The New Landscape of Risk

Why then are we suddenly asking our managers to pursue risk? It is not that the manager's job in the new economy has changed, and risk of itself suddenly brings automatic rewards. It doesn't. We are as prone today to loss through folly, fraud and failed predictions as we ever have been – indeed, in these volatile times, some would say more prone. We desperately need sound and prudent management of the risks we are pursuing – and that means risk aversion on a scale to balance the risk pursuance of the markets.

The problem for managers is that the landscape of risk has changed. Four years of bull run on the equity markets has reduced sensitivities to the downside of risk, and increased appetites for the amount of risk that investors will tolerate. Higher risk means higher profits from the investments. In the 1950s the investment debates were about levels of risk tolerance between the relatively safe bond markets and the perceived riskiness of the equity markets. History has proven the winners correct: the equity markets have consistently outperformed the bond markets in the UK by a factor of 4.5% over the past 100 years. Higher risk equals greater profits, so history seems to say. Now those very same blue chip equities are being challenged by the upstart white hot high tech and internet stocks, and what was adventurous fifty years ago now appears unexciting.

History, from the Romans to the Mongol horde, to the Dutch East Indies Company, also teaches us that changes in the technology of communications infrastructure brings about rapid economic shifts, creating enormous opportunities for profit. Advances in maritime navigation techniques and technology opened up the Asian and American markets for European exploitation in the sixteenth to the eighteenth century. The railways, followed swiftly by the telegraph, prepared the world for the economic and cultural domination of North America by creating around its rich natural resources a vast production and transportation network, that in turn cultivated an enormous domestic market, that in turn nourished a mighty industrial machine hungry for new global markets.

As Alan Greenspan recently pointed out, the mid-1990s saw a new explosion in connectivity. This time it was an information infrastructure, as the technologies of computing, telecommunications and standardised networking protocols converged into a critical mass of global networks capable of real-time transmission of data from any

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Take tendering and procureme
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Take warehouses. Warehouses are expensive items to buy, build or rent. Their management involves all sorts of processes for getting things in and out of them, as well as accurate and timely inventories of their contents. Warehouses, as with any storage systems, are an insurance policy against the risk of not having what you want when you need it. Michael Dell proved that you can use networked information technology to keep your inventory on the road, cutting out an entire stage in the business cycle: storage and retrieval. The consequence of this is threefold: reduced costs, greater speed, higher productivity. Gary Beggs, vice president of Yellow Freight in the United States recently told the *Financial Times*, "We've become moving warehouses". Yellow uses a logistics software called Sysnet, assurance all cost money. In the 1990s automated supply chain management became the watchword for manufacturers and retailers, migrating in early 2000 to a new application for e-commerce – business to business electronic procurement marketplaces. Car manufacturers Ford, DaimlerChrysler, Renault and Nissan Motor have all set up shared electronic marketplaces, as have retail chains Sears and Carrefour, followed in rapid succession by eleven of their global rivals.

Take management information systems. These are designed, in large organisations especially, to overcome the risk of sub-optimal co-ordination of resources, assets or people, and to avoid the risk of poor decisions in response to environmental change. We pay managers, executives and admin staff a great deal of money to gather data, create, check and distil documents, and transfer them to designated points at designated times. Networked organisations with real-time access to customised views of the state of play in any areas of the organisation's activity are not far away – some of them are among us already.

Networks, connectivity, bandwidth and standardisation of information transmission protocols have evaporated many of the traditional risks around which our management systems have been created. The systems we created were borne out of a lack of immediate knowledge, and an inability to respond quickly to change. IT has given us much greater speed of response, and much higher levels of immediate knowledge.

And yet, although the traditional risks have gone, we are patently not without risk. The truth is, we are in a landscape we do not fully understand, and our ignorance itself poses the greatest risk. We are, like the Portuguese explorers hunting down the fabled Spice Islands, navigating new domains. When Julian Robertson bowed out of the Tiger Fund, he stated our common situation very clearly: "There is no point in subjecting our investors to risk in a market which I frankly do not understand". This was an uncanny echo of Warren Buffet's recent admission that investing in the new dot.com marketplace was "outside our circle of competence".

There are clearly fortunes to be won and lost in this new marketplace, as there were with the advent of railways in the 19th century. We see them all around in the new millionaires of Silicon Valley. After four years of the strongest bull run in recent history, millionaire households now make up 4% of the US demographic picture.

As in the chaotic rise of the railroads in the mid nineteenth century, we see today speculative fevers, fraud, insider trading, stock options, stockprice manipulation, bankruptcies, small branchline companies being bought out by larger, consolidating and integrating concerns, irrational shifts in the financial markets. We also see new money, in the shape of the Vanderbilts, Goulds, and Morgans, overcoming the old. We also see the enormous volatility in the markets accompanied, unexpectedly, by rapid growth in productivity and output. From 1860 to 1900 the annual rate of growth averaged 4.3%, and in the midst of financial chaos was the longest sustained period of economic growth in America's history. Alan Greenspan recently remarked on a strikingly similar picture in the United States economy of today: amidst "discontinuous shifts in economic structure" the economy was achieving in the last five years of the 20th century an average of 3.5% growth in output per hour, almost double the average for the previous 25 years.

Analysts point to a "step change" in the economy – enabled by the technologies of information and connectivity. Risk too has changed, and until ignorance of this new landscape can be contained by experience, judgement and knowledge, we will be uncertain as to our ultimate destination: whether it be in the camp of the high rolling winners, or the bankrupt losers, or the middle ground in between. We return, as investors and workers in the late nineteenth century did, to the gaming tables of chance and speculation, risking far more on the rolls of the dice than we ought to, but knowing that if we do not roll, we cannot stay in the game.

It is dangerous to stay away from the risks of the new environment and pretend they don't exist, because the risk of being excluded from the new economy means even greater loss. The risk averse manager understands this, and goes for the lesser risk, engaging with the new landscape, charting it and navigating it for her investors, "Until ignorance of this new landscape can be contained by experience, judgement and knowledge, we will be uncertain as to our ultimate destination."

The ability to set present systems aside, and work from first principles is paramount for success in this new landscape. Risk from failed predictions still needs competitive intelligence – the new tools need to be learned, and new systems devised for disseminating this knowledge to where it needs to go. Risk from folly and poor implementation still needs a focus on developing competencies and skills in oneself and others – it is just that they are new skills and they need to be distributed differently. Risk from fraud is as real today as it ever was, but it comes from new directions as well as old, and the emerging technologies of security, authorisation and financial control need close technical supervision.

Should managers pursue risk? No, they should seek to minimise it as they have always done. That's their job. But in order to do that successfully, they need to engage with it, understand it, tolerate failure only to the extent that it teaches them about success, and ultimately seek to master it.

Should companies seek to pursue risk? All companies engage with risk – business is after all, the making of money through engaging with a risky environment. Companies and organisations can only engage with the level of risk that they can afford, however. Big, mature organisations need to learn how to engage with risk and assess it wisely. Smaller, nimbler, entrepreneurial companies need to learn skills of risk aversion if they are to accommodate growth and brand building.

The question facing both organisations and manager today is a question of knowledge. Knowing the risks means knowing the opportunities. Knowing the opportunities coupled with the capacity to act swiftly means the creation of value. In a connected world, risk has changed its face – our learning curve needs to be steep.

On August 5, 1858, the first transatlantic telegraph cable between Europe and North America was brought ashore in Newfoundland. It failed within a month, and it would be seven years before a successful working cable was in operation, but this date marks our last major shift in the boundaries of business risk. The spectrum of risk accompanying commercial and political communications across the Atlantic was suddenly brought low by the possibility of instant messages and instant news, transmitted independently of the risks and delays of transatlantic travel. It was now possible to do real-time business with Europe, without any of the risks of hazardous transatlantic travel, and knowing that a shipment would arrive only six weeks later than the known market when ordering, instead of three or four months.

One of the first messages transmitted was an instruction to General Trollope countermanding previous orders to send two regiments of troops back across the Atlantic to be redeployed in India. The Indian Mutiny had ended while his original orders were on their way to him by sea, and the telegraph message saved the British government £50,000. Few in the celebrations realised that reduction of some risks meant increases in others. Keeping the lid on industrial espionage, leaking secrets from the 19th century's industrial powerhouse – Britain – to its 20th century successor, the United States, was suddenly much, much harder than sending Customs agents to search the luggage of suspicious-looking American travellers as they embarked for New York.

Two hundred and thirty eight years earlier, in December 1620, the Pilgrims had stepped ashore at Plymouth Rock, five hundred miles to the south of where the transatlantic cable was winched ashore. Their goal was to start a new life by colonising and taming the New World, but they were woefully equipped for such a risky endeavour. Their profile was that of small town petty bourgeoisie, not especially skilled in agriculture, hunting, fishing, botany or construction. They numbered two tailors, a printer, several merchants, a silkworker, a shopkeeper and a hatter amongst them. Their cargo of shoes and clothes, sundials and snuffers, trumpets and books suggested they were moving house rather than creating a new settlement in virgin, undeveloped territory, with no European neighbours for hundreds of miles in either direction. They had neither the tools nor the skills to manage the risks and challenges of their new environment. In their first six months, fifty percent of them died.

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To the company executive of 2005, it might seem that today's companies, with their order-forms in triplicate, documents travelling around organisations accumulating multiple approvals and signatures, handwritten stock control forms, printed bank statements several days old arriving in the mail, training budgets getting larger the further up an organisation you go, strategic management decisions being made by a Board of Directors based on last year's financial performance, are all peculiar features of an obsolete worldview, and especially inappropriate to the new risks and dangers of a wild and virgin territory. In the new New World, the new executive will wonder how so many of the managers of 1999 survived, when their perceptions, skills and attitudes were so evidently unsuited to the new environment.

As with the Pilgrims, so with us. It is a matter of survival. We had better learn fast.

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