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Are You Managing Business Risks?

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Management's ability to identify and manage business risks is critical for any size and type of company. Harlan Platt, a recognized authority on business turnarounds, states "virtually every company, regardless of its size or dominance, will likely go through one or more periods of serious jeopardy to its existence during its business lifetime." The number of business failures is alarming. This supports the fact that every company needs some form of a risk management process. The size and complexity of the company will determine the magnitude of the process. How vulnerable is your company to deficiencies in the key business components shown below? What improvements need to be made to mitigate risks and ensure long-term success?

Ability to generate free cash flow- Any business, whether it's a one-person firm or a "Fortune 100" company, must generate cash flow to survive and to create value. A company can have what appears to be a reasonable net profit and still have a negative free cash flow. This occurs when the business is utilizing a significant amount of capital. Two major capital components are working capital such as accounts receivable and inventories, and capital expenditures for assets like buildings, machinery and equipment.

Debt position- A company having excessive debt where interest costs and debt repayments impact earnings and cash flow, results in elevated risk.

Management process- A productive management process will include such components as: having the right people in the right jobs- beginning with leadership, properly managing employees, planning and executing effectively, have proper operating information and measurements, ensure business processes are effective and efficient, and developing and promoting a winning culture.

Market and competitive intelligence- An effective market and competitive intelligence process should be in place. Unless the company can analyze and understand market trends, determine short and longer-term customer needs, and be one step ahead of competitors, the organization's strategy and direction will be flawed.

Customer composition- Typically, companies will have a reasonable number of customers they serve. Some organizations, however, are dependent upon a few or even one customer. If a large customer, that generates a high degree of profit and cash flow for the company, was to go to a competitor, the company could be at great risk.

Supplier management and relationships- At times companies become "comfortable" with their suppliers or business partners and do not properly evaluate their current suppliers or alternative suppliers in their industry. The best suppliers in the industry might be business partners with their competitors.

Access to external financing- Senior management should have relationships with a number of financing sources beyond their current source of financing such as their bank or lending institution. There are certain things that the company must have in place to obtain financing. These can be a combination of: collateral, profitability (certain lenders will forego profit for the right collateral), quality of accounts receivable, accurate and timely financials, management expertise, length of time in business, and an overall favorable risk profile among others.

Financial reporting practices- Financial statements must be accurate and timely. There are a number of adverse consequences of inadequate financial reporting including poor decision making, it limits or could eliminate external financing choices, an inability to attract the best suppliers/business partners, non-compliance with external requirements such as tax filings and other consequences.

Internal controls- Deficiencies in internal controls can lead to such things as: not billing every customer order, accounts receivable being delinquent and/or uncollectible, inadequate control of inventory, improper disbursements, loss of critical information resulting from not backing up computer files and others.

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