Managing business risk

The commercial world abounds with risks, and life science companies can enhance their ability to manage them effectively, says Stuart Henderson.

The breadth, depth, and pace of change faced by all life science companies pose many challenges and risks. Some of these risks are unexpected, but others—at least to some degree—are both foreseeable and manageable. Senior executives and investors often evaluate a company's ability to manage its risks on the basis of its management's track record, but previous experience alone is no guarantee that a company has sufficient risk management capability to safeguard its future success. A recent study of UK life science companies suggests that many companies pay insufficient attention to business risk management, and would benefit from taking a more strategic approach to this important aspect of business (see "The study"). Although this study focuses on the UK sector, its findings are likely to be relevant to life science executives everywhere.

The silent threat

Business risk is usefully defined as "[t]he threat that an event or circumstance will adversely affect a company's ability to achieve its business objectives and execute its strategies successfully." This definition is a powerful stimulus to get management thinking, covering as it does the broad spectrum of variables that can affect the operation of a company. Business risks include those arising both inside and outside the company, and include both commercial and scientific risks. Perhaps most importantly, "adverse affects" can include the failure of an organization to optimize its assets—both tangible and intangible—resulting in the loss of the company's competitive edge. Simply put, good management of business risk can enable a company to make rational business decisions when faced with the powerful and dynamic forces shaping the global life sciences arena. However, it appears that many managers do not, as a matter of course, evaluate the full spectrum of risks that could pose a threat to their business.

UK executives believe that the growth in outsourcing activities by major corporations, shifting demographics caused by the ageing population, lowering of trade barriers, and improving mechanisms for technology transfer from academia to industry, will have the most positive impact on the sector's development in the medium term (see "The study"). However, the potentially negative consequences of many of these same developments hardly register. For example, executives viewed the trend toward globalization of markets and developments in data storage, analysis, and integration in an overwhelmingly positive light, even though they are "double-edged swords" for the industry. Companies regard high-quality technology, secure intellectual property rights, a clear corporate strategy, and financial prudence—regardless of sector or maturity—as essential for commercial success. However, they consistently attach low importance to the quality of their company's risk management policies and procedures. This could become many companies' Achilles heel.

The nature of risk

Business risk can be split into three groups according to the source of the risk and the degree to which management can control the risk (see Table 1). One might expect a close correlation between a manager's perception of a given risk and the extent to which he/she feels in control of that risk; the perceived risk would then be greatest for the factors over which the manager has least control. However, perceptions of risks are more often driven by the immediacy of the risk than by any sense of control: for example, companies often regard continued access to financing and commercial partners as key business risks, even though these factors are largely governed by external factors such as the erratic movements of stock markets and consolidation both within and without the sector.

This focus on near-term risks means that companies may overlook more serious threats—for example, the globalization of the markets that is fundamental to the company's medium- and long-term prospects—and this prevents them from

The Study

A recent report by Andersen looked at how UK life science companies view their business risk profile and how they seek to manage it. The study is based on the responses of over 70 CEOs of life science companies to a questionnaire covering over 200 separate risk metrics, and interviews with 18 industry leaders. To obtain a copy of "Managing risk, building value—risk management in the UK life sciences," please contact janet.c.maskelyne@uk.andersen.com

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Table 1. Key categories of business risk

Risk category	Example
<i>External risks: Risks that arise outside the organization and over which management can exert little or no control</i>	
Availability of finance	The availability of financing; its timing, —in particular, follow-on funding; acceptability of terms; maintaining a balanced portfolio of investors; market volatility; need for robust valuation mechanisms.
Globalization	Capability and resources to identify, develop, and maintain relationships globally with the right organizations, both scientific and commercial; balancing of the need to access markets globally in tune with local market conditions; global investors having a wider choice of investee company
<i>Internal risks: Risks that arise within the organization and over which management can exert complete control</i>	
People risk and corporate culture	Not attracting and retaining highest calibre staff, both scientific and commercial; local or national skills shortages; company vision neither understood nor shared by all employees.
Market assessment	Reading market trends; identifying competitors; competitor intelligence; ability to rapidly flex strategy in response to market dynamics.
Knowledge management	Capturing and sharing of internal and external knowledge; identifying gaps in required scientific and commercial knowledge and how to fill them; security of knowledge capital created.
Portfolio management	Achieving balanced portfolio of projects; ability to begin, develop, or cut projects rapidly.
<i>Composite risks: Risks that arise partly internally and partly externally over which management can exert some, but not complete, control</i>	
Proprietary technology	Pursuit of good science rather than good business; integrity of intellectual property; obsolescence of technology.
Commercial relationships	Scarcity of appropriate partners; evaluating partner commitment; poor communication; pre-emptive damage limitation with respect to, for example, technology, working relationships, change in partners' priorities.
Investor understanding	Investor appreciation of sector in general, and of individual investment opportunities; cyclical trends in venture capital and institutional investors' investment criteria; investors' ability to differentiate between sub-sectors or companies; private investors; sufficient informed business angels and their backers; retail investors taking relatively uninformed punts; lack of congruence between investors' expectations with respect to the scale and timing of returns and what is achievable
Public perceptions	Impact on the following: immediate buyers' propensity to adopt life science technologies; pricing of products/services; the rate and extent of end-user adoption of life science products/services; pricing of those products/services; investors' propensity to invest in company's specific sub-sector. Other examples include the apparent difficulty the sector has in neutralizing negative perceptions of sector generally, and helping the public to differentiate between sub-sectors and their related issues

considering and mitigating those risks today.

A difficult balance

Prioritizing a company's business risks is usually a matter for senior management. Ideally, the amount of management effort spent on one issue in relation to any other should parallel the perceived degree of risk that it poses to the business. However, many companies find it difficult to allocate resources in this way, with the most common shortfalls being in three specific areas: managing people risk, public perceptions, and knowledge management.

The under-investment in managing people risk is perhaps the most surprising. Most companies regard the quality of their staff as a key determinant of commercial success, and this features fairly high in their risk "ratings". Companies also regard management of knowledge assets as a low-risk issue, even

though effective knowledge management is the key to value creation in life sciences.

Given their resource constraints, early-stage companies tend to undermanage most categories of risk, whereas mature companies "overinvest" in managing risks associated with commercial relationships and technology portfolios (regarded as important for ramping up investor confidence before and after initial public offerings). However, like their younger peers, mature companies also underinvest in managing people risk and global business issues.

Assigning responsibility for monitoring and managing a specific risk to a given individual helps ensure that the important risks are properly managed. Although responsibility for "core activities"—such as developing the company's scientific strategy and financial management—tends to be clear in most companies, regardless of their size or maturity, it is often unclear who is in charge of

developing a strategy for business risk management. In the study of UK companies, most chief executive officers don't tend to get heavily involved in shaping this area of activity until their company has reached full maturity. Until then, business risk management falls to the chief financial officer, and is seen as an adjunct to his or her corporate governance compliance role rather than a strategically important activity in its own right.

Tactical time lines

Many companies, regardless of subsector and maturity, adopt very modest time horizons for evaluating the influences on their scientific and commercial development, and of the risks that they may face. This is perhaps inevitable, given their challenging commercial and technical objectives, invariably tight time lines, and limited resources. Nevertheless, many companies would benefit from adopting a more rigorous and struc-

Table 2. Characteristics of effective risk management frameworks

Characteristic	Benefits
Flexible	Able to evolve with and adapt to changes in the business and, most importantly, help shape the organization's attitude towards opportunities and risks and its ability to deal effectively with them.
Broadly focused	Provides a mechanism for assessing and managing the sum of the opportunities and risks—both internal and external—that might impact the business.
Complementary	Complements management's experience and insight by providing a unifying framework for its application to risk issues.
Unifying	All business functions, managers, and units follow a coordinated process that uses a common language of risk. As a result, business risk management sits at the heart of strategic decision-making, business planning, operational processes, and information systems.
Positive and proactive	Encourages open acknowledgement of risks, and focuses on their upside, as well as downside, potential. Encourages collective responsibility for dealing with risks.
Structured and disciplined	Enables the uncertainties faced by the business to be evaluated and managed by aligning people, processes, technology, and knowledge with the company's strategic objectives.
Systematic	Provides designated owners of process- and risk-owners with a framework for defining the essential tasks of risk management.
Driven from the top down	Driven, demonstrated in action, and actively endorsed by the chief executive officer and the senior management team.

tured approach to appraising and managing business risk. More than ever, companies need an effective framework for managing business risk, and to position risk management as a source of competitive advantage.

Companies are likely to benefit from an effective risk management framework in a number of ways:

- High quality risk management invigorates opportunity-seeking behavior, allowing managers confidently to make informed decisions about the trade-off between risk and reward, and to make business decisions in the context of the company's appetite for, and capacity to bear, risk. This will increase the likelihood of achieving corporate objectives and improved shareholder value.
- Quality risk management processes are likely to play an increasing role in helping companies to reduce their capital costs by demonstrating to investors that management is fully aware of, and can respond quickly and effectively to, the risks and opportunities faced by the business.
- Effective risk management can build a company's image and reputation with its customers, suppliers, and partners.

Help at hand

Companies can now turn to a number of structured and systematic risk management frameworks to help them to manage their

risks. The most important feature of any such framework is that it is fit for purpose.

Arguably, the most important attributes of a successful life science company—in addition to the obvious necessities of excellent management, strong intellectual property, and adequate funding—are innovation, dynamism, responsiveness, and, for all but the largest companies, an unerring ability to get by with only modest resources. Risk frameworks must therefore encourage innovation and creativity in life science companies by actively seeking to distinguish appropriate from inappropriate risk-taking opportunities. Frameworks almost always stifle innovation if they are mechanistic, bureaucratic, or rigid in nature. The key characteristics of risk management frameworks are outlined in Table 2.

Many early-stage companies often consider that such frameworks are of little relevance given their size, the fluidity of their management responsibilities, and the collegial nature of their decision-making processes. However, past experience with companies worldwide indicates that quite the opposite is true: the earlier a business adopts the principles and disciplines of a risk management framework, the more likely it will develop superior risk management capabilities. With better risk management, young companies can move forward with confidence toward business success.