



## RISK

(The Large Nasty Beast and Dinner)

BY

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Presented to the  
Northwest Bottled Water Association  
2012

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In 1992 I gave a speech to the first meeting of the NWBWA in this very same hotel. I have lived sufficiently long enough to return to give a twenty year retrospective on these two decades and to look at the world then and now. I consider this a privilege and an honor to have been invited to speak during such an occasion. I was fifty two then and now I am 72. As we get older, certain things change in our lives that are perhaps inevitable. There are two profound changes with age as I see it.

The first change is being extremely happy that I did not know then what I know now. It's not that I did not have the awareness or the knowledge so much as I did not have the wisdom to adequately deal with the knowledge.

The second is having a patience with time that testosterone does not often allow. It does not mean that I am less passionate about life. It simply means I am more patient with life and love. And perhaps more at peace. I think I also see life as more precious - all life not just mine or those close to me. Time has permitted me to see the wholeness of the concept of living. There is no longer a division of concept of life, but a fully inclusionary vision of the whole of all creatures. For these reasons, I have accepted the concept of risk as being part of life and a very necessary part of commitment to a cause, a vision or a business or to a sense of future.

So, with this state of affairs established and an understanding of my personal perspective, what do I see that has changed? Where do I see the future leading us as individuals and bottlers? In my opinion the determination of risk is going to be the challenge - more than ever.

***First: I see the concept of risk as being constant since man could contemplate whether the large nasty beast (LNB) in front of him had the same idea about dinner as he and who would eat that night. This ancient man was trying desperately to figure out probabilities and consequences of success or failure with some very limited knowledge or in this case, hard data.*** This curiosity about probabilities and consequences to either outcome remains the same question today in its simplest form. The tools are different now, yet survival remains the goal - to live another day literally or figuratively. Admittedly, many still rely on the ancient soothsayer and the oracle. Others rely on new technology and analysis of massive data bases that they have assembled and which they believe holds the key to "knowledge" and understanding of human behavior and the future. Predictability has been the heartland of prognostication. In the end, the decision about risk relates to one's own life experience regardless of the tools at hand. The final decision about risk is a very human scale of measurement. Ask Mr. Jamie Dimon of J.P. Morgan about his most recent banking experience. It points to the nature of human decisions and consequences. Risk and human desire are very fragile components of life and are often intermixed with the absolute belief in the "truths" at hand.

The greatest change in risk management in the last two decades is an immediacy and unpredictability in decision making. Modern risk is an accelerated process of soothsaying which is managed through accumulation and analysis of data. We must make expedient decisions. ***The shelf life of decisions has been substantially reduced today.*** A five year business plan in today's business environment is really about 24 months at best. Anyone who can foresee a 10 year business horizon has little sense of change and will in all likelihood be disappointed with

the results. ***What is important today is to have a vision of what you want to accomplish.*** The vision's viability is more built on the wisdom of basic human behavior than past perfor-

mance of a business or a society. Consumers are changing their goals and aspirations. The business numbers will follow. But how do we measure the risk of a venture, a vision, a consumer or the nature of effort? For example the inventor of digital imaging is Kodak. Today, much of the communications systems and information gathering is built on the very basis of digital imaging. ***Kodak is bankrupt.*** Conventional evaluation of past company performance would never have predicted such a state of this world famous business icon. What did management miss? What did they not understand? How could they not understand the future - they invented it. What is the future of Facebook, Yahoo, Google? Can their past carry them into the future? They are accumulating IP as we sit here. How long will that IP be viable? These are huge gambles. How does one hedge them? What shape and form does the LNB take today? How can we evaluate probabilities and what tools are in our hand?

***Second: I believe that the social and civil conventions of the past are unable to address in a timely fashion, the changes taking place in communications, information and distribution.*** Today, social interaction architecture is changing at speeds that pass whole generations in an instant which dissolves the past reverence to traditions and practices that form cultures and obedience to social conventions, governance and fidelity. This is not the long hair rebellion or the protests of the 60s against the Viet Nam War. The changes taking place are far deeper and more disruptive. The changes we are witnessing today drive at the core of all human relationships at a global, multi-social and political scale. It crosses all boundaries and histories. We see the past crumbling in the thinly veiled lies of historical records and the falsehoods of some of the long held truths within societies - witness the Arab Spring. We suffer from enormous institutional lag or even institutional irrelevance in some instances. We also face a new vulnerability of uncertainty and challenges to our privacy and the sanctity of the individual where tradition has held such.

***Third: I believe that the decision making practices of people are changing.*** What drives them and why do they for example choose what they choose whether a bottle of water, food or a car or political party? Is there a difference in the decision process from two decades ago? Is there an underlying conscientiousness about decisions today that is unstated and driven by virtual existences?

Each of these changes and challenges will influence each of us and our businesses today and in the future. Preserving the past to live in the future will not result in a stronger or meaningful presence. If this is true, what should we cast off?

The western world has experienced generally "good times and predictable times" since the 40's and the end of WWII. Including, in the case of war, knowing the enemy. Our decision base was made on the physical aspects of knowing the enemy and having a face for a target. Our radar systems showed us what was there, not what may or may not be there. We were addressing a physical, visible world. Virtual reality did not exist. We have in a sense been able to predict a secure and safe future for our succeeding generations - till now. This is no longer the case anywhere in the world today. The foundation of our prior decision making was based on a concept of strong predictability in global conditions, stable social and political institutions and the belief

that we understood the nature of human behavior and we were visual in our realities and thoughts. We believed we understood. But we have been lulled into a stupor by good times and stable times and by the dominance of western thought on a global scale and a physically real world.

When I studied economics we were exposed to numerous theories about how things worked and what influenced what and so we created formulas that would confirm such economic and social behavior. These rules were based on our experience in life and quantified from our perceptions as we knew the “truth.” We built certain social conventions and institutions on these well understood and predictable truths. Today I believe that many of these “understood” assumptions have become sources of failure in the world of guesses. The ancient Oracle of Delphi has more relevance than our global business and political leaders at this point. Our social fabric has changed sufficiently to place great doubt on the past correlation of cause and effect. We are not sure any longer. In the words of **Mr. Greenspan, “I didn’t see this coming”** in reference to the economic contraction of the last four years. I was working in Cairo a few days before the upheaval and plans were developing for a normal business process with a client. I can tell you, there was no indication that the Arab Spring was coming to that nation and life was normal at the urban center and at the oasis. But, it exploded into a full-fledged upheaval of monumental proportions. What happened? What didn’t we see or more importantly, why were we blind to the telltale signs that must have been subversively present? What bonds broke? Where did the chemistry lie?

***The chief mechanism of change and social challenge as I see it is the use of the Internet and its role in communication, information accumulation and distribution.*** The Internet has brought a dimension of immediacy and isolation to the social fabric of cultures and practices. It has brought counter intelligence to a new art form. It has overloaded our emotional/intellectual ability to process information and data. E-mail alone overloads most people. This information overload is partially a cultural issue and partially a survivability issue of the human mind. It is like a child who intellectually understands what they have done is somehow wrong, but has no emotional involvement and therefore doesn’t understand the “problem” created by their behavior and thus their punishment for the act itself. It is the difference between knowledge and wisdom. These are mutually exclusive elements of life. In this case, the punished or the punisher is living in virtual reality.

As children we are taught that there are right and wrong answers. From our very first introduction to learning, the simple  $2 + 2 = 4$  is an absolute and is right. This absolute is the foundation of right and wrong in behavior as well. So pretty much at very early age, we learn that gray as a state of intellect is not an acceptable view of the world - particularly in business. Our Board of Directors expects us to drive the business in the “right” direction. One is either right or wrong. Therefore our rational behavior is built on what I consider a false premise that rational thought would lead to the right answer and all of our conjectures must lead to that one rational, right reason. We are not taught about probabilities in our youth. Traditionally, “probability” was at the heart of decisions and absolutes have dissolved in a haze of data without bounds and correlations. Data has become ponderous and an end unto its self - what’s the data say? ***But today, “consequences” carry a stronger role than probabilities in decisions.*** We are by nature not

rational. Yet with this said, when faced with decision making we conjure up what we believe we know and how it might impact our life. Game theories are built on a platform of how we “should behave” within the cultures in which we reside. What we are finding today is that game theories

are facing the challenge of globalization and that we depart more from probability than most want to admit.

So, from a business standpoint one of the great changes that has occurred over the last two decades is the nature of rationale thought. Today, we are faced with a body of data that we often do not have time to study in sufficient measure to extract a clean conclusion. We now face the realm of probability or “what’s the best course of action” and not “what’s the right course of action” and what are the consequences? Do we become dinner for the LNB as a consequence of our decision? The evaluation of probability is wrought with human emotion which is coupled today with a lack of understanding of all of the issues that we face in making a business decision.

I have a suggested reading list regarding the subject of risk that will help one develop a comprehensive view of the concept of risk. They are quite different in their approach to how to evaluate risk. By far the most important reading in my opinion is Peter Bernstein’s book, [Against the Gods](#). The books are:

The most influential is **Against the Gods**, by Peter L. Bernstein. This is the most comprehensive discussion of the evolution of risk evaluation available today written by a very talented author over a lifetime of risk management activities in the investment community. I have read this book probably three times and carry it on my Kindle so I can reference it easily.

The next is **The Black Swan**, by Nassim Nicholas Taleb. The concept of this book relates to the rarity of black swans. They are witnessed in very unpredictable events. The term Black Swan was first used in the 1600s when all swans were determined to be white. So, if a black swan were to be seen, it was an unpredictable and most unusual event. Nicolas Taleb was an investment banker and trader. He discusses the issues relating to exceptional events in unpredictable times.

The third influential book is titled **The Blue Ocean Strategy**, by W. Chan Kim and Renee Mauborgne. The authors review the history of some 150 companies over a century. They argue that in order for companies to remain viable and productive, they must look for “blue oceans” where there is little competition and where technology can cross application boundaries into new uses. If companies remain in red oceans or in head to head competition with each other they continue to fight for less and less market and margin.

The fourth and final book that has influenced my approach to risk is called **The Wisdom of Crowds**, by James Surowiecki published in 2004. This book describes the accumulation or aggregation of knowledge. It reflects how a crowd of individuals can usually come to the correct answer more times than an individual facing the same set of data. It is a revealing evaluation of group intelligence.

I think each of these books is a very important guide not only in the factual evidence of risk/results but in how to think about risk. And it is this latter “thinking about risk” that is so important and has led to my five components of risk cited later in this speech.

The Chinese word for risk is a translated combination of two western words - danger and opportunity.

Peter Bernstein in his remarkable tome on the history of risk, *Against the Gods*, states, “...we tend to resort to more subjective kinds of measurement: Keynes’s “degrees of belief” figure more often in our decision making than Pascal’s Triangle, and gut rules even when we think we are using measurement.”

According to Bernstein, “**We have trouble recognizing how much information is enough and how much is too much.**” This is a very contemporary conundrum. We often confuse luck with wisdom and knowledge.

Pascal’s Law is as follows:

***The consequences of decisions and choices should dominate the probabilities of outcomes.*** Bernstein explains that “***Pascal’s Wager doesn’t mean that you have to be convinced beyond doubt that you are right. But you have to think about the consequences of what you’re doing and establish that you can survive them if you’re wrong. Consequences are more important than probabilities.***”

Here it is, so simply said about risk, can you survive your decision? That’s all, nothing else.

What is our individual basis for measuring risk?

What we know as individuals is the most influential component of our risk evaluation. Depending on our life lived, this can be a very strong advantage or the greatest of weakness. We cannot escape our own sense of history through our life lived. If we do not, for example, study other people, other situations, then our perception of risk is extremely narrow and dangerous.

How we view the world is certainly a result of our life’s experience. But, the world has changed in how we can view it. We are no longer isolated and news spreads faster than we can digest and consider the consequences. The social conventions of cultures were built largely on a foundation of event, consequence and adjustment. Information moved slowly. It allowed social architectures to consider and either modify their behavior or after consideration, look at the event as an aberration. The Catholic Church is a good example. Galileo was right but not within the confines of his contemporary social structure. It took 2,000 years for the structure to adjust. Therefore, to have a decision meet expectations is far more complex than simply making the decision. To be effective and increase the acceptable level of consequences, we must evaluate our decisions in light of the greater world view. If we are insular in our view and knowledge of

the world in which we must decide, then we will certainly end up with an untimely decision, not because it was “wrong or improbable,” but because we were not taking the risk within the context of “the time.”

Today, there are numerous polls taken of various populations. These polls are taken to reduce risk, but in reality, they are taken to identify the “mood” of a time so that the consequences of a decision can be survived by the “decider” in the event it was wrong. The poll allows a greater probability that the consequence of the wrong decision is survivable. In this instance, the poll is the universe of mood. Therefore, as one examines the consequences of a decision, know the universe in which the decision must be accepted. Failure to appreciate this component will increase the probability of not surviving the risk being under taken.

During a 2004 interview, Bernstein was asked what he would teach his grandchildren. He said:

***... I would teach them Pascal's Law: the consequences of decisions and choices should dominate the probabilities of outcomes. And I would also teach them about Leibniz's warning that models work, but only for the most part. I would remind them of what the man who trained me in investing taught me: Risk-taking is an inevitable ingredient in investing, and in life, but never take a risk you do not have to take.***

If we now go back to Bernstein’s reference to John Maynard Keynes comment about “degrees of belief,” we will face the foundations of decision making and herein lies the nature of human logic and its greatest weakness - knowing what we know. There have been a number of papers written which try to address what Keynes meant by “degrees of belief.” Looking at Keynes alone in his work, (*The General Theory of Employment, Interest and Money* - 1931), it is clear that he had trouble accepting the absoluteness of analytical processes and accepted that there are degrees of truths tied in the interpretation of life’s experiences which exceed in importance the “rational logic of numbers.” Although in some instances, “computers” will make decisions for us in a mechanical sense. Computers will shut down the stock market trading mechanism if certain abnormalities are detected in trading numbers. However, the thresholds to which limit switches are set and identified are by humans based on their perceived experience and their accepted “truths.” The ultimate weakness remains with human perception of truth as it has since the beginning of time.

During the 2004 interview with Bernstein he was asked why he thought why stocks began to yield less than bonds which was a reversal of conventional wisdom. He stated:

***“To understand why that happened and what that meant -- and to recognize that what was accepted wisdom for a couple hundred years could turn out to be wrong -- was very important. It really showed me that you don't know. That anything can happen. There really is such a thing as a "paradigm shift," when people's view of the future can change very dramatically and very suddenly. That means that there's never a time when you can be sure that today's market is going to be a replay of a familiar past.”***

***This a most astute warning!!*** I should point out that Bernstein used the term “accepted wisdom” in describing past understanding. I would prefer the term, “knowledge.” It was what was

understood and accepted as a fact. However, applying “wisdom” would have possibly permitted a more astute evaluation of the facts that could have avoided decisions made based on the “accepted knowledge.” We need to question more and accept less as a reality in today’s decision making environment.

So, what do I see as the pathway to risk management and the future? The five components of risk management as I see them are:

**Expectations** - Have a strong foundation of reasonable expectations based on life’s experience. This requires not only a cognizance of your own life, but an awareness of others’ experiences as well. Broaden the foundation of your knowledge. Study outcomes and look at case studies. Then, develop a reasonable promise or vision to achieve. Take that vision or goal to the edge of the envelope. Lead the way and don’t follow. Create a diverse and trusted team of counselors from different experiences. Listen to each advice.

**Predictability** - Evaluate how you view the world. Look at your experience and identify what seems to be consistent in your successes and then try to see if those truths remain valid. Remember the advice from Bernstein, “...that models work for the most part.”

**Beliefs** - The foundation of our decision remains locked into our own set of beliefs as we interpret data. Going back to Peter Bernstein, how much data is enough, how much is too much? No matter where we reside in this data conundrum, our final decision lies in our own experience and points of reference.

**Reality** - Reality is the assessment of the decision results. What is Jamie Dimon’s assessment of the loss of \$3 billion? What are his points of reality? If taking the whole, we are talking a bank with assets of \$2.3 trillion and so a \$3 billion loss is a few days of banking in scale (equal to slightly more than 1/10 of 1 percent) . If we are a regulator working for politicians, it sounds like a moment to fulfill a political opportunity when viewed by the average American as a political tool who considers \$2 billion brought to a personal level a lot of money. Whose reality must we base our decisions on in the end? So, in your own decision making, understand who you represent.

**Consequences** - The key question in the end is based on whether one can survive the consequences of the decision made. Even in the face of the “best” information available, the LNB can still prevail. What then is the consequence that must be survived? If one starts with this as the fundamental target of the best decision making, then probabilities becomes less vital than consequences. This is the foundation of risk.

**Remember, risk is part of life but don’t take risks that are not necessary or that can be considered frivolous.**