Tool #11

How to Mitigate Risks in a Venture

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UNDERSTANDING AND MANAGING RISK WHEN LAUNCHING A BUSINESS

DEFINITIONS:

- Uncertainty: situation in which there are multiple alternatives resulting in an outcome, but the likelihood of the outcome is unknown

- Risk: the potential for loss based on an action taken or not taken

- While uncertainty is uncontrollable, with risk you can predict the probability of some future outcome --- and so risk can be managed;

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EXAMPLES OF RISK FACTORS WHEN LAUNCHING A BUSINESS:

- Customer risks, such as where there are not enough customers who will buy, or customers won't pay what you are charging;
- Competitor risks, such as where competitors undercut the entrepreneur on price or otherwise take the entrepreneur's customers;
- Product-related risks, such as where the product or service you are selling does not perform up to expectations or the customer is somehow harmed because they bought your product or worked with you;
- Supplier risks, such as where a supplier provides inferior or defective goods or services to the entrepreneur, or forces the entrepreneur to buy more than he or she needs;
- Partner risks, such as where a partner in the business does not meet obligations or steals the business's money or assets
- Employee risks, such as where an employee is injured on the job, sexually harasses a customer, or quits and starts a competing business using the entrepreneur's techniques or secrets
- Technological risks, such as where a technical solution does not work, is too difficult to use, or fails to provide the performance or value required by the entrepreneur
- Regulatory risks, such where the business is harmed because of a change in laws or regulations, or is unable to meet a regulatory requirement.

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THREE KEY POINTS POVERTY ENTREPRENEURS NEED TO UNDERSTAND:

Key point 1: Poverty entrepreneurs must focus on minimizing the downside (the potential losses) and not be overly focused on maximizing the upside

Key point 2: Entrepreneurship is not about being a risk taker…it is about being a creative manager or mitigator of risk

Key point 3: From an overall standpoint, **r**isks can mitigated in three general ways:

-getting someone else to take on some of the risks (such as by having a partner)

-by doing things in stages rather than all at once (such as by starting the business while maintaining a job until the customer base is built up enough)

-taking actions to actually eliminate a risk factor, lessen its likelihood of happening, or lessening how much you would lose if it happens (such as by holding less inventory, leasing equipment rather than buying it)

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THE TWO KEY COMPONENTS OF RISK:

Risk has two components, each of which can be focused to reduce the risks surrounding starting a business:

Total risk =	**magnitude of loss**	**(times)**	**likelihood of loss**
(from taking an action such as starting a business)	*(how much could you lose)*		*(how likely is it you will lose what you invested)*

Examples:

-the <u>magnitude of loss</u> might be reduced by initially working from home rather than renting space for your business, by starting on a smaller scale, or by outsourcing a key activity rather than buying equipment so you can perform the activity yourself

-the <u>probability of loss</u> might be reduced by conducting more research on an issue before making a decision, getting customers to pay in advance, or adhering to procedures related to worker safety or product quality

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TWENTY SAMPLE TACTICS FOR MITIGATING OR LESSENING RISKS IN A START-UP BUSINESS:

1. Lessen fixed costs (e.g., borrow equipment rather than buy it, work from home rather than pay to use an office or building)
2. Carry inventory on consignment
3. Outsource key activities rather than investing in people and equipment to do them yourself
4. Use part-time or contract labor
5. Use test markets
6. Rely on staged rollouts
7. Pay employees commissions
8. Pay suppliers or resource providers a percentage of sales rather than an upfront fee
9. Hold less inventory
10. Get customers to pay in advance
11. Sign longer term contracts with key customers
12. Lock in prices with suppliers
13. Negotiate terms with suppliers to return any unsold products
14. Collaborate with competitors (e.g., on sales, purchases, technology)
15. Bundle multiple products together when making a sale
16. Use someone else's money rather than your own
17. Have employees sign non-compete and non-disclosure agreements
18. Carry insurance to cover activities in your business where the most major things could go wrong or major losses could be incurred
19. Lease or rent equipment or facilities rather than purchase them
20. Engage in barter with suppliers where you pay for things you need by providing services or products rather than paying cash