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Making risky growth choices

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SITUATION Risk aversion may limit mid-market firms' upside growth by biasing investment choices towards conservative alternatives. More importantly, aversion to risk may prevent many attractive growth alternatives from even being considered.

KEY TAKEAWAY Gravitating towards what is safe and comfortable may crowd out higher value growth choices. From owners or top managers down through the entire organization, decision makers should be adept at risk assessment and aware of the unintended consequences of risk aversion.

It is not realistic for mid-market companies to insist upon perfect information and to avoid risk entirely. A certain amount of risk is inherent in all decisions. Successful owners and managers are typically aware of the need to take risks to generate top line growth. Mid-market firms willing to take informed chances may be more likely to launch new products, enter distant markets or attract higher quality talent, creating a powerful growth agenda which is distinctive and difficult to copy. When others cannot easily imitate their products or business models, organizations tend to capture disproportionate revenues. On the other hand a risk-averse company is a welcome rival. Their moves are neither ambitious nor challenging to imitate.

Consider a mid-market firm in the process of developing its growth agenda. One opportunity after another is considered, and those with an acceptable level of risk are favored over those perceived to be too risky. While taking on excessive risk can be catastrophic, a quieter type of catastrophe results if firms elevate risk avoidance too significantly in developing their growth agenda.

Although it is easy to say that all paths to growth are dependent on someone, at some point, taking a risk, business leaders must also recognize that people can be naturally risk averse. This might be particularly true for small to medium sized businesses that have long established track records of success. Behavioral economics demonstrates that humans become risk averse when the prospect of losing acquired gains is present. Therefore, if the possibility of a financial setback is part of the risk profile of a new initiative, resistance should be anticipated. In such circumstances, committed and trustworthy managers may shy away from important opportunities because they overweight the possibility of failure against the benefits of success.

Unwarranted risk aversion may inhibit the pursuit of novel process approaches, radical product upgrades, and difficult to imitate strategies that can drive growth. If every middle manager has sifted through their growth options with a bias against risk, the set of alternatives that reaches the top management discussion is already weaker than desired. Without explicit processes to assess risk and to encourage risk tolerance, each employee's conservative decisions result in a choice set dominated by relatively weak options.

It often helps to relax some constraints or use different filters to evaluate growth options early in the process, progressively tightening the risk criteria before making investments of hard dollars. Some mid-market firms open up the choice set by using a structured approach to risk analysis, establishing an appropriately risk tolerant culture, and ensuring that safeguards are in place at appropriate times to balance risk taking with risk intelligence. A structured approach to risk, taking into account your firm's level of vulnerability and other factors, can help managers confront the unknown. Applying risk intelligent concepts can be a significant advantage in choosing where to make investments in growth.

An intelligent approach to risk doesn't eliminate risk entirely, but it mitigates the negative effects of risk aversion. Of the things that don't get done, there is an important distinction between those which aren't done because they aren't considered, and those alternatives which are carefully considered and rejected. Risk intelligence can help mid-market firms generate a broader, stronger growth choice set — and to make better choices from within this set.

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From risk averse to risk tolerant: changing process while preserving culture

Imagine the top management team of a third generation family firm which realized they were in position to generate reliable, slow growth, but nothing more. They were not considering enough high risk options to provide real upside revenue potential, even if they funded the highest risk proposals that emerged from their formal growth planning process.

Nearly all the growth alternatives presented by their managers were safe, sure bets. Firm leaders realized that a conservative culture had deep roots at their company. Protecting the family's reputation and preserving the trust of their long-time customers were noble objectives. But these objectives had resulted in a strong aversion to risk.

To expand the set of growth alternatives without threatening the organizational culture, each manager was asked to submit one growth alternative which was copied from a successful firm outside their industry in each planning cycle. These outside ideas generated new dialogue about growth possibilities. At first, these foreign ideas were discussed and dismissed rather quickly. Regularly requiring external inputs helped the team become more comfortable discussing unfamiliar markets, product extensions, and different sales channels.

In addition, all managers received coaching on risk assessment and risk intelligence concepts. This combination of training and practice increased their firm's risk tolerance through a focused, long term effort. Their growth portfolio included greater variety and higher potential choices as a result.

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