

A Paradigm Shift in the Value of Your Business: Becoming Ductile

A ductile business is more valuable than a regular business. A ductile business is one that bends but does not break. It's one that has the ability to take risk more confidently because the business is risk-aware, able to identify risks as they emerge and able to take advantage of opportunities better than its competitors.

Businesses exist to take risk. Risk is not something to be feared; rather risk needs to be understood as an opportunity balanced with the need to pursue opportunity responsibly.

The path to becoming a ductile organization begins with the Board of Directors and how it relates to risk and risk management within the organization. The Board is quite knowledgeable about business plans, strategic objectives, and corporate "morals". But, the approach that Boards of Directors take in relation to their risk management infrastructures is varied. Recent research shows that there are emerging best practices and that many companies, even those with risk management infrastructures in place, are not pursuing risk management in a manner that incorporates the full development of those best practices.

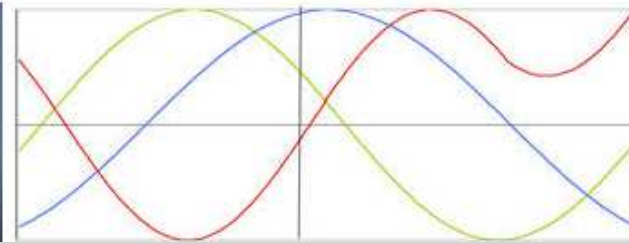
Once the Board's alignment with best practices has been established, the relationship of the C-Suite to the rest of the organization sets what is known as the "tone at the top". This message to all employees conveys that, again, risk is not to be feared,

but is rather an opportunity that needs to be balanced with the need to pursue that opportunity responsibly.

This tone is enhanced by well-planned and designed corporate-wide communications and education programs that raise the risk awareness of the company. It is important to recognize that risk is best managed as close to the point at which it is created as possible. For example, salespeople are likely to understand the emerging risks their customers create better than anyone else. If they are risk aware and recognize the importance of this early sentry work, they become significant contributors to the ductile business.

Finally, the economic incentives presented to key risk generators, key revenue generators and other highly compensated individuals must be aligned with corporate morals, business objectives and risk management objectives. The human psychology around incentives and the influence of the authority from the top of the house is quite complex. An understanding of the complexity is essential to maintaining ductility.

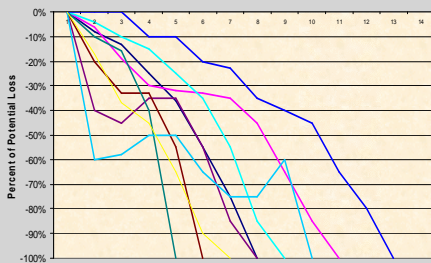
Every company, like every system, has stress points. In many companies where risk management infrastructures are well developed, the stress points have been identified. The process of becoming ductile builds from that self-awareness, creating an organizational structure to manage its stress



points effectively so that a risk event never breaks the system. Through benchmarking communications, education, and properly aligned incentives, ductility can be achieved.

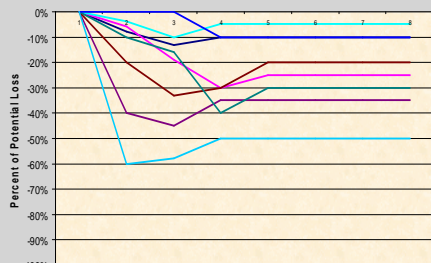
Hundreds of thousands of risk events are realized in every business and some very small percentage will, if left unchecked, break a brittle business.

The figure below depicts the path a risk event takes to its full potential. In other words, absent any intervention, the full change in value of the system that would be realized from the risk event is 100% of the potential impact of that event.



The Path of a Risk Event

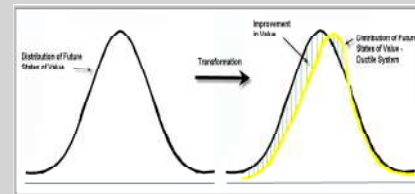
Figure 2 depicts the path of a risk event in a ductile system.



The Path of a Risk Event in a Ductile System

Investors value a business as the discounted present value of some perceived set of possible future states of value of that

business. A ductile system positively alters the perception of possible future states of value of the business. This comes about through an increase the expected life over which the system is being valued, reduced need for capital (reduced potential loss from a given risk event) and its associated expense, a greater ability to take business risks (perceived and real increases in growth) and more benefit from investor perception of the firm.



Ductile Systems Shift the Distributions of Expected Changes of Value

Research shows that investors care much more about downside variability (i.e., outcomes that are worse than the average) than upside variability, making the importance of being ductile even greater.

Ductility is a paradigm shift in the way in which a business views itself, its risks and its opportunities. It's also a paradigm shift in its value to greater heights than can be achieved, sustainably, without ductility.

About Us

Ductibility is private advisory service. We provide benchmarking research through our Research Circles. We design risk education and risk-awareness-building programs. We review and analyze compensation and incentive structures for alignment with corporate objectives.