Bringing Value to Scorcerading

Part III in Series on Risk Management

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Addressing risks of an agribusiness through a strategy that mitigates downside risks and effectively manages upside risks is necessary for success in today's competitive environment. Our previous two columns on risk management outlined a risk scorecard that classified qualitative risks into six categories. This article focuses on how a manager can interpret the risk scorecard and use results to form effective risk management strategies.

INTERPRETING THE RISK SCORECARD

The risk scorecard (Figure 1) is comprised of six risk categories and three dimensions of risk—potential, exposure, and likelihood—associated with each category. Potential and exposure categories represent upside and downside risks, respectively, while likelihood is the chance of these risks occurring. Each measure is based on a 1 to 5 scale with 1 being low or unimportant and 5 being high or very important. Using the numbers from the completed risk scorecard, the decision-maker can plot each risk's likelihood/potential and likelihood/exposure score on Graphs 1 and 2, respectively.

The graphs are a visualization of the risk scorecard. Ideal and adverse quadrants are labeled and arrows are utilized to show possible paths a manager might take in managing the risk. As an example, ABC Seeds Inc. completed a risk scorecard (Figure 1). Since ABC Seeds recently acquired a state-of-the-art research laboratory, it gave technology a potential score of 5 and a likelihood score of 4. In essence, ABC Seeds knows it is in a position to develop innovative products that positively impact profits. Therefore, the company is in the ideal potential quadrant for technology risk and current strategies are sufficient.

The likelihood/exposure score for ABC Seeds' financial risk category places the risk in the adverse quadrant, which indicates immediate management of the risk is needed. An example of this would be if ABC Seeds were a startup seed company with limited financial resources. Through strategic alliances with venture capitalists, it could begin to decrease the score of financial exposure. The likelihood of financial exposure may be unaffected since the seed company is underway and venture capitalists may not provide multiple rounds of funding. However, continual interaction between both parties of the alliance should cause the likelihood of financial exposure to decrease.

Often strategic risks fall into neither the ideal nor adverse quadrants, rather, into one of the two questionable quadrants. These quadrants present the greatest dilemma in strategic risk management. As the arrows in graphs 1 and 2 indicate, risk strategies should move a risk from a questionable quadrant to the ideal quadrant. For example, a risk category score in the upper left quadrant of the potential plot (Graph 1) tells a manager to focus on strategies that increase the potential score. If a new category score on the exposure plot (Graph 2) were in the upper left quadrant, a manager would focus on decreasing the likelihood of the downside risk.

POTENTIAL RISK MANAGEMENT STRATEGIES

Continuing our scorecard example (Figure 1), potential risk management strategies are provided to demonstrate how to move from a questionable quadrant into the ideal quadrant. One section for increasing the likelihood of the business/operational risk (#1 in Figure 1) would be to hire a market firm to develop a customer relationship management database that contains information such as expectations of customer service and product performance. To increase the potential exposure, financial allocations to uncertain investment projects (#2 in Figure 1), ABC Seeds should utilize real options analysis to determine the proper timing of investments. To decrease the likelihood of losing future turnover (#7 in Figure 1), ABC Seeds could increase human resource management to provide expertise in tactics. A way to reduce exposure from a delay in seed delivery to customers (#10 in Figure 1) would be to ensure multiple customers (avoid concentration) and provide incentives to participants in the distribution channel to deliver on time.

We have presented a systematic way for firms to assess their tactical and strategic risk positions. Through the qualitative ranking system, scorecard, and graphs, decision-makers can develop strategies for risks to maintain their competitiveness by exploring their potential risks and reducing their exposures. Decision-makers should note that some decisions can have cross-risk implications, and those interactions should be considered before implementing any risk management action. The next article in this series will address the consequences of risk management decisions via a decision tree analysis.

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