

Strategic Risk Management by Nonprofit Organizations

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Two Levels of Nonprofit Risk Management

- Risk Minimization Strategies
- Prudent Risk Taking

Risk Minimization

- Examples:
 - Eliminating obvious hazards
 - Buying insurance
 - Risk pooling through associations or umbrella groups
 - Diversifying income, programs, assets
 - Building reserve funds and endowments
 - Avoiding change/maintaining status quo

- Appropriate where:
 - Chances of bad outcomes can be reduced without significant sacrifice of benefits or increases in cost
 - The value of additional security exceeds the extra costs or potential upside gains of a more aggressive choice

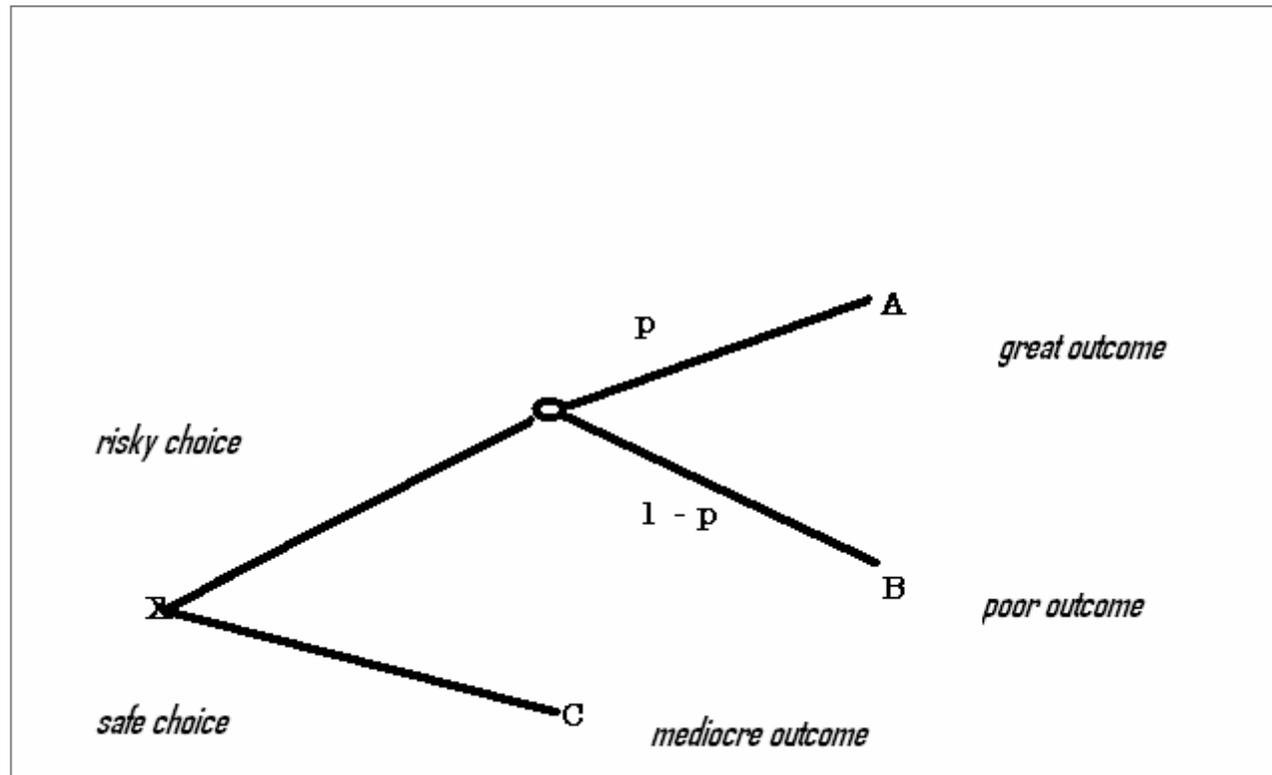
Opportunity costs of risk minimizing

- Sacrifice of potential returns to other uses of resources spent on excessive insurance or risk pooling memberships
- Potential (current) benefits forgone of funds tied up in reserve funds or endowments
- Loss of overall (social, financial) returns from excessively conservative (over-diversified and/or low risk-weighted) portfolios of income sources, programs and assets
- Long run sacrifice of innovation and high performance by avoiding entrepreneurial behavior and change

Prudent Risk Taking

- Includes sensible risk minimizing policies
- Recognizes that assuming some risk is necessary to achieve reasonable goals, mission, sustainability and social impact
- Requires nonprofit leaders to establish risk policy
- Requires a leadership mindset of strategic risk taking

A framework for strategic risk taking



Examples of Nonprofit Strategic Decisions under Risk

- Deciding whether to undertake a new venture or program initiative
- Deciding to close a program down or change its direction
- Deciding whether to expand or reduce capacity (e.g., staff, space)
- Engaging new leadership
- Entering a collaboration

Sources of imprudent decision making under risk

- *Poor estimates of the consequences* of different choices (A,B and C)
- *Poor estimates of the probabilities* of good vs. bad outcomes (p , $1-p$): *cock-eyed optimists, incurable pessimists and data disparagers*
- *Inappropriate risk preferences:*
 - *Nail biters:* excessively conservative decision makers in view of good odds for success or minimal chances or consequences of a poor outcome
 - *Gun-slingers:* decision makers who gamble in view of poor odds for success or disastrous consequences of failure
- *Poor logic:* decision-makers fail to compare the value of the certain choice (C) with the “expected value” of the risky choice
- *Poor behavior:* decision-makers forgo “due diligence” in acquiring and analyzing available information

In closing

- Risk minimization has its place
- Being very safe might mean being sorry
- Prudent risk taking is intrinsic to efficient use of resources and future success
- Even Einstein didn't like the idea of God playing dice with the universe
- But so He does; even the god of nonprofits!