hazard Risk

Hazard risk relates to the physical assets of an organization such as property, buildings, equipment, and inventory; both external and internal. What are the external risks your products and/or facilities could suffer from damage, fire, storms, floods, etc.? Are you properly insured so damaged facilities can be repaired or replaced? Internal risk management includes preventative maintenance. Are there frayed electrical wires that could lead to a fire? Is there a leaky roof that could lead to damage if not repaired or replaced? Does a vehicle need new brakes to prevent a possible accident? Brainstorm with your team to recognize as many potential hazard risks as possible?

Another hazard risk management strategy is business interruptions insurance which covers the loss of income from a disaster.

Financial Risk

Financial risk is the risk a company's financial assets could be adversely affected by

- bad debts
- currency exchange rate
- interest rates
- inflation

Bad Debts: If you invoice customers who pay you at some future date, you assume the risk they will never pay. If your terms of sale state the invoice is due in 30 days, every day beyond 30 diminishes the probability you will ever collect. When an invoice passes 90 days, it is highly unlikely that you will ever collect unless your invoice terms are "due in 90 days". Yet, often small businesses carry receivables on their books that are a year and a half to two years old. Why do the work if you aren't going to get paid?

Currency Exchange Rates: If you do business or get paid by companies, in foreign countries, fluctuations in currency exchange rates can significantly impact your business. Work with your banker on a strategy to minimize currency exchange rate risk.

Interest Rates: Rising or falling interest rates can affect timing to borrow money. You don't want to be forced to borrow when interest rates are high. When you need to borrow, talk to several banks to get the best rate.

Inflation in key ingredients or parts you purchase can squeeze your margins. Strategies such as like buying in bulk or hedging transactions can minimize the impact of inflation. Your banker, financial advisor or accountant, can help you design an inflation strategy to fit your business. *Gator Bite: In a recession, everything is on sale. If you have great cash reserves you can take advantage of bargain prices.*

Economic Risk

Economic risk recognizes the reality that the economy goes through cycles. Good times never last, Bad doing well times never last, so you must be prepared for both. Use period sof prosperity to prepare for the bad times that will inevitably occur. Squandering precious cash on unnecessary purchases or personal lifestyle can come back to haunt you. Economic recessions will occur in the future. Make sure cash reserves are adequate ro avoid laying-off employees or declaring bankruptcy.

Operations Risk

Factors that could adversely affect the company's operations include theft, equipment failure, website crash, telephone outage, data processing system crash, supply chain interruption, etc. What do you do if you can't produce or deliver your products or service? Good financial internal control measures can minimize the likelihood of theft of company assets, including theft of cash. Are people who handle cash covered by an insurance bond for theft? Does your IT system have adequate backup and been tested to make sure you can retrieve data? How will you communicate with customers, vendors, and employees if your phone isn't working? If selling products through your website, what is the plan if the website crashes? If production equipment fails, do you have spare parts for repairs, backup equipment, or alternative production plans?

Strategic Risk

Strategic risk considers risks from competition, product failure, obsolescence, seasonality, and spoilage.

Competition

What are the major threats from other companies selling the same products or services? What are you doing to stay ahead of the competition? Is your delivery system keeping up with the competition? Is your customer service comparable or better?

Product Failure

What are the risks of product failure, poor quality, or injury to customers? Do you have adequate insurance for these risks? Audit the production of your product or service to minimize errors. Using cheap ingredients or components may save money in the short run but cost you big in the long run.

Obsolescence

What is the risk that your product or service will become obsolete or be replaced by a new or better product or service? Don't get complacent. Over time, virtually every product or service will be superseded by something superior. Even if the product or service is essentially the same, delivery methods may change. Technology changes are the most obvious source of obsolescence; but add to this changes in consumer tastes, preferences, and fads.

Seasonality

Are there any seasonal patterns that could affect your sales of products or services positively or negatively? In lean months when cash flow drops, how do you cover the ongoing administrative costs of the business? Can you add new services at certain times of the year to make up for lost revenues and keep employees? When business slows, what can you do to improve operations, delivery, quality, etc. in the future.

Spoilage

Is there a risk that items you sell or have in inventory can go bad? Food can rot, chemicals can deteriorate, and shelf-life can be exceeded. What can you do to minimize the risk that your product can go bad?

Can a service company's product go bad? Yes, after extensive preparation of legal documents or a financial plan, if laws and regulations suddenly change or the customer changes their mind, you may have to begin anew. Make sure you have clearly defined what the customer wants. Sometimes the customer isn't sure what they want so you have to help them figure it out. Yes, that takes time but not as much time as redoing the product. If you don't have time to do it right the first time, you certainly don't have time to redo it.

Opportunity Cost

Opportunity cost is a risk. Choosing one alternative normally eliminates choosing another, especially when spending money. If you buy the truck, then maybe you can't buy the forklift or perform needed building maintenance. Carefully assess the pros and cons of each alternative. Are you giving up too much in one purchase to allow another? What is the potential cost to your business? Which opportunity provides the most benefit in terms of increased revenues, decreased costs, or improved productivity, and over what period of time? List all capital (large) expenditures and projects you need in the next few years. How much will each one cost? How will each add value in terms of higher revenues, lower operating costs, or increased productivity or efficiency? What is the return on investment (ROI) of a purchase?

Succession Risk

Succession risk recognizes that you aren't immortal. What happens to your heirs and employees if you aren't there? Do you have a succession plan?

If you plan to sell your business or turn it over to a family member, do you have a written plan in place? A business with sloppy accounting and operations procedures will not attract many buyers or command a good price. Get your business house in order. Preparing to sell starts at least five years in advance.

Size Risk

Many small business owners want to be, well, small, and that's OK. However, there are risks to being small. If your business only has a couple of employees, what happens if someone gets hurt, or sick, or worse? If there are three of you and one goes down, you have lost one-third of your staff. What if the person who is injured is the only one qualified to do a particular type of work. If you are a sole practitioner and have health issues that inhibit your ability to perform your family may have zero income. Can you form a strategic alliance whereby someone, or another company, can cover for you if you are unable to perform.

Employee Risk

What if your "star" employees leave. Star performers can leave any time. They are in demand and have opportunities. What are you doing to retain those stars? Also, what about the employees that stay, or the ones you didn't hire?

Discrimination in virtually any form is illegal and current, prospective, and former employees sue companies frequently for discrimination of various types. These lawsuits can irreparably damage your firm even if you are innocent. Once they become public, at least half of the public will think you are guilty without knowing the facts. What can you do to prevent these types of lawsuits; and if they do occur, minimize the impact? Number one, have a human relations advisor or employment lawyer on your team to advise you. Employment law is complicated so you want to be sure you have policies and procedures in place clearly stating the company's position. These policies need to be in the employee handbook, but that isn't enough. The handbook is a start, but it needs to be supplemented, at least annually, by follow up communications reminding employees of company policy.

We live in a highly litigious society where people blame others for their own failures. There are those who literally make a living suing other people and companies.

IT Risk

Technology and software change constantly. Systems & websites crash. What are you doing to keep up, prevent disasters, and maintain systems? Keeping up with everything is impossible but you can continually learn more and get better.

Substitution Risk

Is there a less expensive or better-performing substitute for your product or service? A common example would be a store brand vs. a name brand such as Wal-Mart canned beans vs. Delmonte. Identify potential substitutes for what your business sells and determine how to meet that competition.

Customer Concentration

Is your business overly reliant on one customer? The reality is, every customer you now have will be gone at some point in the future. Companies merge, go out of business, purchasing agents change, tastes change, styles change, etc. A general rule of thumb is no customer makes up more than 10% of revenues. 50% or more is a huge risk. Profitable while it last but devastating when the customer leaves. What are you doing to broaden your customer base?

Summary

Understanding the risks associated with your business enables you to make smart decisions which could “soften the blow” if and when the worst happens. You can’t anticipate everything but you can have a contingency plan for most situations.