Risk Management Simulation

Risk management relates to reducing the cost of risk, meaning reducing the cost of the actual management of risk. People invest their money, whether it's in bonds or stocks, with the hope of acquiring profit or gains. The question one shall ask regarding risk management, "Is the risk appropriate for the returns?"

As the simulation clearly demonstrates, people demand a higher return on their investment in exchange for taking that greater risk. In Adrian's case for example, who has a high-growth risk profile, it is not feasible to risk a lot for too little.

Financial challenges faced by Kramer and Associates, and especially by the director of this investment consulting company deal with attempting to manage clients' portfolios to suit each and everyone's future financial needs. In summary, the simulation involves three clients with different risk profiles. Adrian O'Donnell has a high-risk growth profile, and wants to see returns as quick as one and a half to two years time. Tonya Davidson has a conservative-risk growth profile, and wants to see a steady growth of her investment over the span of 10 years. John Barrett has a moderate-risk growth profile, and wants to see steady returns over a period of five to six years.

The challenge arises on how to allocate their investment funds to meet their desired risk and returns level. With treasury bills, the returns are almost exactly what was promised initially, therefore making them an almost risk-free investment. The returns on T-bills are on average about five percent. Stocks on the other hand, have returns of average 10 percent per year. In this case, companies may eventually experience bankruptcy, which means a depletion of one's stocks in that company, or that company

may experience enormous growth, meaning that the investor will experience enormous returns. Therefore, the simulation challenges the consultant to find the right mix of investment options to satisfy the goals of each client.

In doing the simulation, one has to remember that if one obtains for example of 5-percent return on a low risk stock or no risk T-bill, would it be a financially wise decision to invest in a stock that yielded say a four-percent return? It would not; because this would incur a higher chance of negative results (losing your investment) to make less than one would with no risk. One has to justify choosing high-risk investments, and thus expect higher returns on those investments.

To manage risk properly, companies must be very familiar with risks they are undertaking. Risks need to become transparent, and therefore companies need to understand exactly what risks they face and how these risks could impact their fortunes. Let's consider Hewlett Packard, which is the world's largest computer and Electronics Company, ranking 11th in the Fortune 500 list, with a powerful team of 142,000 employees, and doing business in more than 170 countries. The company had had headquarters in countries like Canada, Singapore, Japan and Switzerland and it's Research and Development (R & D) investment of nearly $4billion continuously fuels the invention of new products, solutions and technologies. HP's quick ratio has made a great increase in the last three years, which is a sign of increasing liquidity improvement for the creditworthiness of the company.

As the competition increases, the firm needs to establish investment strategies that can provide adequate funds for the new projects to compete with other rivals like Dell, Toshiba and others. Stocks can offer greater returns in the short term but they are too

risky. On the other hand, bonds have less risk but they are also long-term investments. Thus the best strategy is to invest in its own infrastructure and projects, which have the potential to offer more returns than the first two alternatives. HP has greater leverage than most of its competitors, which means that the company can offer greater returns to shareholders but is also riskier. However, the firm's size allows HP to practice its generic strategies related with low cost, improving technology and quality by using economies of scale. The company seems to use the advantages of having satellites in different countries but additional investments will be needed to protect the strong competitive position in these regions and establish new bases in areas that have economic growth potential. Thus the company can make investments and establish new bases in areas, which may have strong economic potentials in the future, like China, India or Russia. For example, HP can make investments to develop its existing offices in two big cities, Shanghai and Beijing. The Shanghai office can be upgraded into a corporate headquarters like the other corporate headquarters in Singapore and Tokyo. The firm can also spend more funds to increase researches in mobility and build new wireless technology labs in key areas like Silicon Valley, Japan and Germany. These labs will focus on increasing network security, cost saving and developing new products.

Since the firm's major earnings are coming from the printing division, this creates a risky situation for the company. HP can avoid or reduce this risk by using the benefit of merger with another computer giant and can increase its production in PC and workstation markets. However, there is a great pricing pressure in the overall PC market. Dell is a strong competitor and has a focus on the standardized computer markets. The company eliminates inventories more efficiently than any of its competitors which is a

main threat for HP. Thus an acquisition strategy may not change anything except increasing inventory levels and costs if the firm does not focus on its internal operations and reduce its inventory levels. Besides the new merger or acquisition target should be a profitable company, because the company should take lessons from the past. For example, the Compact Merger is already considered a failure that increased the overall costs of operations.