An entrepreneurial approach to risk

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Karen Campbell, Research Fellow at the Wharton Risk Center, explains why entrepreneurial thinking could help to tackle climate and other risks.

Which comes first, the risk or the opportunity? Does opportunity bring risk or does risk create opportunity? Does it matter?

Many of the 50 global risks identified in the World Economic Forum’s Global Risk 2013 report are not one time “shocks”, but threats that develop in complex ways depending on decisions made by individuals or different groups, from businesses to governments. This makes predicting risks especially difficult (see Risk Management 2.0) and means that improving resilience to uncertain challenges might be the best risk management strategy.

But how can we build resilience in practice? Global Risks 2013 includes a special section on national resilience, which identifies five attributes that can make a system more resilient: robustness, responsiveness, recovery, redundancy and resourcefulness. Strategies to boost these attributes often rely on predictive rationality – that is, estimating how a risk might play out over time and carrying out a cost-benefit analysis to decide how best to deal with it.

For example, for a given expectation of the risk of flooding in a particular area, leaders can invest in raising buildings, constructing dams and levees, and having an emergency flood plan in place for their community as part of a long-term strategy. This is likely to enhance the robustness, response and recovery attributes of resilience.

Since it is not always possible to predict how risks will materialize, though, a school of thought for managing uncertainty has emerged, known as effectual decision-making. It identifies four principles for making decisions when faced with uncertainty: bird in hand (focusing on current resources), affordable loss, leveraging contingencies (being flexible, expecting surprise) and stakeholder pre-commitments (getting commitments from different groups before a risk materializes).

It so happens that effectual decision-making is found to be the decision-making process expert entrepreneurs use to manage their unpredictable risk of a new endeavour. Could using effectual
processes also help manage unpredictable complex global risks? Two entrepreneurship researchers pointed out that entrepreneurs have the potential to help other stakeholder groups manage and mitigate the risk of environmental degradation and climate change (one of the top risks in Global Risks 2013).

The good news is that entrepreneurship researchers find that being an entrepreneur does not require being born with a certain personality trait or a higher propensity for risk-taking. Rather, anyone can be an entrepreneur by learning to think effectually. Furthermore, applying this type of rationality could enable individuals, communities and nations to be resourceful – an attribute of resilience. For example, individuals can enhance resourcefulness prior to a risk event using effectual reasoning by working with stakeholders on mutual aid agreements (building stakeholder pre-commitments). This reciprocity increases resilience by speeding resources from unaffected areas to affected areas.

Many top corporate risk managers use The World Economic Forum’s Global Risk Report to generate risk scenarios. This process can be an effectual strategy that harnesses the internal knowledge and capabilities of the organization, which speeds organizational learning and increases flexibility in an ever-changing environment. Through a larger project at the Wharton Risk Center, we are identifying other effectual strategies risk managers in S&P 500 companies are using.

It is tempting to read Global Risks 2013 as a warning, but instead it could be viewed as 50 value-creating opportunities for stakeholders who not only want to survive, but want to help us all thrive in a complex world full of risk. The best global risk management strategy might be to see opportunity where others see a problem, and solve it. What are your value-creating solutions to the 50 global risks?

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