

RISK VERSUS UNCERTAINTY

Background... Noise... Rumor... Data... Information... Knowledge... Judgment... Wisdom?

As owner-managers, we are deluged with data, but is more data and more rapidly acquired data actually contributing to the higher quality decisions that drive higher values for our enterprises? Or are we failing to understand how to strategically allocate resources in our markets because we are misinterpreting the information? One of the most frequent errors we observe owner-managers make is the failure to distinguish Risk versus Uncertainty.

There is extensive literature on Risk and Uncertainty. The difference between them is clear, and simple to evaluate. With Risk, the actual outcome of a decision may be unknown, but the distribution of the probabilities of alternative outcomes is known. Decision making clarity is achieved by assessing the most likely outcomes for each alternative: Probability multiplied by likely outcome = expected value.

In the domain of Uncertainty, this is not true, because in Uncertainty (by definition), each situation one encounters is in effect, fresh or unique. There is no reliable platform to support traditional strategic (Risk) analysis. Each scenario becomes exposed to guesswork and conjecture, which only promotes argument and confusion. Owner-managers and CEOs, who have long preached against “surprise” as the worst outcome of any management effort, now find themselves living with it.

In the data rich world we live in today, choice is abundant. Yet empirical research has shown that frequently, in the anxiety of too many choices, we feel overwhelmed. And often what we “know” is based on only a modest level of understanding. Paralyzed by the complexity of decisions they have to make, some executives invariably attempt to solve this conundrum by seeking out even more data. The result is an overabundance of unconnected facts with no way to see the alternatives clearly.

Nonetheless as owner-managers, despite uncertainty, we have to act. Most of us don't work in laboratories where we can stop the experiment at will. We have to deduce answers on the fly from the data at hand, limited though it may be. The vast majority of all of our decisions are (and will always be) made on imperfect or incomplete information. Some believe that more information will provide a more clear view of the future, and hence improve their decision making. The reality is that additional information in the domain of Uncertainty often clouds the decision making process.

This is the Age of the Entrepreneur. We recognize that thinking about these issues requires an uncommon degree of honesty. But life, like markets, surely offers the highest benefits to those willing to take on risk. And the happiest and most successful owner-managers will employ every tool in their toolbox. So if you truly understand Risk versus Uncertainty, you will recognize which domain you are in, and thus what set of tools that you can best employ.