

Chapter 9-12

Risk Management: The Big Picture

The last four chapters in this book represent the heart of the book, insofar as they are focused directly on risk management, rather than on the economic underpinnings or on risk assessment. We begin in chapter 9 by defining our objective in risk management as increasing the value of the businesses we run, rather than reducing or increasing risk exposure, and follow up by developing a valuation framework that incorporates all of the elements of risk management. We end the chapter by arguing that the key to successful risk management in a business is the decomposition of risk into risk that should be passed on to investors in the company, risk to be hedged or avoided and risk that should be exploited. Chapter 10 examines the first two components and presents a framework for determining not only which risks should be hedged but also what tool (insurance, derivatives) to use in hedging risk. Chapter 11 draws on corporate strategy and competitive advantages to analyze what risks should be exploited by a business and the payoff to this risk exposure. Chapter 12 concludes both the section and the book by drawing lessons for risk management from across the book.

Since these chapters represent a straddling of valuation, corporate finance and corporate strategy, the language reflects. There are portions that draw heavily on financial theory (when we look at the link between value and risk, for instance) and sections that are almost entirely qualitative (the strategic assessments of risk).

<i>Chapter</i>	<i>Questions for Risk Management</i>
9	What is the objective in risk management? How do we get a complete picture of the consequences of risk management?
10	What are the risks that should be passed through to investors and why? What are the risks that should be hedged by a business? Which hedging tools should you choose when hedging risk?
11	What are the risks that should be exploited by a business? What is the payoff to exploiting risk?
12	What are the general propositions that should govern risk management?