Risk Management among Startups - Strategies & Solutions

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***Abstract*: In the process of designing, launching and running a new business, entrepreneurs world-wide are exposed to numerous risks. Entrepreneurship is associated with the capacity to and willingness to develop, organize and manage a business along with any of its risks to earn a profit. While most budding entrepreneurs focus on the launch and running of a business, they fail to take a note of significant risks that may lead to losses and ultimately a business shutdown.**

Owing to the novelty of business startups and the impact of these ventures on economic growth and sustainability, contemporary entrepreneurs are investing significant resources in terms of time, money and effort on the management of risk in their businesses. Entrepreneurship is often associated with true uncertainty, particularly when it involves the creation of a novel good or service, for a market that did not previously exist, rather than when a venture creates an incremental improvement to an existing product or service.

To gain a competitive advantage, entrepreneurs cannot just acknowledge the risk of a business but must also efficiently manage risk. However, the business plans of many entrepreneurs lack clarity on various operational risks their new enterprises might face. By incorporating risk management into the planning process, the entrepreneur gains a better understanding of the business system and has a tool for analyzing and managing various operational risks. The present paper explores the inherent risks in a business and the integration of risk management with entrepreneurship for the success of business.

***Keywords*: Risk Management. Entrepreneurship, Operational risk**

Introduction

Entrepreneurship and risk usually go together as starting one's own business has a huge opportunity cost in terms of the salary and the perks foregone by choosing to give up a lucrative job offer for starting a business venture. In-spite of starting businesses with good investment and viable business ideas, many startups fail to see the light of the day because of unforeseen risks that could not be managed efficiently. There is a gap between the risks perceived by an entrepreneur and the actual risks assumed. Though entrepreneurs spend significant time and efforts to develop a robust business plan, failure to integrate with active risk management threatens the very survival of a business. The integration helps the entrepreneur to get a better understanding of the business system and the operational risks that the business might be exposed to.

It is the gap between the perceived risk and the actual risk that can impair the survival of the business. A risk that could not be perceived cannot be managed. The business continuity plan must take all possible risks that a business is likely to face. Most business plans take into consideration the assumptions based on present conditions and their future prediction is based on experiences of recent past. To make the business plans more concrete, entrepreneurs must challenge the underlying assumptions. They must acknowledge that the future has many possible outcomes and depict the way the business can be managed through each of these possibilities.

Risk Management

The job of an entrepreneur does not stop at formulating a robust business plan. The risks that the business is exposed to need to be handled on a day-to-day basis which need be managed through an efficient risk management process. The risk management process typically consists of the following four phases

1. Risk Identification
2. Risk Measurement/ Assessment
3. Risk Control/ Mitigation
4. Risk Monitoring

The first and foremost step in risk management is the process of identify the risks that the business plans to manage and define the risk appetite of the business. Once the risks that would be managed are identified, they need to be measured as risk or loss unless measured cannot be mitigated. Risk control measures need to be carefully identified and implemented. There should be a system of continuous monitoring and feedback to see that the risk control mechanisms are effective.
Risks are mainly evaluated on the basis of their frequency and magnitude. The risks can be classified based on the probability of number of times the loss event is likely to occur and the severity or the impact of the loss.
They can be classified as

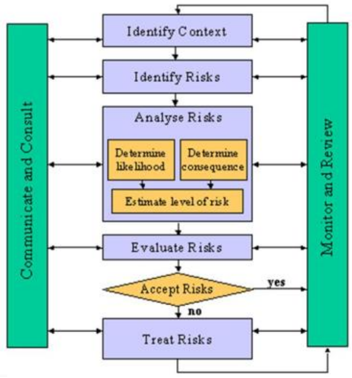
- Low Frequency Low Severity
- Low Frequency High Severity
- High Frequency Low Severity
- High Frequency High Severity

A Guide to Risk Management

	Low Frequency	High Frequency
Less Severe Loss	**Retain**	**Reduce**
More Severe Loss	**Transfer**	**Avoid**

Risks that are low frequency, low severity can be ignored and do not require risk management resources. Even the high frequency low severity resources do not need to be extensively handled as they do not have the potential to drastically impact the organizational earnings. They can be managed through risk reduction. However, the other two categories need a robust risk management system so as to minimize the adverse impact on corporate earnings.

Risk Management Process



Another classification of risk that businesses face can be on the basis of the importance and urgency in the need to manage risks. On this basis, the risks can be classified as

1. Ignorable Risks
2. Nuisance Risks
3. Insurable Risks

4. Company Killers

Ignorable Risks: These risks are very minor risks and are rated very low both in terms of their frequency as well as severity. They do not cause any significant damage to the business or the firm. These risks can be ignored and do not require any resources for their management

Nuisance Risks: These are risks that are very low in terms of their severity and do not cause any significant damage to the business in the long run. Such risks can be avoided through efficient internal processes and controls.

Insurable Risks: These risks can cause huge damage but the probability of their occurrence is quite low. Insurance can be used to cover such risks. Following is the list of types of insurances and the risks that are covered by them.

- Property Insurance can mitigate losses from fire, theft, and natural disasters.
- Key Executive Insurance can reduce losses from the death or incapacitation of a management team member.
- Liability Insurance can mitigate lawsuits resulting from product defects or on-site injuries to visitors.
- Errors & Omissions Insurance can mitigate lawsuits from disgruntled customers.
- Directors & Officers Insurance can mitigate lawsuits in cases of negligence, harassment, or discrimination.

The Company Killers: These risks have a high probability of occurrence and adverse impact on the business. These risks can threaten the existence of start-ups and the big corporates alike. They are very exhaustive. Few of them are discussed below.

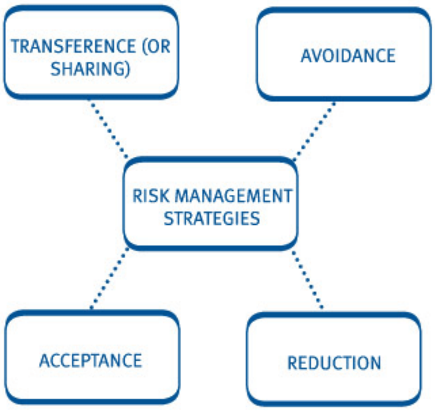
- Strategic Risks: E.g. Entry of a competition in the market
- Compliance Risks: E.g. Implementation of a new standard or regulation
- Operational Risks: E.g. Breakdown of a machine or disruption in the supply chain
- Financial Risks: E.g. Bad-debts by a borrower or hike in the interest rates of a bank loan

Risk Management Strategies

Risk can be handled by adopting a variety of strategies, right from avoiding it to transferring to a third party. These strategies can be classified as

- Risk Avoidance
- Risk Retention
- Risk Reduction
- Risk Transfer

In the first method, risk can be eliminated through careful analysis of the business environment and supporting it with needful efforts and finances. Risk can be accepted in cases where the cost of eliminating is too high. Risk can also be reduced, by implementing new policies, safety measures etc. albeit with associated costs. Risk can also be transferred to third parties that take up risks for additional charge or commission. It can be transferred by resorting to insurance.



To sum up, risk management is to identify the chance and severity of the unfavorable circumstances and to find the correct course of action to mitigate their effect. Such programs with reference to threat assessment and risk management are often called Business continuity plans. They describe the corrective action when business disruption occurs. Though it is not possible to eliminate all risks, these processes will minimize their impact on business cycle.

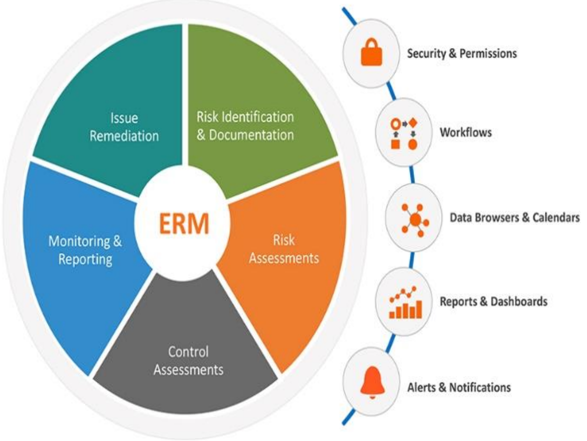
The Options….

Insurance shares the burden of risk management of entrepreneurs and the enterprise. It can be used as a tool to protect against losses associated with some risks. Although some costs cannot be insured, in some cases they are a necessity. However, insurance companies now are getting more and more particular to see that all kinds of risks can be managed.

Long term insurance plans here have tremendous use at a personal as well as at the business level. From a business owner's perspective, they can be given as an executive benefit or an employee benefit, either way they can fetch up to 100% tax benefit for the organization and hence, have now become an important aspect of financial planning.

Retirement planning can avoid future financial troubles. Entrepreneurs may have a hard time relating to this idea as planning and saving for retirement is contrary to the mentality of entrepreneurs. Diversification is a key tool of risk management. Some attractive instruments which one can ponder upon are zero-coupon bonds, Cash-balanced Pension Plans, Individual Retirement Accounts (IRA), business valuation or transfer etc.

Enterprise risk management (ERM) includes the methods and processes used by organizations to manage risks and capitalize on opportunities related to the achievement of their objectives. ERM provides a framework for risk management, which typically involves identifying particular events or circumstances relevant to the organization's objectives (risks and opportunities), assessing them in terms of likelihood and magnitude of impact, determining a response strategy, and monitoring progress. By identifying and proactively addressing risks and opportunities, business enterprises protect and create value for their stakeholders, including owners, employees, customers, regulators, and society.



Most risk managers and consultants believe that proper management of risk is the key to the longevity of an enterprise. On the other hand, a poorly conceived business is bound to stop the business before it takes off. Hence, an entrepreneur must take all the time to make a good business plan.

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