

# Private Companies How To Tackle Uncertainty with Pro-Active Risk Management

by Jason Hickey



Private companies undergoing a period of sustained growth can face uncertainty in all aspects of their business. Uncertainties around product quality, customer loyalty, operational capacity, financial structuring, tax and access to capital have always been a fact of life for high-growth companies.

During a period of growth increased complexity and urgency can make it harder to foresee the ramifications of decisions. Therefore, to ensure that a company's growth is managed effectively, it is important to put in place strategies, policies, processes and systems to support decision making.

Risk management – the identification, assessment and management of risk exposures – can enable private companies to consistently and systematically manage the uncertainties inherent in business growth.

Risk management is of benefit to any company in which the owner or owners want to devolve responsibility and accountability for decisions to a wider group of managers and employees by developing sustainable decision making capabilities in the business.

While risk management processes will add an element of formality to the management structure, it should not reduce flexibility. As the owner normally makes the major decisions in most private companies, their risk management processes can and should be less rigid than those used by larger public companies. The owners of Irish businesses have a fine tradition of making successful decisions based on an ability to react quickly to the changing business environment.

The principles of a more formal approach to risk management should be centred on providing guidance on what risks to take and how much risk the business can withstand when making decisions.

## Consider Your Options

Developing a full range of real-time systems to identify and monitor risk is prohibitively expensive for most private businesses. As a result, it is best to look at risk as a number of options available to the owner(s) or management team. A risk management strategy clarifies who is responsible for making decisions and acts as the basis upon which they should make them.

Designing a risk management process involves answering the following questions:

- ▶ What is your company's long-term direction, the business plan(s)? How do you intend it to operate and succeed into the future?

- ▶ What creates value for your company and what are the potential threats, uncertainties and opportunities that impact those value drivers?
- ▶ What management processes need to be put in place to plan, deliver, execute and monitor your company's strategy and the risks associated with it?

In responding to these questions companies may wish to consider the following risk management activities:

### INTEGRATE RISK MANAGEMENT INTO BUSINESS PLANNING

Risk management starts with clear goals. Once you decide to make executives responsible for important decisions, increased clarity around goal setting is required to ensure everyone is working towards a common aim. Goals should be SMART: specific, measurable, achievable, realistic and timely, such as sales targets or increases in profitability.

The first stage of developing a risk management strategy is having a clear understanding of what activities your company tends to undertake in order to create business value. The company's broader system of values and objectives will set the parameters under which it performs these activities. The commencement of a new financial year represents a clear opportunity for companies to reconsider their approach to risk management as an integral component of the business planning process.

### DETERMINE THE RISK MANAGEMENT PROCESS

The next stage involves identifying those activities that have the highest impact on the value of your business and prioritising those that are the most uncertain or volatile. This may require some analysis, including identifying the activities or 'value drivers' and determining their sensitivity or volatility.

## Establishing The Risk Management Organisation

**It is important that risk management becomes an integral component of the daily activity for all employees of the organisation where everyone has a role to play.**

Establishing clearly defined areas of accountability for the management of risk will also seek to embed risk management into the daily activities of the company. This often takes the form of a risk management policy addressing roles and responsibilities, boundaries of operation and key risk management activities to be completed at each stage of the business lifecycle. The policy seeks to identify and reinforce the main risk management activities such as establishing the acceptable operating boundaries for the company, determining appropriate mechanisms to monitor them and possible responses if anything goes wrong.

## KEY STEPS IN THE RISK MANAGEMENT PROCESS

### STEP 1

Identify the key business activities the company undertakes to achieve the goals set out in the business plan.

### STEP 2

Understand the key risks associated with the business activities by performing a detailed assessment addressing impact and likelihood of occurrence and identifying the associated consequences to your company. This will result in an overall prioritisation of risks for your company.

### STEP 3

Define the key actions to be undertaken to mitigate the risks to an acceptable level, assigning ownership for each action plan.

### STEP 4

Determine how best to monitor the risks going forward. This is often achieved by ensuring risk management is an agenda item at all management meetings.

## Understanding The Changing Business Environment

Risk management should not focus solely on historical variance analysis – the difference between budgeted and actual figures.

Risk management should consider future activities – understanding what risk factors will prevent your company from meeting its business goals and then managing or mitigating those factors.

A key component of successful risk management relates to a company's ability to clearly understand the current and future business environment it operates within.

### Monitor leading as well as lagging indicators

Companies should seek to monitor risk factors using leading as well as lagging indicators. Relying on lagging indicators such as budget to actual variance will not identify a significant risk until it is too late. For example, cash collections is one of the most important value drivers for service businesses. A commonly used indicator for the health of cash is accounts receivable. However, because days outstanding is a lagging indicator, by the time it reaches a point where it is considered a problem, the company may already be in trouble.

A leading indicator would provide advance warning that people are not going to pay their bills. Customer satisfaction levels might suffice. When customers don't pay their invoices on time it is often because they are unhappy with the service. A sudden drop in customer service levels could be an early warning of late payment, giving the company time to implement corrective measures.

Risk management is not the answer to all ailments. But it can provide a powerful mechanism to understand uncertainty and volatility in the business and develop the right strategies to economically manage any such exposures.

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