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3 insights to master 'risk'

In An Economist Walks Into A Brothel, author Allison Schrager shares amazing insights on risk using the experiences of corporate honcho Kat Cole, the COO of Focus Brands. I have summarized a few below.

You can efficiently evaluate how risky a decision is ONLY if you are clear what it is you want. You cannot evaluate risks if you are unware of your goal.

Kate had a chaotic childhood. Her father was an alcoholic and her mother had to work multiple jobs and kept the family on a $10-a-week food budget. Kat, just nine at that time, had to shoulder a fair amount of responsibility as she had two younger sisters.

When Cole was studying at the University of North Florida, she worked as a waitress at Hooters. She excelled and was named the franchise's best employee. They requested her to go to Australia to train employees at a new franchise. At that time, she was not in possession of a passport and had never stepped on a plane before. She grabbed the opportunity.

Her studies began to get severely affected. She had no powerful and connected friends. Nor did she have an affluent family to fall back on. She wasn't going to Silicon Valley, where dropping out of college is considered by some to be a bad of honour. (Think Bill Gates and Mark Zuckerberg). In her world, college was the surest path to success and stability. So when she decided that she would drop out of college for the job, it appeared like a ridiculous call.

What was Cole's goal? To get a good job and achieve the security and stability she lacked as a child.

Now she was being presented with a way to get what she ultimately wanted, even if it was not on the terms most people would be comfortable with. She explains in the book: "It was not that difficult a decision because I had a compelling alternative. I was travelling around the world. I was doing something I loved. I was good at it. I had an opportunity to keep doing it."

The gamble paid off. Big time. She was offered a salaried job at the corporate headquarters and became an executive vice-president by the time she was 26. At the age of 32, she was hired by Cinnabon.

All gambles do not pay off. But you increase your odds for a more successful outcome if you can define and articulate your goal.

Taking a risk without a goal is just like getting in a car and driving around aimlessly expecting to wind up in a great place. If you have a destination in mind, you are much more likely to end up there.

In order to have a better job, you need to know what you want from your career.

In order to have a better relationship, you need to be clear about what you are looking for in a partner.

We often lionize risk takers, but the difference between who succeeds and fails isn't who takes the boldest risks – it is who takes smart risks, or risks with a clear objective. Simply articulating what you want and setting that as a goal is an extremely powerful tool.

Cole owes her success to taking risks in a smart way. Her success comes down to being good at identifying her goal and the least risky way to get there. For most of us, dropping out of college would be risky, for Cole it was a lower risk choice because at such a young age she had a job she loved and was appreciated for. It seemed a better option to stick on and work her way to an executive job rather than accumulate college debt.

Risk-free is different for everyone because it depends on your goal.

You need to articulate your goal if you have to venture down the least risky path.

When Cole was hired in 2010, Cinnabon was faced with six years of net sales decline. The recession kept people out of malls and airports. Consumers wanted healthier choices. The sugary, buttery, indulgent cinnamon roll was getting the cold shoulder.

Cole's team suggested that they produce a low-calorie option. They suggested reducing the 880 calorie product to 599 calories as research indicated that sales went up with a lower-calorie alternative.

Cole's goal was clear: increase sales. So would the above solution do that? No. Here's why:

- The research applied to high-frequency snacks like chips; no one eats a cinnamon role as frequently.
- It would ease the conscience of the health-conscious customer but the collateral damage to their taste buds would be significant. Being full of artificial sweeteners and stabilizers, the taste would defeat the "once-in-a-while yummy indulgence."
- For a customer concerned about healthy alternatives, 600 calories would not win the battle against 880 calories. It would still be a sinful extravagance.
- A diet pastry was a bigger risk because the new product would not guarantee increased sales, and risked diminishing the brand, which was all about quality and decadence.

The solution: A smaller roll would entail working with an existing and loved product without compromising the company' reputation.

Cole convinced franchise owners to offer the petite rolls. Their reluctance was that the product being smaller (size) and cheaper (cost) would translate into lower profit. But she convinced them to bet on volume. Within a few years revenues doubled and Cinnabon became a billion dollar brand.

Remember this:

- Start with the risk-free option, then progress to make the right call.
- The risk-free option is whatever delivers what you want with total certainty. Let's say your objective for today is to have a pleasant evening. Risk-free could be binge watching Netflix and ordering in. Risky could be going out as people in the restaurant will not be wearing masks and social distancing may be violated.
- The path of least risk looks different to different people. It is your goal that will give you clarity and help you analyse the best course.
- The same principle applies to investing. There is an investment known as the risk-free asset that offers investors something no other asset can: predictability. Risk-free promises a certain payoff no matter what happens. If markets crash, you will still get paid what you were initially promised. If markets boom, you only get paid what you were initially promised. The price of that risk-free asset is the most critical piece of information in any decision you might face.
- Ask yourself: What is your ultimate goal? If you achieve it, what does that look like?
- How can you achieve your goal with no risk at all or as little risk as possible? In other words, what would guarantee you would accomplish your goal?