Posted: 9/13/11 05:45 PM ET

Enterprise Risk Management: Are We Ignoring the Segment With the Most Critical Need?

Jay Vadiveloo
Senior Consulting Actuary, Towers
Watson Risk & Financial Services
http://www.huffingtonpost.com/jay-vadiveloo/enterprise-risk-managemen_b_961002.html... 9/14/2011

In the wake of the 2008-2009 financial crisis, the practice of Enterprise Risk Management (ERM) has begun to permeate the business and academic world. However, most of the current ERM guidelines and principles are designed for large- and medium-sized organizations. Minimal attention, until now, is being paid to the largest, fastest growing and most important segment of the American economy, small businesses.

Small businesses, defined by the U.S. Small Business Administration, are characterized by having up to 500 employees for most industries, and as a single entity, small businesses account for approximately half of our country's GDP. Small businesses also comprise more than half the employment in the U.S. and have generated 64% of net new jobs over the past 15 years. With numbers like these, it is hard to argue that a viable and healthy small business segment is not of critical importance to the growth and stability of the U.S economy.

Over the past few years, I have been focused on applying my expertise and experience as an actuary to bring the benefits of ERM to life for small businesses. In partnership with the Goldenson Center for Actuarial Research at the University of Connecticut (UConn), we have developed an ERM program for small businesses. This initiative, supported by UConn's actuarial science students, is intended to provide this crucial segment of our society with the risk management framework that small businesses, which experience one of the highest failure rates, so desperately need.

The outcome of this two-year experimental initiative has been truly remarkable. While this initiative wasn't based on any concrete, formulated theory, the result has been a well-defined and efficient process that teaches small businesses how to leverage the ERM principles previously used by much larger organizations.

With all of the uncertainty and turbulence in today's economy, positioning small businesses to mitigate risks and maximize opportunities has become key to their survival and success. Through our work, we have identified key risks that every small business should recognize and understand.

"Key man" risk [the risk of a single individual controlling the fate of the small business], lack of competitiveness and operational inefficiencies are some of the most common risks we encounter. Unlike ERM for large corporations, business growth opportunities and risk management go hand-in-hand for any ERM analysis for small businesses. As an example, a small bagel retail chain that we analyzed recently lacked an automated process to track sales and profits by item and by store. As part of our recommendation to the company, we developed a user-friendly Excel model which enabled the owners to do precisely this. The report revealed that less than 10 percent of the individual items contributed to more than 50 percent of the store's total profits, a revelation to the business. Based on our analysis, we also suggested updating the company's website and streamlining the Drive-Thru menu so traffic flow would not be inhibited. The findings of the report even suggested revamping the store image to appeal to a younger customer base.

While the current economic environment presents many risks for small and large businesses alike, small businesses, by virtue of their entrepreneurial nature, are more capable of adapting to change quickly and can be more resilient in economic downturns. However, small businesses can just as easily fail due to an unanticipated risk shock, as they generally lack the surplus cushion or political clout larger companies may enjoy.

My work with small businesses through the Goldenson Center illustrates why the principles of ERM are vitally important for small businesses. While we are able to support a handful of small businesses each year, this work can be done on a larger scale, with actuarial students partnering with small businesses across the U.S., and possibly around the world. This is basically a form of micro risk management, and similar to micro-financing; with a potentially huge payoff since any reduction in the failure rate for small businesses could have a positive cascading effect on the entire economy.