Strategic Risk Assessment Through Scorecarding

By Brian Briggeman, Josh Detre, Michael Boehlje, and Allan Gray

Our previous article developed a broad taxonomy of the risks faced by an agribusiness and noted why they should understand both tactical and strategic risks. In a competitive environment, it is important for a firm to be willing to take certain risks if it wishes to create long-term value. Risk has both an upside and a downside; focusing only on risk avoidance could cause a firm to overlook opportunities to create value. To truly understand how to manage risk, firms should start by conducting a critical assessment of each risk they face. This article describes an approach to do so.

Assessing Risk

Each risk category identified in our previous article has three dimensions of risk: potential, exposure and likelihood. These dimensions help us characterize the risk for a firm in terms of the impact each category can have on its profitability, image, and competitive position in the marketplace. Assessing these dimensions of risk is the key to understanding how to deal with it.

The dimension of potential refers to the upside or additional value the risk category offers to the firm. When thinking about risk management, this dimension of risk is often overlooked and can lead to the deterioration of a firm's long-term value. Potential can be thought of as the opportunity that the firm has if it takes risk. When outcomes are favorable, the firm may find itself with such benefits as a new market, more loyal customers, a distinct cost advantage over competitors, or another strategic advantage that creates long-term value. Starting the risk assessment process by measuring potential can frame the firm's goals and potential gains for taking the risk. For a seed company, a business relationship risk that results from supply chain arrangements might create potential in the form of loyal retailers, who could promote the company's seed products over those of its competitors.

The next dimension is exposure, which is an examination of the downside loss that a risk poses for the firm. Exposure asks, "If this category of risk has a bad outcome, how bad will it be?" Exposure is often thought of in terms of how many dollars the bad outcome will cost the company due to lost customers, a tarnished image, legal fines, etc. Measuring exposure is important because the firm must realize how dire circumstances could be for the company if the bad outcome were to occur. By assessing the exposure, management becomes aware of the dangers of the risk and can make informed decisions based on possible exposure. An exposure that may arise from a supply chain arrangement would be if the retail sellers reneged on the terms of the contract. In essence, loss of the contract would reduce sales volume, causing returns to fall.

Likelihood, the final measure, is the chance a potential or exposure event will occur. Having determined the potential (exposure) of a particular risk category, a firm wants to know what the likelihood is that this exposure could be realized. For example, it might decide that there is a "medium" likelihood that the potential event occurs and "high" likelihood that the exposure event occurs. Measuring the likelihood helps put potential and exposure events in the proper perspective.

A Scorecard for Assessing Risk

Figure 1 provides a scorecard that you can use to assess each category of risk for your firm. The scorecard contains the six broad categories of risk identified in the last article and asks you to rate these risks on a scale of 1 to 5. A 1 indicates that the risk category is low, unimportant, or has minimal impact and a 5 implies it is high, very important, or has a large impact. Following our example, we have rated the business relationship risk potential a 2 with a likelihood of 2 and exposure 4 with a likelihood of 3. This rating is purely our management team's informed assessment about the risk. The rating itself is not what creates value in the assessment process,;rather, it is your team's discussion of risks that provides insight into the opportunities and challenges that they provide.

Having learned how to assess risk, we will introduce in the next article in this series a tool that allows characterization of management actions—whether to take certain risks, avoid those risks, or manage them carefully.

Figure 1. Risk Assessment Scorecard

Category of Risk	Potential: Low 1	2	3	4	High 5	Likelihood: Low 1	2	3	4	High 5
1. Business / Operational	1	2	3	4	5	1	2	3	4	5
2. Financial	1	2	3	4	5	1	2	3	4	5
3. Business Relationships	1	(2)	3	4	5	1	(2)	3	4	5
4. Market Conditions	1	2	3	4	5	1	2	3	4	5
5. Policy and Regulation	1	2	3	4	5	1	2	3	4	5
6. Technology	1	2	3	4	5	1	2	3	4	5

Category of Risk	Exposure: Low 1	2	3	4	High 5	Likelihood: Low 1	2	3	4	High 5
1. Business / Operational	1	2	3	4	5	1	2	3	4	5
2. Financial	1	2	3	4	5	1	2	3	4	5
3. Business Relationships	1	2	3	(4)	5	1	2	(3)	4	5
4. Market Conditions	1	2	3	4	5	1	2	3	4	5
5. Policy and Regulation	1	2	3	4	5	1	2	3	4	5
6. Technology	1	2	3	4	5	1	2	3	4	5

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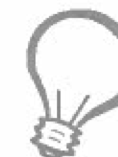

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