

Outside the Comfort Zone

Managing risk is a necessary part of entrepreneurial businesses and one where taking the right approach can bring lucrative rewards and countless opportunities.

By Tim Wallace

Successful entrepreneurs recognise that risk comes with the territory. But they tilt the game in their favour by being prepared to play the hand that fortune deals them. They work the odds, knowing when to hold and when to fold.

They know also that without risk being an inherent part of business there would be no opportunity. As Charles Dickens might have written had he been a management consultant, risk is the worst of times and the best of times, the winter of discontent and the spring of hope.

“Business is constantly changing, and the rate of change is accelerating,” says Harold Clough AO, Chairman of West Australian engineering design and construction company Clough Limited. “The great thing about change is that it always creates new opportunity.”

Clough joined his father’s business in 1954 and says since then his company has made its biggest advances by taking risks at the limit of its ability — and succeeding.

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“It’s usually not an option just to maintain the status quo. Much as very often you’d like to, just the nature of the thing doesn’t allow you to do that. If you can’t remain static at whatever level you happen to be at, you’ve either got to go up or down, and given that option you’ve obviously got to go up, so generally you’re tending to always be trying to expand the business.”

Clough says an entrepreneur is someone who will take a well-evaluated risk. “We certainly take risks, but we try to make sure the odds are on our side. Sometimes, even though the odds are on your side, you still lose, but on the balance, if you get the odds right you’ll come out in front. That’s why the bookmakers usually do much better than the punters, because they run a book when there’s enough off-setting bets to cover the ones where they miss, and you’ve got to run a business like that.”

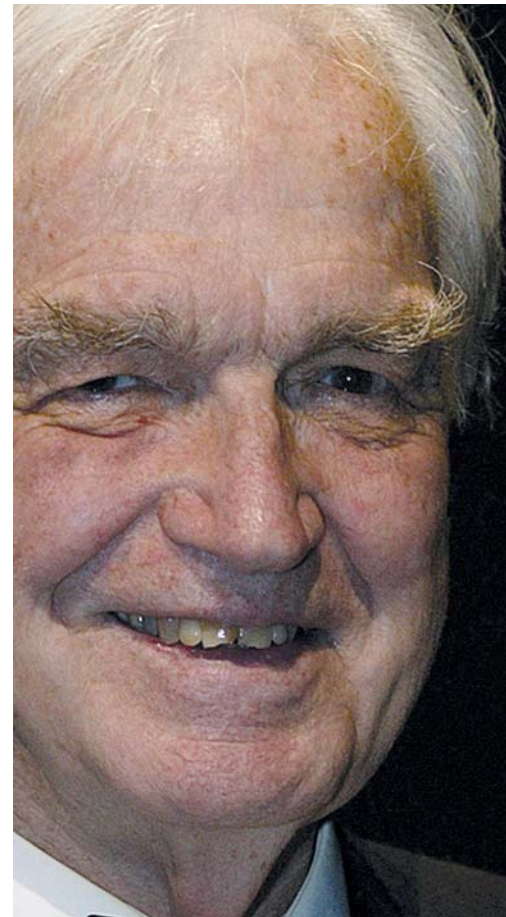
David McGregor, a Partner in the Entrepreneurial Growth Markets group at Ernst & Young says, “a common issue within growing companies is an ill-defined range of what is acceptable risk. If there is a Board in place, then quite often the risk expectation of entrepreneur/management and Board have not been discussed and aligned. Previous success and gut instinct in risk-taking is no guarantee of future success. Our experience has shown that those companies that blend gut instinct with planning, discussion, execution and debrief are the ones that tend to succeed more often than not.”

Doing nothing is often more risky than taking a deliberate risk, says Adam Davis, who survived the character-building episode of watching his educational dot-commer Tribeca shrink from a market capitalisation of more than \$100 million to \$5 million in 12 months.

“In some respects the decisions we made at the time to undertake massive organisational restructures and move the company forward in a different direction contained a high level of risk,” Davis says.

“Yet from other perspectives that was almost the least risky option. It was almost a paradox, in the sense that doing something different tomorrow to what you do today is risky, but when you face a situation where that’s the only way you will survive, not addressing that risk is actually more dangerous than doing so.”

To survive where so many other dot-com ventures languished, Davis moved Tribeca away from its original business model — online education focused on the secondary school market — to financial services education, aggressively pursuing growth through



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Harold Clough AO is Chairman of Clough Limited which is one of Australia’s largest multidisciplinary engineering construction, operations and maintenance contractors.

Clough Limited has interests in the oil and gas, minerals, infrastructure, manufacturing and property industries. The company’s 4,000-strong workforce operates throughout Australia, Asia, the South Pacific, the Middle East and offshore Europe.



NAME David Bohn
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David Bohn is Managing Director of Foursticks. Foursticks develops proprietary technologies that improve the performance of business critical applications on computer networks.

Founded in 2000, Foursticks has had six quarters of consecutive growth with exports making up almost 80 per cent of its revenue. Foursticks closed a major deal in the US in late 2003, the same year industry giant IBM took an equity stake in the company.

acquisition, consolidation and the integration of training businesses along with organic growth. The company is back to a market capitalisation of \$30 million — “still a long way from when we originally listed four years ago, but out of the 200-odd technology companies that listed during that time we’re one of only a handful that have survived, let alone that have generated a profit and paid a dividend for two years.”

Davis recognises the risk that is inherent but unavoidable in the company’s need to grow. “As a listed public company we’re still very small, with a market cap of \$30 million. That’s almost irrelevant to the markets. So one of the key issues for us is how do we become relevant, how do we significantly grow the scale of our operating business so that we can be relevant to the capital markets and it makes sense for us to actually be listed.

“Now, to do that you need to undertake probably higher risk business activities, such as pursuing further acquisitions, raising capital, perhaps utilising debt to leverage up part of the business; and all of those things have a level of risk.

“Risk is something that is inherent in everything we do, from a personal or a business perspective, and the important thing is to manage risk, and to try to appreciate the relationship that exists from a business perspective — risk and return — and to identify as an organisation where you sit on that risk-return spectrum.”

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McGregor appreciates that pressure the market can bring. “In order to get on the radar of the market, small listed caps need to grow quickly, which invariably is through risky strategies. This is where use of a risk framework becomes critical when analysing decisions. The framework ensures consistency, encourages research and discussion, consideration of what could go wrong as well as what could right. The framework enables clarity to be given to the team, management and the board,” he says.

Finding the balance in your team between those who excel at business development and those who are good at corporate governance is key, says David Bohn of Foursticks, the technology company that streamlines computer networks. “Certainly I think a large number of entrepreneurs don’t have the adequate skills to build a big company.”

“My idea from day one was to bring in an experienced board, to start with good corporate governance skills and understanding, so they could help me understand the issues, and also would be perceived by investors as better from a management and risk-management point of view.”

Employing the right people is crucial for Bohn. “Access to experience is a great way to manage risk,” he says, citing the importance of his own formal and informal networks of advisers. “Hopefully through their experience, and our openness to listen and learn from them, we can avoid some mistakes.”

Foursticks, founded in 2000, is now in its third-generation management team. “No one from the first team is in the current team at a management level,” Bohn says, “and we are transitioning management again. Most of our business is in the United States, so we need to develop a more US-centric management team.

“When you go through phases of growth, from 12 people to 50 or 100, it is a very different dynamic, and I think the core of the culture needs to remain but it’s not going to be the same; you’re then at the point you need a lot more systems and processes and repeatability to manage risk. It comes back to getting the right management team who have done it before and can do it again.”

Having been there and done that came in handy when SARS and the war on terrorism put the brakes on travel and threatened Foursticks’ foray into the Asian market. “We pulled out quickly because we just couldn’t fund the time we thought it would take to get

back on track,” Bohn says. “That was a good decision, though it meant we never realised some of our growth in the region.”

“We had about eight to 10 deals in the pipeline, and two were close to being finished. We stuck with those, managed them from head office, and then closed them about a year later. If we’d hung around for all of them and kept pouring money into that then we would have been struggling. Some of that came from our managers’ experience when the Asian meltdown happened.”

“To grow the business profitably we’ve had to take some substantial risks. But what we do well is manage those risks – and understand them. And more importantly, we understand the consequences of the risk.”

An eye on the future and being nimble enough to change direction is a big part in the risk management strategy of Madman Entertainment in distributing and marketing arthouse and niche videos and DVDs.

“Yes, the internet is an issue and piracy is an issue and emerging new formats is an issue, but they’re all just conjecture at the moment,” says Tim Anderson, Joint Chief Executive Officer with Paul Wiegard. “We see a good few years in the DVD industry yet.”

“And we’re not big speculators. We’re not going millions of dollars into the red against future earnings. We’re very much invest in a product now, release it six months later and realise a profit hopefully within a couple of years, if not within year one. In that sense we’re working very much in the now, which is low-risk. Even if the business did turn on its head in three to four years time, I still expect us to be quite profitable for the next few years.

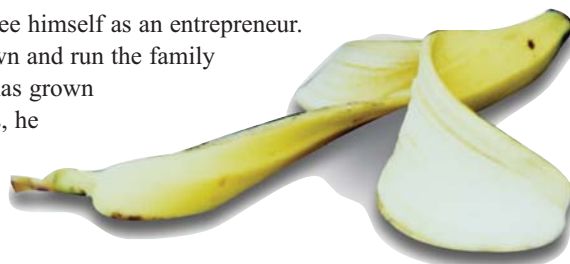
“As far as risk management goes, in terms of seeing what’s coming up, we’re a small company so we’re not spending millions of dollars on speculation and buying out clever internet technologies like a lot of the big boys are, and I believe that most of them are just wasting their money based on speculation at the moment.”

“We are savvy. We’ve got our own very good IT and production departments. We do everything internally, and we’ve got a fantastic team that is very well-versed in all the latest technologies. We’re basically going to observe what is going on in the industry, and when we feel the time is right I think we’re small and flexible enough to make changes rapidly.”

Anderson regards the business of publishing and distributing DVDs as comparatively low-risk. “No one’s going to get a disease or food-poisoning or accidentally cut their own throat from opening a DVD case,” he says. “We’ve got product liability insurance but overall I feel were quite a low-risk business.”

One issue, though, is product supply. To minimise the risk of relying on outside resources, Madman has its own production department and printing company. “So as far as being across critical paths and timelines of production, and making sure the product is of the highest possible quality, we’re risk-managing that by the entire process being transparent to us and being in full control over where our product is at,” Anderson says. “That is possibly something that is unique to us, in that we produce pretty much everything ourselves.”

Philip Rossi says he doesn’t see himself as an entrepreneur. But as the fourth generation to own and run the family business, which he estimates he has grown 1000 per cent in the past 12 years, he does see himself as leading an entrepreneurial organisation that embraces and manages risk.



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Tim Anderson and Paul Wiegard are Joint Chief Executive Officers of Madman Entertainment, an independent distribution company specialising in arthouse and Japanese animation (anime) videos and DVDs.

The company distributes to retail and rental stores nationally, and has takings this year of some \$55 million. Madman Entertainment controls around 90 per cent of the Australian anime market.



NAME Soheil Abedian
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Soheil Abedian is Joint Managing Director of Sunland Group. Sunland Group is a property development company with a reputation for work of outstanding quality, originality and distinction. The company's current projects include Q1, the world's tallest residential tower, at 80 levels, due for completion in August 2005.

Sunland Group has achieved double-digit growth every year since 1995, and posted a record net profit at June 30 2004 of \$55 million with revenue of \$390 million.



NAME Adam Davis
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Adam Davis is Chief Executive Officer of Tribeca, which provides a broad range of education, professional development and compliance solutions to the financial services sector.

Tribeca ranked first in *BRW* magazine's *Fast 100* list in 2003, and is the 13th best performing company on the Australian Stock Exchange. Tribeca has experienced 500 per cent growth in three years and employs more than 80 people.

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“If you’re an organisation such as ourselves where you’re bringing on new products into new markets all the time, you’re going to be faced with an enormous amount of variability,” Rossi says. His company, Tapex, is a leading-edge manufacturer of plastic extruded products for a variety of industrial and domestic purposes; from the bright orange safety fencing around roadworks to the twine butchers use to tie up meat. He says the business is a very different business to what it was two or three years ago.

“We live by the philosophy he who dares wins, because there’s a correlation between risk and return. To grow the business profitably we’ve had to take some substantial risks. But what we do well is manage those risks — and understand them. And most importantly, we understand the consequences of the risk.”

Rossi nominates three levels of risk management. First, the process risks — the risks of the things you do every day. “On that we have a very, very clear documented strategy. They’re risks we just don’t like to take, they should be managed absolutely brilliantly,” Rossi says. “We have back-up plans, we have documented what-if scenarios, etc.”

The second level of risk involves the likes of acquisitions and big strategic moves by the organisation. “We want to know the worst-case so it’s not going to bring everything down in a screaming heap,” Rossi says. “So hopefully we don’t get any surprises in what we do, and if we do they’ll be pleasant ones, not bad ones. To manage those types of risk we very much have strong views within the organisation that everybody has an input into the decision-making process, or the risk analysis, then we use a lot of external people to help us out.”

And the third level of risk, says Rossi, is the risk of not doing anything at all. “I think this is where my competition has failed dismally. They have faded, whereas we are reinventing ourselves through developing new products and new markets.”

McGregor has witnessed those companies that get it right — ones that usually allocate sufficient time to plan and discuss decisions prior to execution. However, one area often overlooked is the debrief, or reflection. Many decisions are made during stressful times and companies do not take the opportunity to look back in order to see where they could improve.

“Risk is about level of knowledge,” says Soheil Abedian, joint Managing Director of Sunland Group. “Limited knowledge makes everything risky.”

Abedian considers risk management the fundamental of his property development business. All along the line his company manages risks, striking a balance between the design factors that make a product marketable, through to pre-selling to reduce the financial risk and using its own construction firms to control timing and keep building costs in check.

But the real entrepreneur can only manage risk so much. At some point, and probably at many, there is a need to take the greatest risk of all, which is to back yourself.

“When you are visionary, at the beginning because it is so different, so out of the norm, you will have more people saying no than are saying yes. And after, when it happens, everyone will accept that it was visionary and was good, and that is why progress has been made, because somebody has an idea, they go through the hardship, they put it together, and the rest of the people follow it.

“It would be a little bit stupid of me if I tell you that whatever I’ve done in my life is 100 per cent.” Abedian says. “I believe we are learning irrespective of the financial outcomes and success. We are challenging ourselves in regard of the design and construction. To say that one of them didn’t go well financially I couldn’t tell you, because we’ve been very lucky in that area.”

“But I don’t see that successful entrepreneurs are necessarily those who have just a financial motivation. I believe they are those that are pushing the boundaries, to create something else that nobody else in that industry has done, irrespective of the financial outcome.” ■



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Philip Rossi is Managing Director of Tapex, a leading manufacturer of plastic and polymer-based products.

Tapex was the first company in the world to produce blown film yarn for synthetic sporting surfaces. It now produces Pinnacle FB, one of the world’s leading sports fibres.

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