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Ready your business plan for risk

Business owners should take time to shore up areas vulnerable to risk

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Tyler Anderson/National Post
Paul Kerr, CEO of Scalar Decisions: Downturn exposed risk in company's business model

A technology systems integrator, Scalar Decisions builds mission critical infrastructure. It has 50 employees across the country, with offices in Toronto, Ottawa, Vancouver, Calgary and southwestern Ontario. Until the recession hit, the company was in all-out growth mode.

"The last 12 months did not go as planned," says Paul Kerr, chief executive of Scalar. "We had four years of phenomenal growth and then everyone in the world got thrown the economic crisis. It has forced a lot of people to learn about risk and what the specific risks to their own businesses are."

That's exactly what happened at Scalar. "The downturn didn't kill us, but it did expose the risk in our business model and it forced us to build more risk mitigation strategies into that model."

Scalar has a process called Key Business Screamers, similar to the notion of Key Performance Indicators. "We have six indicators and we evaluate them every year. They are called screamers because they should scream out to you whether you are at risk or not," Mr. Kerr says.

"At the start of the year we ask: 'What are the most important things to our business?' Either you are doing them right and it's good for business or you are doing them wrong and they become a risk to the business. Our six indicators are: sales; revenue recognition; cash flow; accounts receivable; profit; and employee salaries (the latter is commission based, so we track whether employees are earning what they expect to earn)," he says.

"We have targets for each and if we aren't meeting those, that means we are at risk. On a weekly basis, we make sure the risk factor doesn't get too high, and that we aren't ignoring problem areas. If we are doing well in all six, then business is humming along."

Risk management is a topic many small business leaders have a tough time wrapping their heads around, for good reason, says Brad Cherniak, co-founder and partner at Sapient Capital Partners in Toronto. "The prime objective for small business is to grow, to be different than they are today. That prime objective consumes resources. Big companies can afford to navel gaze, small business don't have that luxury. Anything that takes resources away from the prime objective is a risk. And that includes devoting staff to risk management."

The underlying question is: How do you approach risk in a way that doesn't increase your risk? "Risk management is an investment in itself," Mr. Cherniak says. "Businesses should treat it as such because on the one hand it creates safety mechanisms that allow you to react to bad events. On the other hand, it takes resources away from the prime objective."

Mr. Cherniak offers the following advice:

Start with a plan. Risk management implies something is happening that you don't want to happen. "Opportunity and risk are two sides of the same coin," he says.

"The way you counter that is by planning. You have to distinguish between what is expected and what's unexpected. To do that you have to have a forecast and define what you are expecting, what your core activity is and what's an experiment. In effect, you are creating a baseline to track performance."

Build cushions into the forecast. "Often companies run so tight that if you are a little bit off in your forecast it blows up." Cushions give you a bit of leeway for the unexpected and this effectively becomes a risk management tool.

Set up a core group to track performance against the forecast. "This should include everyone in the inner loop -- the CFO, head sales manager, who ever you can speak frankly to, so you can anticipate problems rather than react to them. This will allow you to see the wall before you hit it. It could take place weekly, biweekly, monthly in normal circumstances."

Keep in mind, there are ways to operate your business that reduce the nature of risk. For example, Mr. Cherniak says, cut as many fixed costs as you can. "Outsource what you can to reduce costs, and never be complacent about what you are spending money on. Looking at ways to run your business better is the best risk-management strategy for most companies."

For Mr. Kerr, managing risk is a science; it's all quantitative. "There are targets on each of our indicators so we know whether we are falling behind, are on plan or ahead of plan. We want to assess risk at the beginning, measure it and manage it. This whole screamer concept is the way we do it."