

Food for Thought

May 2009

In this economy, don't become risk averse

Food for Thought is our way of sharing interesting concepts on corporate leadership and management with others who might find it useful. The thoughts offered are intended to be controversial and thought provoking. They always follow our motto of helping develop logical leadership.

In this economy it might seem prudent to become less tolerant of risk. But, be wary of becoming risk averse. In fact, we posit that, if you have the capacity to take risk, this is the best time to be embracing of risk – because the rewards for taking risk are actually higher when most others are intolerant of it.

We must first be clear about what is risk and reward. Risk is the uncertainty of future outcomes. More formally, risk is the standard deviation of the economic values of possible future outcomes. Reward is the expected value (mean) of those possible outcomes. Each of us, and each of our organizations, have a risk-reward profile – i.e., a graph that lays out the minimum amount of reward we seek to undertake a given level of risk. People and organizations that accept a lower level of reward for a given level of risk are said to be more risk tolerant.

In these economic times most people and most businesses have become less tolerant of risk. If you have the capacity to take risk, you can actually garner a greater level of reward for a given level of risk, than you might have been able to in steadier economic times. That is why you should be less tolerant (i.e., demand a greater reward) but more embracing (i.e., willing to explore more thoroughly) of risk.

Let's illustrate this with a few concrete business examples. If you are a roofing contractor and you come across a job that you might otherwise have shunned because of the complications and gotchas inherent in that job, you might seriously consider the job in this economy because you can command a higher price for it. Remember, like you, most people are weary and there are fewer bidders for that job. Likewise, if you are considering a risky acquisition don't walk away just because it is risky. Command the reward that might be available for undertaking that risk in this

economy. This is the logic that has led private investors to gobble up many of the toxic default swap loans in bank auctions. The discount on those loans – a proxy for the reward – has made them very attractive.

Needless to say, if you don't have the capacity to take risk this discussion is moot. But if you do, this is the best time to seek out opportunities. The rewards are plenty.

We have received many responses to our Food for Thought mailings, asking if you can freely share and forward these thoughts. Indeed you can. All we ask is that a clear attribution to LogiStyle and our contact information are included. For the interested reader, we have archived some of our recent Food for Thought mailings at our website, and can be viewed at LogiStyle: Food for Thought Archive. As always, we welcome your comments. We hope your business is doing well. If we can be of any assistance please feel free to call – even, if just to chat.

Best Regards,

Balaji

Balaji Krishnamurthy

LogiStyle, LLC

P.O. Box 91182

Portland, OR 97291

(503)789-1338

balaji@logistyle.com

www.logistyle.com