Mitigating Risks for Small Business Owners

Creating a Risk Management Plan

Small business owners make up most of the U.S. economy. While the statistics are not often reported by the media, according to the U.S. Small Business Administration (SBA), almost 50 percent of Americans either own or work for a small business.[1]

Further, the SBA states that small businesses account for:

99.9%
OF THE NATION'S FIRMS

99.7%
OF ALL FIRMS WITH PAID EMPLOYEES

2 OUT OF 3 NEW JOBS IN THE U.S. EACH YEAR

That's the good news. The not-so-good news of small businesses is as sobering as the good news is exciting. According to data from the Bureau of Labor Statistics[2] about:

20/100 **OF SMALL BUSINESSES FAIL IN THEIR FIRST YEAR**

50/100 **FAIL IN THEIR 5TH YEAR**

It's important to note that these statistics reflect all small businesses, but the reality is that the facts are different when you look at business success and failure by industry.

And while there might not be statistics to support this next statement, creating a risk plan that touches on four major categories should improve the chances that a small business will survive. Let's examine the four major risk categories.

MARKET RISK

Market risk is a broad topic that can cover just about any aspect of your business. But it makes sense to focus your market research on two key groups: your consumers and your competitors.

Marketing 101 suggests that you need to understand your consumer base and your competitors well before you launch a small business—and you probably do. But have you gathered empirical data to support your business ideas?

Start by answering these basic questions:

- First, is there a demand for your product or service?
- If there is a demand, how many people would be interested in your offering?
- Are there competitive options that are already available to your customers? And if so, what do people pay for these alternatives?
- How is your offering different?

The answers to these questions will lead you to additional questions and information. By taking time to answer them, you will better understand your opportunities and limitations for gaining customers.

CREDIT RISK

There are many reasons why 50 percent of small businesses fail by their fifth year, but there are a few reasons that seem to recur more often than others. At the top of the list is a lack of funding.

In fact, according to an analysis by CB Insights, 29 percent of small businesses failed because they ran out of cash (interestingly, 42 percent failed because there was no market demand for their products or services).[3]

But cash flow is not just tied to start-up capital, it is also very much tied to accounts receivable—when your customers pay you. And since many business transactions are conducted on credit, it's important for small businesses to understand their clients and their clients' ability to pay.

If you open a coffee shop and your clients pay with cash or a credit card, then your credit risk is not very high. But when you open a business where you don't ask for payment before (or when) you deliver your product, then your credit risk increases.

It sounds simple, but make sure that you check the credit of any customer that you're extending credit to.

OPERATIONAL RISK

Investopedia defines operational risk as "the risk not inherent in financial, systematic or market-wide risk" [and] "includes risks resulting from breakdowns in internal procedures, people and systems."[4] That's a big one.

Small business would do well to summarize operational risk as "human risk" and recognize that:

- It changes from business to business and industry to industry; and
- A business with less human interaction will by definition have lower operational risk.

Do you know the operational risks in your business? You might have the best product, but are there weak links in your supply chain or internet security or with your aging (or young) sales force?

REPUTATIONAL RISK

Reputational risk is the one that probably keeps most small business owners up the at night. It's also the one that can be very challenging to manage. Reputational problems often begin inside the organization. But third-party relationships also heighten reputational risk as more companies are being held accountable for the actions of their vendors or other business partners. In addition, perceptions will often vary from location to location, so an issue that threatens a location in Connecticut, for example, might not matter in Arizona.

But as Warren Buffet said, "it takes 20 years to build a reputation, and five minutes to ruin it."

Create a Risk Management Plan

Owning and operating a business—no matter its size—will bring you a number of risks that can dramatically alter your business and potentially cause you financial hardship.

But you can protect against those risks by creating a risk management plan in a few very simple steps:

- Identify the risk.
- Assess the likelihood of the risk.
- Attack the risk.
- Periodically monitor and review the risk.

Ways of Dealing with Risk

There really are just four ways of dealing with risk. You can:

- accept it;
- transfer it;
- reduce it; or
- eliminate it.

And good risk management will improve the likelihood of your business succeeding.

Let me know how I can help you build a customized risk management plan for your business.

SOURCES

1 https://www.sba.gov/sites/default/files/advocacy/All_States.pdf

2 https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm

3 https://www.cbinsights.com/research/startup-failure-reasons-top/

4 https://www.investopedia.com/terms/o/operational_risk.asp