Analyzing the Risk and Reward of Starting a Business or Project ©

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“Risk includes the possibility of losing some or all of the original investment.” As risk is so much more for many of us the word requires a broadened definition. “Risk is the possibility of losing that which has importance to the participant in the activity for which there is not an assured outcome.” Risking the loss of a small amount of my money is not as important to me as the possibility of others losing an amount which has greater importance to them. So much for money risk, which may be but a small element of total risk.

Risk includes the possible psychological devastation, which can result for some in simply being wrong as measured by the success of a venture. This ego-based loss can be reduced by discussion with advisors prior to commencing the project as it is hoped this writing will encourage. There is a career risk if the project is undertaken within an institution or company and the employer is unsympathetic to the natural process of innovation and invention. It is the willingness to err in the pursuit of change which encourages those with ideas and insights to take the risk of creating something other than what they have been directed to do.

For many years I have advocated that business schools offer a course within their entrepreneurship program on “How to terminate a business with dignity and honor”. To my knowledge no such course has ever been offered. The leading entrepreneurship academic at Harvard explained to me that his compensation was based in part on the number of students taking his courses and that none would sign up for such a course. He asked me “How many kids would want an "A" in “How Best to Close a Failing Business”? He further said, “If they’d come to such a class they would do so wearing ski masks.”

There are reliable signs when a business is not likely to make it. I once drafted a book titled “Knowing When To Close a Business” and couldn’t find an interested publisher. One publisher said they’d do the book if the title was “How to Save a Failing Business." I declined, as the chance of doing so is small and a saving a failing business is extremely difficult.

If the entrepreneur is honest and open with investors, employees and creditors as to the progress being made and the cumulative factors which might prompt termination, the entrepreneur’s credit and credibility will be far enhanced over the disarray if forced closure occurs.

A significant part of risk analysis for a business is identifying those on whom there is a sequential dependence. Who has to develop what and when? Who has to deliver what and for what price and when? What has to happen regarding the financing and when? What must prospective customers do and when? Are there permits or licenses involved and if so who is responsible for getting them and when? Note that in every case there is a “when” question. The when answers determine the amount of funding needed and a business plan should be a timetable of events requiring X amount of expense versus income events providing Y amount of income. Of course, as is well known and accepted, things cost more and take longer to be delivered than planned and therefore funding should include a buffer or contingency amount. The need to seek funding before revenues have really started is likely to be a very dilutive to equity; an expensive and frustrating experience for the entrepreneur. Therefore those starting a business are advised to be over-funded rather than under-funded at the time of obligation commencement.

An assessment of likely achievement of the expected action can be made to identify the weaker suppliers or the areas needing buttressing. The entrepreneur is ever in the position of depending on the performance of others and the degree of dependence should be understood and measured.

The concept of reward also requires definition and “a thing given in recognition of one's service, effort, or achievement” is not really applicable for those accepting the risk of creating something. The undertaker of risk does not get rewarded for effort or service -- only for achievement. Therefore, achievement of what? There is a need for success to be defined. In some cases, particularly of invention, something simply working is a success and achievement. Proof of concept can justify a reward and will certainly result in the inventor enjoying satisfaction.

The creation of a product or service ready for licensing or sale is an achievement. However, it is only the positive response of prospective licensees or customers, which, if the level is at least as predicted, will constitutes real success for those who demonstrated faith in the venture.

Therefore it is vital that those who start projects or businesses fully understand, by discussion with prospective licensees and customers, a realistic initial revenue expectation and the likely increases if the product or service is as good, or better than the alternative.

In the business planning process, the revenues and resulting profit have to be realistically reflected in the determination of level of funding required. The starting of something on a basis of “they will love it and have to buy it” without customer prospect confirmation is empty and likely to produce disappointment. The project and business has to be based on more than a “if we build it they will come” belief, especially if the participation and investment of others is a necessary component of the effort.

Finally, those creating activities which will benefit others, should have the potential to become enriched. In the normal venture funding approach to the financing of new companies, a significant level of ownership of the business is transferred to the capital providers. As the business needs additional money, increasing substantial amounts of ownership are transferred, usually along with a lessening of management control. Of course, the (usually) more experienced and sophisticated capital providers should have been able to predict at the outset that more money would be required for project completion.

For the reasons fully explained in the following websites I believe that "Royalties are the better way of both investing in and financing of privately owned companies." Investors should profit by sharing in revenues, and founding business owners and management should retain control, compensation and other benefits of profitability.

www.Royalties.Website, www.REXRoyalties.com, www.REXdebt-shareRoyalties.com, www.REXComparator.com, www.REX-PV.com and www.REXScaledRoyalties.com and www.PacificRoyalties.com.

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