

**May 28, 2014**

**Christian Embassy Luncheon, Ottawa**

**“Taking Risk On Purpose”**

- Thank you, John, for your kind remarks.
  - I am delighted to be with you today to share some personal thoughts from my several decades of full engagement in the financial services sector.
  - My comments will focus upon business lessons I have learned as well as how my faith has informed both my professional and personal life.
- My topic today is “Taking Risk on Purpose.”
- In preparing for this talk, I searched for an entertaining cartoon on risk taking.
- As it happens, there are dozens of cartoons on risk taking but I found one I really like because it is so relevant to my topic.



CARTOON BY MICHAEL MITTAG, WWW.HAUDEGEN.CH

- I like this cartoon for a couple of reasons.
  - First, my business experience included several years in investment banking and I have spent much of my business career dealing with investment bankers; and
  - Second, this cartoon gets to the heart of my talk by humorously asserting that we can earn large returns without taking any risk!
- **My message today is simple and relevant to each one of us: *Taking risk is good provided one takes it on purpose.***
  - Taking risk is good because it is the gateway to reward.
    - Riskless investing for lucrative returns is an oxymoron.
    - Conversely, we cannot achieve high returns, including reaching any great goal or dream, without taking risk.
  - However, good risk taking requires that it be done “on purpose.”
    - “On purpose” implies that the potential reward is commensurate with the risk taken.
    - It also implies that one is able to identify the risk and analyze it intelligently.
    - The assessment of potential reward and risk, taken together, translates into calculated, or “on purpose,” risk taking.
    - David Packard, one of the founders of Hewlett Packard, said, *“Take risks. Ask big questions. Don't be afraid to make mistakes; if you don't make mistakes, you're not reaching far enough.”*
- Risk is a topic that is very real to me, since I spent my entire career in the financial services sector identifying and assessing risk.
  - I was involved in numerous different areas of the capital markets and banking and, over four decades, I dealt with virtually every area on the risk-return curve.

- My focus today will be personal lessons that I have learned on the subject of risk.
- First, however, I want to share some general reflections on the topic of risk and return.
- Risk is a fundamental fact of life.
  - A simple definition of risk is the uncertainty that surrounds the outcome of any activity.
  - My wife and I were recently in the country of Panama on a Global Exchange sponsored by my organization, LeaderImpact. As it happens, Panama offers one of the best examples of risk taking on purpose - the original construction of the Panama Canal from 1904 to 1914 and the doubling of capacity currently underway.
    - The obstacles to completing the original canal were immense. They included:
      - Choosing the most appropriate civil engineering approach. For example, constructing a sea level canal versus a canal utilizing locks;
      - Improving the then existing equipment technology such as cranes and dredges to do the necessary work; and
      - Dealing with disease including yellow fever and malaria, which ultimately killed tens of thousands of workers.
    - In sheer scale and cost, this construction project was at that time by far the largest ever undertaken.
    - Panama is now engaged in a major expansion of the canal and, once again, risks are manifesting. These include:
      - Large cost overruns; and
      - Potential competition, including the proposed Nicaraguan canal project.

- Clearly, the country has concluded that the rewards in terms of the increased revenue from growth in canal traffic outweigh the risks. This is an excellent example of taking risk on purpose.
  - Even if we are not engaged in the investment business, we take risk every single day, for example crossing the street or playing with our kids or, in my case, our grandkids.
  - Most of you here today are from the realms of diplomacy, politics and business. I am sure you can attest to the reality of risk as a fact of life as you go about fulfilling the responsibilities of your chosen vocation.
- Risk adds zest to life and it is impossible to earn investment returns or experience true fulfillment in any endeavor without taking risk.
  - The late Stephen Covey, the author, has said, *“The greatest risk is the risk of riskless living.”*
  - Risk can be assumed on purpose. We know it is present and we take it intentionally while at the same time taking steps to mitigate it.
    - For example, I took up riding a motorcycle 18 months ago;
    - I knew it was dangerous and therefore took a course on motorcycle safety;
    - Lesson number one: assume that every driver I see when riding my bike woke up that day with the express intention of killing me!!
  - Risk can also be taken unknowingly.
    - I have certainly discovered this reality and I suspect that every one of us has at some time or other.
- Risk taking in the financial services sector is a classic example of taking risk on purpose.

- While most of you here today are not involved in the financial services sector, many of you have been involved or will be involved in investing from time to time.
  - Alternatively, you may be involved in raising capital or helping someone else raise capital at some point.
  - Finally, you may simply find the world of investment mysterious and are interested in learning more.
  - In light of these factors, I find most people have some personal interest in the subject of financial risk taking.
- Today, I will focus on just one aspect of financial risk taking, namely the assessment of investment risk in individual business enterprises.
- I have learned many lessons over my investment, corporate banking and project finance career. These lessons have sometimes been learned the hard way through partial or total loss of the funds invested!
- For purposes of this presentation, I have selected just four of these lessons. They relate to:
  1. Management risk;
  2. Forecast risk;
  3. Problems related to insufficient cash; and
  4. The self-control challenge.
- After my talk, there will be a time for questions and answers at which I would be pleased to provide specific personal examples of any of these lessons. Also, I will provide a handout covering a more comprehensive list of lessons learned after the talk.
  - **My first personal lesson relates to risks associated with the management of the business in which one is considering investing.**
  - **Management is the single most important critical success factor in virtually all businesses and particularly in early stage ventures. It is also the**

**most difficult risk to assess. Here are a number of personal observations regarding management risk:**

***i. First, never compromise on the issue of integrity.***

1. If someone lies once, assume that they always lie and, on this basis alone, do not invest.
2. Include due diligence calls to someone who owes you more than they owe the CEO! That is one of the best ways to uncover character and competence problems.
3. Typically, if you limit yourself to the references that they provide, you will receive a biased report. Ask for bad references!

***ii. Second, understanding the entrepreneur's motivation is critical.***

1. How strongly does the entrepreneur want to succeed?
  - a. How much money has he or she invested? This is just one indicator but an important one.
  - b. How hard do they work? Laziness and success do not go together.
  - c. Do they really understand that the road ahead will be full of challenges some of which they have not presently identified?
  - d. Is there evidence from their track record to confirm how well they deal with adversity?
    - i. Do they quit?
    - ii. Do they make contingency plans?

1. Plan A

2. Plan B

3. Plan C, etc.

iii. Do they remain positive in the face of negative developments?

2. What drives the entrepreneur to succeed?

a. Are they passionate about meeting some need that they have identified in the market?

b. What are their values? Are they good values?

**iii. Third, ensure that the entrepreneur has a healthy respect for risk. By their nature, entrepreneurs are optimists. This attitude is critical to success. However, they must temper their optimism with realism and contingency planning.**

1. Perhaps surprisingly, great entrepreneurs usually have a healthy degree of risk aversion.

2. Richard Branson, the very successful British entrepreneur, said, *“Throughout my business life I have always tried to keep on top of costs and protect the downside risk as much as possible.”*

○ **So, my first personal lesson relates to management risk. My second personal lesson relates to the need for, and reliance upon, quantitative forecasts.**

**Attractive quantitative forecasts are a necessary but not sufficient condition precedent to investing.**

- My number one rule from experience: Forecasts are always wrong!!! 100% of the time! This truth also applies to corporate and public sector budgets!
- While I like numbers and quantitative analysis, I quickly concluded following my MBA that a lot of quantitative models

I had learned were not particularly helpful and that I seldom moved beyond adding and subtracting!!!

- Spend time developing a well-reasoned “base case.” ...50/50 rule;
- Upside and downside scenarios...Five or six are probably sufficient to map out the risk return landscape;
- A comment on historical financial statement analysis in the case of established businesses with a track record:
  - Analysis of historical financials helps us to identify and better understand the risks inherent in any business.
  - Often simple questions regarding the reason behind historical results help us identify previously unknown risks and quantify them.
  - The danger of using historical quantitative analysis to arrive at definitive conclusions about risk and return was underscored in the financial crisis of 2008.
    - The reality was that risk had become much greater than reflected in the historical record as the quality of mortgage underwriting had deteriorated substantially.
- **My third personal lesson relates to the often-committed mistake of trying to solve problems by injecting more cash. When the inevitable problems arise, remember that lack of cash is NEVER the real problem; it is almost invariably a SYMPTOM of the real problem!**
  - Fix the real problems, and then inject the cash.
  - This lesson also applies to raising kids!!
    - Beware when they present the problem as simply lacking cash.
    - I think everyone here must know that the real problem lies elsewhere!

- **My fourth and final personal lesson relates to controlling your own urges.**
  - Arguably, the investor himself or herself is the single biggest risk factor in the investment equation.
  - Warren Buffett, one of the greatest investors of all time, has said, *“Success in investing doesn’t correlate with I.Q. once you’re above the level of 25. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing.”*
  - I myself am not immune to these uncontrolled urges.
    - Once, my colleagues and I were so committed to going forward with a particular investment in one of the funds we managed that that we suppressed the clear warning lights that were flashing brightly.
    - As a result, we made the investment and promptly lost our money!
- I have been discussing the investment business and the fact that taking risk is good provided one takes it on purpose.
- I would now like now to shift gears and share with you a little of my personal story and specifically the best risk that I ever took on purpose.
- Briefly, I was born in Vancouver, BC.
  - From an early age, I was extremely goal driven. I wanted to be number one and was prepared to work very hard to get there:
    - I strove to obtain the highest marks in school and university; and
    - I strove to achieve the highest levels of success in business:
      - As I launched into my business career following my MBA, I was intent on getting to the top as quickly as possible.
  - In 1973, my wife, Mary, to whom I have been married 45 years, had a dramatic encounter with God and, as a result, made the decision to become a follower of Jesus Christ, which she shared with me.

- I could immediately see wonderful changes in Mary including a new sense of peace, joy and purpose.
  - I was happy for her.
  - However, I did not grasp the relevance of her decision for me. I was at the time very content with my life, in particular the way in which I was progressing toward my career goals.
- I was among the very first hired when Citibank entered Canada in 1974. I loved the prospects for advancement within what was then by far the largest, most profitable and most international bank in the world.
- After several promotions and moves from Toronto to Montreal to New York and back to Toronto, I was appointed VP of Citibank of New York in 1977 and shortly thereafter assumed responsibility for corporate banking in eastern Canada.
  - At the very moment of achieving the goal I had set for myself three years previously and upon which I had been singularly focused, I found myself asking a very fundamental question:
    - What was that all about?
    - What was the purpose of all the striving and stress to become VP?
  - I suddenly realized with great clarity that I would experience the same feelings and questions when I became SVP of the bank and beyond as I pursued greater accolades, responsibility and compensation.
    - Needless to say, these revelations were extremely disconcerting.
    - I knew then that I needed to pursue the question of purpose.
    - There simply had to be something more to life than finding my identity in work and pursuing power and money.

- I understood that achieving these goals without answering this fundamental question would inevitably be deeply unsatisfying.
- In December 1980, Mary invited me to church in Montreal and I accepted because I had finally arrived at a point where I was deeply dissatisfied with my life.
  - On the outside, I had all the trappings of success. On the inside, I was confused. I concluded there was no risk in being open minded.
  - During that service, I had a similar encounter with Jesus Christ to the one that Mary had previously experienced.
- I was so overwhelmed by my experience of His reality that I seriously considered changing course and going into Christian ministry.
- However, I decided to remain in business and ultimately became CEO of my investment management firm. However, my experience of life, including my priorities and attitudes, changed.
  - The question of purpose and destiny was fully answered to my complete satisfaction. God became real to me and therefore He, as the Creator, is the source of my life's purpose and Jesus' sacrifice on the cross guarantees my destiny.
  - While work remained an important part of my life, it did not consume me any longer.
    - Whereas I had previously often experienced high levels of stress, I now felt a genuine peace in the midst of every business emergency and they tend to come with some frequency in the investment industry!
      - This included dealing with the inevitable **ethical pressures**.
        - The financial services industry, and particularly the investment business, is among the most highly regulated in the

world precisely because of the conflicts of interest and the pressure to not do the right thing for your clients in order to make more money.

- I now made every effort to do the right thing in every situation.
- Also, I prayed over my business and often received **wisdom** as to which course of action I should take.
- Over the years, we experienced major **adversity** in our business on occasion but I always felt God's peace even when others were having great difficulty coping.
- Mary and my children became much more important priorities to me than they had been.
  - While Mary and I had always enjoyed a strong relationship prior to my decision to follow Christ, we were now "on the same page" in terms of our shared faith.
  - As a result, we became much better at resolving the conflicts that crop up from time to time in all marriages, since we were both united in seeking God's will in every circumstance.
- In summary, I believe that my decision to follow Christ was the best risk I ever took on purpose.
  - It was a risk in the sense that I was relinquishing control over my life to God rather than remaining the master of my fate.
  - However, I firmly believe that the benefits of trusting God in terms of finding peace, purpose and security about my future far outweigh the risk.
  - In any event, I strongly believe that the much greater risk is to live one's life without reference to God.

- Thank you for your attention and I would be pleased to answer any questions.