Taking Calculated Risks

Risks of a business start-up

What is risk? **Risk** can mean several things

- The chance of loss or damage
- The probability that something goes wrong, leading to a loss
- When a hoped-for outcome does not happen

If setting up a new business was risk-free (i.e. a "dead-cert") then we'd all do it. The bad news for entrepreneurs is that investing in a start-up is highly **risky**.

What is the risk? The main risk is that the **business will fail** and that the entrepreneur will **lose his/her investment**. In the case of a sole trader or partnership, the entrepreneur may also end up **personally liable** for the debts of the failed business (an important reason why savvy start-ups use private limited companies as their form of business organisation).

Another risk is that a failed business will leave the entrepreneur struggling to finance another business or getting a normal job.

And yet another risk is the stigma of failure itself. There is no reason why people should be ashamed of failing in business, but in reality they are.

Taken together, you can see why these risks are often the motivation for an entrepreneur to keep going, even when the business is struggling badly. When you are "risking it all" then you put heart and soul into making the business a success.

Learning the lessons of failure

A good way of thinking about the risks being taken is to consider why start-up and small businesses fail. If you can learn from and avoid these mistakes, then the new business has a greater chance of survival and success.

Here are the main reasons why new businesses fail:

Poor management	Plain and simple. Poor decisions are taken; costs are not kept under control; management don't understand their market & customers well enough and offer a poor quality product
Sales lower than expected	It is very easy to over-estimate the sales that will be achieved by a start-up. The business plan can be over-optimistic about the price that customers will accept and the volumes they will buy
Start-up costs too high	Another common weakness of start-up business planning. Sometimes costs are simply missed out altogether. Alternatively the amount is under-estimated. This is a big concern at the start-up stage, where finance is limited. A delayed product launch is often

	the cause of start-up cost overruns.
Unexpected shocks	These can come in various forms – e.g. the floods in the UK during 2007 or the Swine Flu pandemic in 2009
Too reliant on a small number of customers	A start-up that is too reliant on one or a few customers is at greater risk of failure than one which has a broader, more diverse customer base. If the customer relationship breaks down, or the customer itself fails, then the business is at risk.
Poor quality	This is linked to poor management. Persistent poor quality products or services will ultimately kill a business.
Overtrading	Sometimes a small business can grow too quickly and, as a result, it runs into serious cash flow problems. A business whose sales grow rapidly might find that customers take too long to pay their debts, whereas stocks build and suppliers demand payment on time. The result can be a business which appears to be successful and profitable, but which runs out of money.

Taking a calculated risk

An entrepreneur cannot avoid risk in a start-up and everyone knows that a large proportion of new businesses eventually fail. The trick is to assess:

- What the main risks are in a new business (e.g. unexpected costs, lower than expected sales, failure to secure distribution)
- The **probability** of the risks happening (this has to be an estimate)
- What would happen if the risks occur – cost, cash etc

The third part of the assessment above is perhaps the most important. For the small business, often starved of cash, even a relatively small event can prove disastrous. The entrepreneur has to assess the potential impact on the business of a risk, but also assess the **upside** (where things turn out to be better than expected).

So, a calculated risk can be defined as follows:

"A risk that has been given thoughtful consideration and for which the potential costs and potential benefits have been weighted and considered"

Entrepreneurs take calculated risks everyday, since they take decisions everyday. Each time they take a decision they are weighing up the significance of the options and (often intuitively) working out whether to go ahead.

Rewards from enterprise

That's enough about the negative side of setting a business up. What about the rewards?

We looked earlier at the motivations for setting up a business. Many of the **intangible rewards** that arise from being in business happen because these motives are achieved.

- A sense of satisfaction

- Building something
- Being in control
- Making that first sale
- Opening a new location
- Employing more people
- Getting an industry award or good publicity
- Getting great feedback from customers

These are the kind of **non-financial rewards** that give entrepreneurs a buzz.

However, ultimately, it is the financial rewards that justify the effort and make taking the risk worthwhile.

To illustrate the potential financial rewards, here are some examples:

- Karen Darby sold her business SimplySwitch, a service allowing consumers to compare rates for gas and electricity suppliers among other things, to the Daily Mail for £22million
- Linda Bennett, one of Britain's most successful female entrepreneurs, sold her women's fashion chain, LK Bennett, to two venture capitalists for £70million
- Gerry Pack started up his business Holiday Extras providing airport hotel rooms and parking with just £100. He sold it in 2005 for £43million
- Darren Richards started up his online dating agency (DatingDirect.com) with just £2,500 and sold it eight years later for £30million

You should also remember that there is a strong tradition of entrepreneurs who have built and sold one business for a substantial amount going onto build other successful businesses. They never lose the entrepreneurial buzz. Such people are called "**serial entrepreneurs**".