*Here's how to determine your risk threshold and how to take reasonable risks that open possibilities for leadership, personal growth, and innovation. Start with a beginner's mind.*

# The Art of Prudent Risk Taking

BY HERBERT S. KINDLER

The words *prudent* and *risk taking* may seem contradictory, but one dictionary defines *prudent* as "exercising sound judgment in practical matters; managing carefully; being circumspect and cautious." *Risk taking* can be defined as making decisions that have the potential for gain or loss, with uncertainty built in. A decision made under risky circumstances can be sounder when the decision maker is circumspect and prudent. But he or she has to know which risks to pursue and which to abandon or modify.

The potential gains include money, health, power, respect, prestige, and positive relationships. The losses include the possibility of injury, liability, embarrassment, and wasted resources. The probability of gain or loss is rarely known definitively. An exception is a state lottery, in which this equation spells out the odds:

Expected Outcome Value = Probability of Occurrence x Value Derived

If the pot is $20 million and the odds of winning are one in 40 million, your lottery ticket has an Expected Outcome Value of 1:40 million x $20 million = 50 cents. If you pay more than 50 cents for a lottery ticket, you're operating on another agenda.

In most work-related situations, probabilities are less precise and more subjective. They're colored by a person's past experience, organizational culture, and propensity for risk taking. It's important to understand one's risk taking patterns, one's perceptions rooted in personal and professional history, and the degree to which cultural injunctions encourage or deter prudent risk taking.

## The patterns

Two patterns can distort how one interprets the evidence for making decisions involving risk: risk preference and risk avoidance. The *Risk Taking Inventory* (see information at the end of the article for how to get the inventory) helps people determine whether they tend to be risk seekers, risk avoiders, or risk neutral. Knowing that can be valuable because people with a risk-avoidance pattern may miss opportunities to influence desired outcomes; people with a risk-preference pattern may make themselves, others, or their organizations vulnerable to unnecessary risk. A self-assessment inventory can help people understand the filters through which they judge the degree of risk.

*Illustration by James Yang*

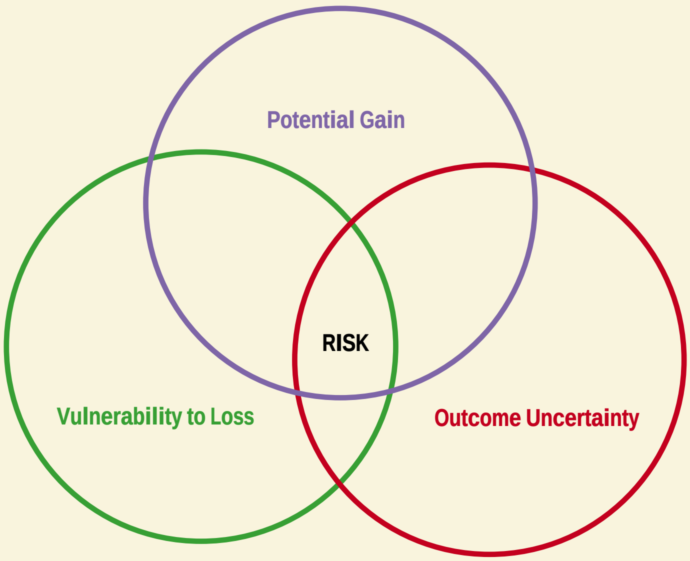
People with a risk-preference pattern tend to
- underestimate uncertainties
- act based on over-optimism
- seek excitement and novelty
- overestimate the probability of attaining the desired outcomes
- decide impulsively.

Motto: Nothing ventured, nothing gained.

People with a risk-avoidance pattern tend to
- overestimate uncertainties
- defer taking action based on over-pessimism
- prefer security and comfort
- underrate or ignore the probability of attaining the desired outcomes
- postpone making decisions or close the door too quickly

Motto: Better safe than sorry.

RISK-TAKING MODEL




One's experience and expertise with similar past issues can keep one from seeing new possibilities. A *beginner's mind*—a Zen Buddhist term—can be helpful. In that state of childlike curiosity, we are free from limiting assumptions and open to fresh perspectives, which can be discarded later if they don't fit our needs.

New or subtle changes can render someone's past experience inapplicable. Hidden in what appears to be "the same old thing" might be heightened customer expectations, staff changes, new product components, altered test procedures, or lower inventory levels. Risk is inherent in newness, and it deserves thoughtful exploration.

## The culture and training

To what degree do employees think your organization supports prudent risk taking? Some companies routinely question each proposal—whether from marketing, production, or engineering—by asking, "Has the issue of risk been addressed?"

One executive told me how during a performance appraisal she said to one of her staff, "Glenn, as I review your past three evaluations, I see that every program you initiated has been a complete success. That tells me one of two things. Either you exaggerated the results—and I'm sure that's not the case—or you didn't stick your neck out very far to take some reasonable risks. Which is true?"

Glenn replied, "Rather than answer your question directly, I want to say something I've learned from my three years with you. You don't tolerate failure."

The lesson is clear: If you want to support risk taking, you will have to raise your tolerance threshold for when your staff or team members may miss the mark. Instead of blaming them, ask them what they learned from their "failure" and make sure you communicate to them that you realize that falling short of expectations is inevitable from time-to-time. When employees feel vulnerable, that's likely to fuel their risk avoidance.

Some companies institutionalize risk taking in their performance review process. One firm lists risk taking among its six "success drivers," defined as: "Takes calculated risks to capitalize on the potential for greater results; not afraid to explore new approaches or present original recommendations he or she believes would generate superior results."

Such actions assure that risk taking will be embedded in a company's culture. Most importantly, organizations need, by word and deed, to encourage employees' innovation, reward their creativity, and not punish occasional failure. They also have to provide training on risk taking, supported by adequate resources.

Such training should be presented in a larger, problem-solving context using the following framework.

Diagnosis.
- Clarify objectives worth taking a risk to attain.
- Identify people who have a stake in the risky decision and determine in what areas their interests match.
- Assess your own propensity for risk taking.

Planning and preparation.
- Choose a change strategy—either a conservative, step-by-step incremental change or a radical transformational change.
- Recognize that transformational change—also known as reengineering and zero-base programming—usually involves high, short-term risk.
- Deal proactively with stakeholders' resistance.
- Plan three phases of change. (1) Unfreeze old beliefs and behavior, (2) initiate change (usually the most risky and resistance-evoking phase), and (3) restabilize the system.
- Evaluate your plan addressing these areas: economic, technical, political, social-psychological, legal-ethical, and environmental.
- Improve the reward-risk ratio.

Implementation, follow-up, and learning.
- Monitor and evaluate progress, making needed mid-course corrections.
- If your action plan fails, activate a predetermined contingency plan.
- Reinforce what's working well; learn from what isn't.

## The reward-risk ratio

Using the risk-taking model (see the figure), ask

- How can I improve the odds of achieving hoped-for gains?
- How might I lessen the vulnerability to loss?
- How can I lessen uncertainty about outcomes?

Here are some suggestions for probing each risk factor.

Seeking better odds for greater gains.

- Determine what commitment you need to achieve stakeholders' objectives.
- Identify limiting assumptions that inhibit creative alternatives, such as reframing problems as opportunities.
- Think of cost as an investment without present economic value, but that may forestall change if the initial decision makers have a personal investment in making "sunk costs" pay off. Antidote: Bring in decision makers who have no emotional attachment to maintaining the status quo.
- Determine what ethical influence you can apply to gain more control or marshal support.

Reducing the probability and impact of loss.

- Develop a worst-case scenario and determine how you'd recover.
- Explore ways to limit loss (similar to a stop-loss instruction to a stockbroker) or have a safety net.
- Consider sharing the risks through alliances, partnerships, insurance, hedging, and diversification.
- Test your plan on a trial run, a small scale experiment, or phase it in gradually.

Lessening uncertainty.

- Decide whether to let events unfold further.
- Determine whether the facts are being distorted by your own risk-taking bias, either to seek security or stimulation.
- Gather information from staff, customers, and suppliers regarding urgency, cost, and the likelihood of triggering undesired rumors.
- Seek multiple perspectives via interviews, surveys, and focus groups.

At its core, risk taking means coping with elements beyond our knowledge or awareness. The challenge is to respond after self-reflection and exploration to prudently take risks that support productive change. ■

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