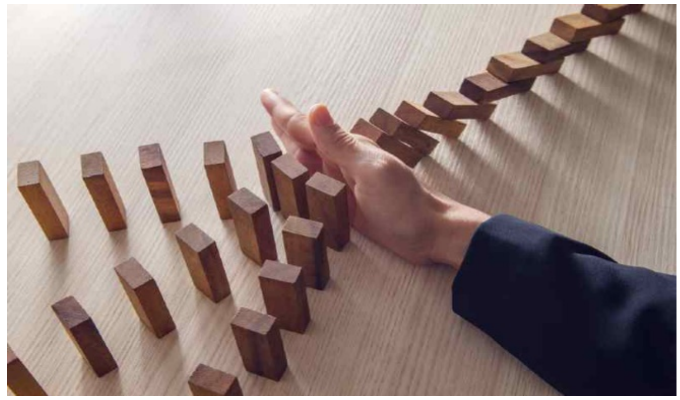
Taking Smart Risks



Succeeding in business and in life always involves a degree of risk. Knowing how to take risks, when to take risks, and how to mitigate risks is essential to finding success.

If we try to play it too safe, we can be sure that our rewards will be small. But if we can grow comfortable taking smart risks and learn how to manage and mitigate them, the rewards will surely follow.

The key to managing risk lies in paying attention to both the big picture and the little picture. Here are five basic ways I've learned to manage and mitigate risks:

1. Fundamental Position

As a high-school football player, one of the first things I learned was that you always had to be prepared for anything and in the "ready position" when on defense. We also called this "fundamental position," which was:

- Both feet are solidly on the ground at shoulder width.
- Both legs bent slightly, ready to spring into action in any direction.
- Both arms hanging straight down, hands just above the knees, ready to shed a block or make a tackle.
- Head up and eyes alert.

"Fundamental position" is another perfect model for managing risk.

2. Diversification

Another popular risk management theory is that of diversification. The theory here is that different asset classes (e.g., bonds, stocks, real estate, oil, and gas, etc.) are not correlated and move in different directions at different times.

The principle of diversification is a good one and can be applied to every aspect of your life. By having more diversity and balance in your life, you are less dependent on any one thing, and in a better position to deal with any loss.

3. Ripcord

In business, the best risk managers have an exit plan for each major risk they take. At Amazon, the fastest-growing company in the world, they call it “the double-swinging door.” What they mean by this is that for every door they walk through (risks they take), they need the ability to turn around and exit. They take many large risks, but they always have an exit plan to mitigate or limit their losses. Then they do their best to make it work.

At Trammell Crow Residential in the 1980s, we followed a similar strategy that we called “the ripcord.” For every investment we made, we negotiated an exit strategy. If the deal went bad, we ensured we had a “ripcord” that we could pull to minimize our losses and parachute to safety. The real-estate developers who didn’t practice this principle ended up being “victims” of the recession.

4. Alignment

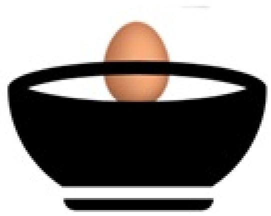
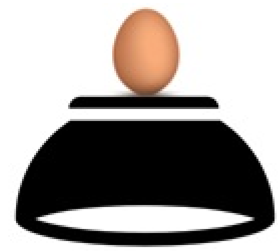
“Take calculated risks. That is quite different than being rash.” – General George S. Patton

One of the less talked about risk-management principles (which I didn’t really learn until late in my career) is the power of alignment. By alignment, I mean having your values and goals be aligned with the people you are associated with in your business and personal life.

Our values were clear in the homebuilding business: quality, customer service, and profits—so alignment with our trades was usually pretty good. But getting alignment in philanthropy and investing in new ventures gets a lot trickier. As they say, the translation of “joint venture” in Japanese is “same bed, different dreams,” so it’s important to have the same dreams as your partner. I have learned that you can take risks with markets but not with people. Dealing with people of integrity is absolutely essential.

5. Stable and Unstable Equilibrium

There is one last concept of risk that I would like to share with you. This is actually a physics principle that can be applied to business and to life. It is best explained by these two images of an egg and a bowl:

Both images show two stationary objects at rest and in equilibrium. Under stable equilibrium, the egg can be moved, but it returns safely to equilibrium. Under unstable equilibrium, if the egg gets moved, it crashes to the floor and makes a big mess!

One way to stay in stable equilibrium is to do business and have relationships with people you know and trust. We can all interact with friends, enemies, or strangers, but if we choose not to interact with friends and people we trust, we depend on enemies or strangers, which is essentially “unstable equilibrium”.

We can avoid unnecessary risks and are much safer in a stable equilibrium position. So, try to avoid putting yourself in a vulnerable position in business or personal relationships, where a small vibration could create a life-changing disaster.

T.W. LEWIS is the author of SOLID GROUND: A Foundation For Winning In Work And In Life and the founder of T.W. Lewis Company, an award-winning Scottsdale, Arizona-based real estate and investment company. Tom and his wife Jan formed T.W. Lewis Foundation to support higher education, children and families in need, youth character education, and various local and national non-profits that strengthen Americas’ civil society.