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ISSUE HIGHLIGHTS

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Managing Your Industry Risk

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With every business venture, there are inherent risks that can affect its success. Initially companies address these risks within the business plan. A common problem is that risks noted at the beginning of a project or investment are later forgotten. Venture capitalists carefully evaluate the risk exposure a company may have during an investment. Engineers will weigh risks when designing a new technology. However, in many cases little formal risk management is done afterwards. Not only do risks change in intensity, but new ones emerge, and others disappear. As an industry or company develops, risk factors change, and vulnerabilities emerge.

As a venture capitalist or entrepreneur, it is important to take an active and deliberate role in managing your risks as your company and industry develop. Doing so ensures that your strategy stays on track through business growth and industry change. Managing your risks on an ongoing basis is just as important as considering them in the first place. Failure to do so may not only bring about a crisis by surprise, but also may result in missed opportunities.

The following is an introduction to managing industry risk.

Identify the Forces that Affect Your Company and Industry

"Risk management can be overwhelming. Start with the highest priority item and add other risks as your efficiency and resources increase."

Although individuals are often aware of the forces that affect their companies, many rarely make a conscious effort to identify and categorize the forces. Identifying and categorizing are the first steps toward managing risks and are worth the time. Moreover, it is important to re-identify and re-categorize regularly, with the frequency dictated by the volatility of the particular industry.

A simple model to begin with is *Michael Porter's Five Competitive Forces*. Feel free to expand on it as needed to fit your business and industry.

(1) Buyer Power

- Emerging customer-driven trends
- Consolidation of buyer market

(2) Supplier Power

- Supplier changes, industry realignments
- Mergers and acquisitions
- Changes in buyer segments served

(3) New Entrants (or changes with existing entrants)

- Acquisitions and mergers that create new companies
- Partnerships, relationships, alliances that change a company's competitive positioning

(4) Threat of Substitutes

- New disruptive technologies
- Re-packaging of existing products

(5) Industry Rivalry

- Existing competitors
- New competitor strategies (rule-changing moves)
- Government regulation changes

This undertaking will leave you with a sizable list of risks that can alter the success of your company. Determine the weight and severity of each of these items and prioritize them *1* to *n*. As resources are easily strained, and projects balloon out of control, it is best to concentrate on "high-risk" areas that will have the greatest affect on your success. Risk management can be overwhelming. Start with the highest priority item and add other risks as your efficiency and resources increase.

Controlling Risk—Identify, Analyze and Predict

Every company's best tool to manage its risks is Competitive Intelligence (CI). Competitive Intelligence is a forward-looking decision support system that helps you identify, monitor and manage your risks. It is the practice of creating a system to pick up signals, apply an appropriate analysis framework, and make sound judgments about the future. CI creates the advantage of strategic decision-making and greater control, displacing more reactionary measures.

Detection

The first step is to create an early warning system or "radar net." After you have identified the risks that affect your company, consider the indicators that signal these risks. For each of the most crucial risks determine all possible indica-

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tors. Correctly identified indicators give you an important forewarning of impending change.

This task requires you to think in a "cause and effect" way. If you have trouble doing this, look at a past occurrence. Identify the signs that led up to that event. How might these signs have been detected beforehand? Apply this thinking toward your current risks.

"Companies rely on the connections and networks of their board members - industry insiders or venture capital investors - only to find that those insiders all shared the same erroneous beliefs. That's how a bubble happens - collectively shared but poorly examined assumptions."

– Agnes Imregh
Vice President of Marketing at LuxN

As a common example, let us postulate that disruptive technologies are a major risk factor for your company or a portfolio company. A disruptive or substitute technology is a new product or service that meets the same basic market requirements as an existing product or service but does it in an inherently different way. Over time, disruptive technologies can displace incumbent products or services through lower cost, ease of use, etc.

Some indicators of an impending disruptive technology are:

- Patents (newly filed and trends)
- Research (academic, funding)
- Technology life cycle positioning (Base Technology stage of Technology "S-Curve")
- Bibliometric indicators (published information, flow of scholarly information)
- Industry player moves (Direct and indirect competitor moves, parallel industry changes)
- Unanswered market needs (charting customer needs against current product offerings)

Companies will need to develop their CI systems to capture (and monitor) these changes. This involves utilizing internal resources and often the use of external CI professionals. The best method to prepare any company is corporate-wide training and awareness of competitive intelligence practices and corporate goals.

The majority of these efforts requires human source intelligence collection. Essentially, this involves targeted questioning of key people with access to the pieces of information that make up the intelligence puzzle. Typically, this includes company personnel at all levels that gather and feed intelligence into the corporate system. External consultants can provide additional intelligence through the targeted questioning of key industry resources.

Analysis

Expert analysis depends on choosing the proper framework to organize the data and collect signals. This helps to form a clear picture of the competitive landscape. Management of disruptive technology, for example, would require the simultaneous tracking of business conditions and long-term technical trends.

Here are some common Science and Technology CI analysis techniques used to analyze disruptive technologies:

- Patent analysis (Noting trends and patterns)
- Reverse engineering analysis
- Structural modeling analysis (Linear statistical modeling)
- Contextual analysis (Data mining)
- Competitor technical profiling
- Trend analysis (Using formulas such Bass or Harvey Innovation Diffusion Models)
- Technological substitution model analysis (Fisher-Pry/Pearl-Reed Curve)

Judgment of Future Events

The critical factor in managing risks is the sound judgment of future events. You must apply the intelligence gathered to the strategic decision-making of your company. This is often a joint venture between CI professionals and the key corporate decision-makers. Use the collected intelligence to make well informed strategic decisions now to put the organization in a more competitive position in the future.

The field of *science and technology CI* forecasting is too large and complex to address here, but there are a number of techniques used to feed intelligence into disruptive technology forecasting models. The most common is the "Individual Expert Opinion." However, this often falls short of expectations. *The Delphi Technique*, *Lead user analysis* and *Relevance tree models* also make use of judgmental forecasting techniques but are more structured and advanced. *Forecasting by analogy* uses historical data and current intelligence to draw analogies. *Trend extrapolation* also makes use of analogy comparisons by noting the frequent pattern for technologies with a known natural upper limit. Alternatively, *Scenario modeling* can be used explore other developments where the future might significantly deviate from current trends. *Precursor correlation* methods plot research and development versus commercial production timeframes.

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The method you choose depends on your industry, intelligence needs and available information. The key is to make the most use of the information and intelligence you have already gathered. Choosing the right model will give you the best possible vision of future events.

Summary

Managing industry risk is no longer an option; it is a requirement for a company to stay viable and competitive. Relying on guesses, unqualified information and assumptions to make strategic decisions proves to be costly when strategies created fall short of expectations and fail to meet industry demands. Last minute strategy changes also substantiate the need for risk management through lost opportunities and wasted resources.

To manage risk successfully requires getting beyond the less sophisticated and *ad hoc* methods commonly used. It was once believed that a few calls to known contacts in the industry would provide all the needed information about a situation. Agnes Imregh, vice president of marketing at LuxN, said, "Companies rely on the connections and networks of their board members - industry insiders or venture capital investors - only to find that those insiders all shared the same erroneous beliefs. That's how a bubble happens - collectively shared but poorly examined assumptions."

Biased views, opinions, and unqualified gossip among colleagues can be misleading and costly. With global competition, volatile market places, mergers, acquisitions, and changing technical landscapes, an entirely informal approach not only proves to be ineffective but foolhardy. Simply reading industry publications or commonly available market research reports from the large consulting firms does not provide any competitive advantage when everybody is reading the same commentary.

Unless a conscious effort is made to manage risks through organized intelligence, your company or investment relies on tactical fire-fighting instead of innovative strategy-making that anticipates future events. The market is currently full of companies with one foot already in the grave trying to re-invent themselves. What will distinguish survivors is the employment of strategies that change with the environment. Proactive risk management allows you to compensate for industry changes to keep your company on top.

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