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The Art of Appropriate Risk Management

There are two aspects of this idea of balance. The first is risk vs. reward. If you've ever been in a casino, you know how it works; the bigger the payoff you're going for, the bigger the risk you have to take. Let's look at roulette. If you bet on red, for example, you'll win almost half of the time but you will only double your money. On the other hand, you can win 35 times your money if you bet on a single number but you'll win, on average, only once in 37 spins.

We all know that in business, as in all things, higher return is almost always accompanied by greater risk. The casino analogy falls short in the fact that you can't change the odds at the casino; the house will always win.

You can, however, improve the odds of business success if you appropriately manage your risk.

That brings us to the second aspect of balance, degree of risk vs. level of risk management. The degree to which the risk must be managed must be proportionate to the inherent risk. When the risk is high, a venture must be managed much more closely than when the risk is low.

New Product Development is an activity that is inherently risky. Happily, the risk is often justified by the potential for big payoffs in the form of sales, profits, and shareholder value but it must be managed with appropriate rigor. Provide too little rigor and your project will run out of control, creating losses in countless ways. On the other hand, too much rigor (also known as red tape) will slow the process unnecessarily. The result will expose you to perhaps the biggest risk of all; getting to the market after business conditions have changed or after your competitor has launched his own product, putting you in second place.

Because the risk varies from company to company and from project to project, the process you use for managing your new product development activities must be simultaneously rigid and flexible. It must be rigid in that core principles must be sacrosanct. For example, the new product must be one that fits the strategy of the corporation and returns a profit at or above the company's threshold. At the same time, however, the process must be flexible in that the degree of rigor applied at each stage of the process must be only what is appropriate for the risk involved.

To do otherwise would either create unacceptable exposure on high-risk projects or unnecessarily delay low-risk ones.

About J. H. Welsch Consulting, L.L.C.

Jack Welsch has had over 4 decades of experience in engineering and new product development at all levels and has been awarded over 35 U.S. patents. He has been directly involved with the phased and gated development process since 1979 and has spent much of his time and energy in the continuous improvement of the process. While most of his career has been spent in manufacturing companies, he has taught the business aspects of product development as an adjunct instructor, at both Lehigh and Wilkes Universities. In addition to his roles as Principal of J. H. Welsch Consulting, L.L.C., he is Chairman of Wilkes' Industrial Advisory Board.

J. H. Welsch Consulting, L.L.C. is dedicated to helping firms improve their new product development process.
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