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MoneyTalk

Surviving the Financial Crisis

FOUR STEPS TO GOOD RISK TAKING

The impact of the financial crisis is being felt all over the world and has rarely been out of the news in recent months. But what is the impact for you and what steps can your company take to ride the storm? IMD Professor Didier Cossin offers four steps to good risk thinking…

In October my colleagues and I discussed the global financial meltdown in an IMD Webcast. Three months on, I am struck by just how many companies, industries and countries have been hit by the crisis - even the booming Middle East is feeling the affects of this economic downturn.

I have also been struck by how people are reacting to the situation. Some are in denial, some are panicking and some are being ultra-conservative – none of which is the best approach in a time of crisis.

So how can you prepare for the future when the future is so uncertain? How do you get the best out of the worst of times and manage this financial crisis? These are questions I am frequently asked at the moment and something I have been helping boards and CEOs with over the last few months.

Strategy and tactics : Looking to the future, you need to consider your strategic direction and, in the shorter term, your tactics.

In terms of strategy, my advice is for companies to return to what they do well, to differentiate themselves and make the most of their competitive advantage. For example, it is well known that, in recent years, some quality-driven companies have compromised on quality in the pursuit of growth and easy profits. Now is the time for them to come back to their core, even if it means a short-term hit on assets or earnings.

Similarly, in a company driven mostly by people, it is more important than ever to look at the quality of people you are recruiting and ensure you are hiring the best – the people who will make a difference and help develop the business.

While you cannot predict what the markets will do or how you or your competitors will be affected, you can be aware of the potential risks and plan for them. This brings me to my four steps for good risk thinking:

1. Risk identification
2. Risk assessment
3. Risk management
4. Risk sharing or structuring

Risk identification: Risk identification may sound easy but it requires a strategic view. You have to understand the competition, the forces of the economic environment and social responsibility. In today's climate, good risk identification should be done at the top management level.

For example, in the automotive industry you would need to consider future oil and steel prices. While it's impossible to know how much oil is going to cost in a few months time, the one certainty you have, ironically, is uncertainty. The key is to be able to plan for that uncertainty.

Sticking with the car industry, a significant proportion of profits had, until recently, come from finance deals. With this area of the business now dead in the water, companies need to rethink their business model and work out how they will move on.

Risk assessment: Of course nobody can fully assess risk. The goal of risk assessment is to raise awareness. Even if the predictions are wrong, the process of evaluating your business and its pitfalls helps. It enables you to work out how to tip the balance to create value, protect yourself from your suppliers, and organize contracts in a more meaningful way.

Once you have pinpointed your key risks, it is vital that you test them against potential real-life scenarios – including a worst-case scenario. This will help you re-evaluate, or give your more confidence in, your strategy.

Risk management: The next step is to look at how you can manage the risks, whether you can cancel them out, or better still whether they offer any opportunities to create value.

In the past reducing risk has tended to fall to the financial side of the business. But there is a limit to the impact financial techniques can have on risk, so you need to look for ways to reduce any identified risk from every side of the business.

One way to significantly reduce risk comes back to a point I made earlier – returning to your company's core. By differentiating your company and making the most of its competitive advantage, it will be much easier to manager your risks as they will fall within your capabilities – your comfort zone.

Risk structuring: The final step – risk sharing or restructuring – is perhaps the most interesting. Put simply, risk sharing means accepting those risks where you have a competitive advantage and leaving other risks to those who are better placed in that market.

In the past, when confronted with risk the easiest thing was to push the risk on to the weakest link, for example, the supplier. This no longer works as this could cause a supplier to go out of business leaving you with a problem.

Instead it's about finding a balance with your suppliers and operating under a contract that makes real economic sense, where you accept and share some of the risks.

I have been impressed with what Syngenta, a manufacturer of fertilizers, agrochemicals and pesticides, is doing in Latin America. Having learned from the downturn in agricultural markets there a few years ago, it now offers farmers yield guarantees. This means the farmers are inclined to buy more of the product at a higher price and without defaulting, so it's a win-win for both parties.

It's a great approach. And in my view, if you take the right approach today not only can you survive the financial crisis, but you can strengthen your business and build real long-term value. For now that's as much as any business can hope for.

Copied from a publication by Professor Didier Cossin (ubs Professor of Baking & Finance.

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