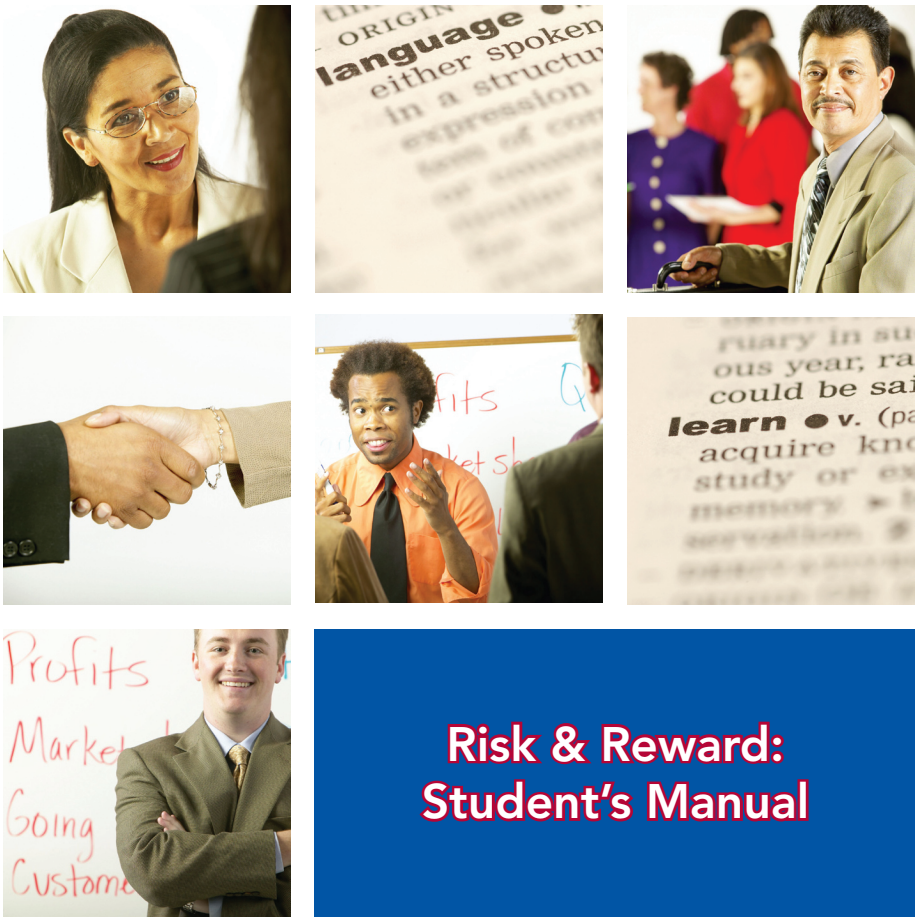
DAVE VOLEK'S BUSINESS ENGLISH™



Risk & Reward: Student's Manual

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DAVE VOLEK'S BUSINESS ENGLISH™

About Dave Volek

Engineer. Businessman. ESL Instructor. Inventor. At the heart of the comprehensive suite of Dave Volek's Business English (DVBE) modules lies my diverse expertise in business, engineering, and finance; my interest in people and education; and my passion for creating innovative solutions that bridge the inherent gaps of traditional business English instruction. My proven, unconventional approach helps business and technical professionals build strong, practical English skills for the dynamic workplace.

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Risk and Reward: Instructor's Manual

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INTRODUCTION

So you think you're a **savvy** businessperson! Well, here's a good test of your business skills: Risk & Reward (R&R). In this DVBE module, you can now be a **venture capitalist**! If you invest wisely, you will see your **seed money** grow.

You already know that no business has a **100% chance of success**. Any business can fail for a number of reasons: a poor **business plan** or poor management, **unexpected response from the competition**, **changing consumer tastes**, changing prices, government legislation, or just some bad luck. Risk is a natural part of business; if you don't want to take risks, you shouldn't be in business. But there's a skill to manage that risk wisely.

In this DVBE module, not all your business decisions will be successful. You should expect to fail quite a few times. But if you make enough right decisions at the right times, you should **come out on top**.

So, do you have **what it takes** to be a big player in the world of business?

START

The instructor will give you the ***R&R Cash Flow Sheets 1*** and ***2.*** You will have €1,000 (one thousand euros) to invest for each of the first six years. This seed money stops after the sixth year. Then you will have to **rely on** the cash flows of your previous investments to make additional investments.

For each year, the instructor will give you three different investments, each with a different **risk and reward profile**. Your group will use its business English to discuss and evaluate the three investments and to choose one of them.

After you inform the instructor of your choice, you will draw a **random number** from the instructor's random number generator. If the random number is less than the **probability of success** for your chosen investment, your investment is successful and you will be awarded the cash flow of that investment. You should then enter that cash flow on your cash-flow sheet. If the random number is greater than the probability of success, then the investment has failed and you get no cash flow. Whether you have success or failure, you then **proceed** to the next year.

Each successful investment provides cash flow from four to twelve years. In any year, you can have cash flows **coming from** several different investments. You must add up these cash flows to **determine** your total cash flow for each year.

Each year, you must **reinvest** the entire cash flow from that year into your chosen investment. You cannot **put** some money **aside** for another year. (This rule makes the bookkeeping of this exercise much simpler.)

SCORING

While your main goal should be to practice your business English, this exercise also involves a little competition. Your group should strive to have the highest **rate of return** in the class. Make **shrewd** investments!

To calculate the rate of return, we will start with the well-known **compound interest** formula:

$\mathbf{P_2 = P_1 \times (1 + i/100)^n}$, where:

- $\mathbf{P_2}$ = **principal** at time 2 (usually at the end of the investment period)
- $\mathbf{P_1}$ = principal at time 1 (usually the start of the investment period)
- **i** = **interest rate** (expressed in % per year)
- **n** = number of years

To make this equation more **relevant** to this module, we will make some changes:

$CF_F = CF_1 \times (1 + R/100)^n$, where:

- $\mathbf{CF_f}$ = your final cash flow at the end of the exercise
- $\mathbf{CF_1}$ = your initial cash flow at year 1, which is €1,000
- **R** = your rate of return, in % per year
- **n** = the number of years you have **progressed** in the exercise

We need to find **R**, so we must do some **mathematical manipulation**:

$\mathbf{R} = 100 \times (10^x - 1)$, where $x = [\log (CF_f/1{,}000)]/n$

For example, after 12 years of investing you have achieved a cash flow of €2,000. Your rate of return is calculated as follows:

$\mathbf{x} = [\log (2{,}000/1{,}000)]/12 = [\log (2)]/12 = 0.301/12 = 0.0251$

$\mathbf{R} = 100 \times (10^{0.0251} - 1) = 100 \times (1.0595 - 1) = 5.95\%$

With this formula, it is not important for all groups to be at the same "time" in the exercise. Some groups will spend more time discussing their investment choices than others. Some sets of investments will require a lengthy discussion to make a good choice; other sets will not need so much time. If one group finishes the exercise with 12 years of investing and another finishes with 17 years, the rate of return calculation will still determine who is the better investor. The group with the highest rate of return is the winner.

STRATEGY

In any year, you will get three investment opportunities. Some investments will be fairly safe; some will be quite risky.

You can get a low rate of return if you choose the safer investments. But if you choose this strategy, there is not much opportunity to practice your business English. You just choose the least risky investment and no discussion is required.

However, the R&R exercise—for you to practice your business English—is designed to give the riskier investments more profit. If you want to have the highest rate of return, you need to take some risk. But if the risk is not well managed and you run into a **streak of bad luck**, you could **go belly up**!

To be successful in this exercise, your group must **strike a balance** between making safe and risky investments. To find this balance, you could ask yourselves these questions:

- What is more important right now: going for more profit or **ensuring** longer cash flows?
- If this investment is successful, how will it **affect** our cash flow?
- If we are in a year of relatively high cash flow, how should we make best use of this year of high cash flow?
- If we are in a year of relatively low cash flow, how should we make best use of this year of low cash flow?
- What could happen if we draw three risky investments for the next year?
- How will this investment affect our cash flow at the end of the exercise?

By answering these questions, your group might find it easier to reach decisions in R&R.

When your cash flows tell you that you can afford to take a risky investment, go for it! Making risky investments will give you greater profits, more opportunity to practice business English, and more fun! And, it's not real money!

LANGUAGE STUDY

R&R has introduced you to the use of some basic statistics, which has its own unique language structures. Here are some structures you can use:

The **probability of success** is 25%.
The **chance of success** is 25%.
The **probability of failure** is 75%.
The **chance of failure** is 75%.
A **success rate** of 15% is not enough.
The **rate of success** is 15%.
The **failure rate** is 85%.
The **rate of failure** is too high.

There's an **80% chance** this investment will fail.
There's a **20% chance** this investment will be successful.
There's a **75% probability** this investment will end in failure.
There's a **25% chance** this investment will succeed.

We are not in a good position to take on an investment with just a **35% success rate**.
With its **65% failure rate**, we should stay away from that investment.

Investment #31 has a **5% better chance** of being successful than Investment #33.

Forty-five percent is an acceptable risk for us right now.
Fifteen percent is not enough.

Investment #35 will fail **85% of the time**.
Investment #2 will succeed **95% of the time**.

The **odds** are 40% **for success.**
The **odds for failure** are way too high.
The **odds** are 25%.

The **likelihood for success** is 65%.
We can't consider that investment because of its high **likelihood of failure**.
The **likelihood** is 65% that we will be successful.

The **odds** are **50/50**.
The **chances** are **60/40**.
Probability for success is about **80/20**.
I think it's about **65/35**.

I think this project has **even odds**.
The chances are **even**.

VOCABULARY QUIZ 1

You need to search only four rows up or down to match the correct definition to the word or phrase.

1. savvy	a) the investment money used for starting a new business
2. venture capitalist	b) practical and perceptive
3. seed money	c) when customers change their buying habits, usually in an unpredictable way
4. 100% chance of success	d) the strategy for how a business intends to earn profits
5. business plan	e) the competition does not react in the way that was anticipated
6. unexpected response from the competition	f) an investor who invests money into multiple businesses and usually does not take a management role in any company
7. changing consumer tastes	g) how much money is coming in and going out of a business
8. come (out) on top	h) "failure is not possible"
9. what it takes	i) having the necessary requirements
10. cash flow	j) the chance of an investment being profitable
11. rely on	k) a financial description showing the success rate, possible profits, and possible losses
12. risk and reward profile	l) to be the best at some competition
13. random number	m) to calculate, estimate, or figure out
14. probability of success	n) a number used for statistical analysis that is not influenced by the analyst's preferences
15. proceed	o) to depend on

16. come from	p) to emanate from
17. determine	q) to save
18. reinvest	r) the interest earned from both the principal and the interest earned in previous fiscal periods
19. put aside	s) to advance, to go ahead
20. rate of return	t) to take profits from previous investments and invest them again
21. shrewd	u) wise, clever, having keen insight
22. compound interest	v) related to the matter at hand
23. principal	w) the amount of the original investment
24. interest rate	x) a measure of how well an investment is performing
25. relevant	y) become bankrupt
26. progress	z) a rearrangement of an equation so that it is more useful to solve the problem
27. mathematical manipulation	a) the price for using the money of others, expressed as a percentage of the principal
28. streak of good/bad luck	b) to find a moderate position that is away from the extremes
29. go belly up	c) to make certain
30. strike a balance	d) to advance or go through
31. ensure	e) take the opportunity that is before you
32. affect	f) a series of events that are either all lucky or all unlucky.
33. go for it	g) to cause a certain outcome, to influence

FURTHER READING ON BUSINESS RISK

The petroleum industry is always working with risk. For any prospective oil or gas well, an oil company usually **conducts** a **thorough** geological analysis of the area. Regardless of how well this analysis is **carried out**, there is no **sure way** to know if oil is present until the well is drilled and tested. What most oil companies do is assign a probability of success for any prospective oil well and estimate the **return** if the well is successful. It puts these two **parameters** into a fairly complicated equation and compares the results of all prospective wells. The oil company then puts its money into the best possibilities—and leaves the inferior choices for another year.

Quite often, new information gained from this year's drilling can make the undrilled areas look better or worse than before. That's because oil gathers in "pools:" a successful **exploration well** leads to more wells in the area; an unsuccessful well suggests an area not to **put** any more money **into**.

The petroleum industry manages its risk in another way. Instead of being **solely** owned by one company, most oil wells have several oil companies as investors. One of these companies, usually the biggest investor, makes the day-to-day decisions and pays the other companies the profits as the oil is sold. By taking a smaller **stake** in more wells, an oil company is **spreading** its **risk**, which means it is less likely to run into a streak of bad luck while still earning the same average profit on its investment as it would have had it invested in fewer wells.

The pharmaceutical industry must also manage risk. It takes a lot of money and time to bring a new drug to the marketplace. With about six out of ten attempts for a new drug ending in failure, a drug company **recovers** the investment in these six failures from its successful drugs. Three in ten new drugs only **break even**. One in ten becomes a big **hit** and generates great profits that pay for its research and development (R&D) and production costs **many times over**.

Some politicians and social thinkers believe the profits from the successful drugs are **excessive**—and would like to see drug companies earn just a "reasonable return." What these people don't acknowledge is that there is no way to know which new drugs will prove to be useful. It seems a pharmaceutical company needs to go through ten expensive development trials to find that one very profitable product. If the profitable drugs do not pay for the R&D of the failures, pharmaceutical companies won't have any incentive to **embark** on any new research. They will just continue manufacturing their current **lines**, and no new drugs will be discovered.

Another case of risk management is an aviation manufacturer that has a very specialized product with only a few **potential**, yet large, **clients**. Such clients will base their decision on how well the product meets their **specifications**. However, the manufacturer's existing lines **fall short**, so the manufacturer—if it wants to be competitive—has to make some **modifications**, which require substantial R&D. Even though such a manufacturer may spend **millions** to develop the new technology, there is no **guarantee** it will be successful in attaining the specifications or actually getting the sale.

So this manufacturer has to assess risk twice: first, how much to invest in R&D to ensure a reasonable chance of success, and second, the risk of actually making the sale or not. But if it get the sale, they will make great profits for many years on the new line.

An important **side benefit** in taking on such a challenge is that the manufacturer could develop new technology that could be useful elsewhere—even if it does not make the sale.

A SAMPLE CONVERSATION



Tim, Sara, and Fred are an R&R team. Here is their cash flow sheet to Year 14:

Year	Total Cash Flow	Cash Flow	Cash Flow	Cash Flow	Cash Flow
1	1000	1000			
2	1000	1000			
3	1000	1000			
4	1000	1000			
5	1300	1000	300		
6	1300	1000	300		
7	300		300		
8	1800		300		1500
9	1800		300		1500
10	2970		300	1170	1500
11	3690	720	300	1170	1500
12	3690	720	300	1170	1500
13	3690	720	300	1170	1500
14	3627	720	300	1107	1500
15			300	1107	1500
16			300	1107	
17				1107	
18					
19					
20					

In Year 14, they are given these three investments:

Investment #10	Investment #13	Investment #32
Probability of success: 80% Cash flow: €600 per €1,000 Cash flow starts in one year Cash flow lasts for four years	Probability of success: 70% Cash flow: €400 per €1,000 Cash flow starts in one year Cash flow lasts for eight years	Probability of success: 25% Cash flow: €3,600 per €1,000 Cash flow starts in five years Cash flow lasts for eight years

Here is the conversation as they make their decision:

Fred: So we got two **fairly** safe investments this time, and one risky investment. What should we consider first?

Sara: One thing we need to look at is our cash flow. We only have cash flow happening until Year 17.

Fred: So?

Sara: Well, if we take #10, we will only increase our cash **coming in** to Year 18. If we have a streak of bad luck in the next four years, we could be **broke** by Year 19.

Tim: I see what you mean. You want to pick an investment that **extends** our cash flow further into the future.

Sara: Right! I think we should **rule out** #10 even though it is the safest investment. This means discussing the **pros** and **cons** of #13 and #32.

Fred: I can go along with this. Investment #13 **goes** for nine years **whereas** Investment #32 goes for 13 years. Is this a **significant difference** here?

Tim: I don't think so. In both cases, we are going **way past** our current **range** of cash flows. If either is successful, we will resolve the problem of not having a long enough cash flow in the **intermediate term**. We should consider another financial parameter to **base** our decision on.

Sara: The risk level between the two is significantly different. We have 70% **versus** 25%. How should we consider this difference?

Fred: If we look at Year 16, we are going to see our cash flow **drop by** about €2,200. I think this is important.

Sara: Why?

Fred: Well, **right now** we have about €3,600 to invest. If we have two bad investments in a row, our investment **drops dramatically** to €1,400. We need to make this extra €2,200 really work for us. If we don't, our rate of return will certainly suffer!

Tim: Are you suggesting that we **go with** #13?

Fred: Yes, it has significantly less risk. We should be taking safer investments to protect our two remaining years of high cash flow.

Sara: I have to agree. Let's call the instructor over! Mr. Smith!

Instructor: Have you made your decision?

Sara: Yes, we would like to invest our money in #13.

Instructor: OK. It has a probably of success of 70%. If you draw a random number less than 70, you **earn** the cash flow. So who's **picking**?

Sara: Tim, you pick. You had **lots of room** the last time you picked.

Fred: When Tim picked that "03" card last time, I wished we had chosen Investment #39. We would be **smiling a lot** right now if we had.

Tim: OK, but picking these cards is very stressful. I can't handle all this responsibility.

Instructor: It is 68. You just **squeaked in**!

Fred: Great, let's enter our new cash flow.

Sara: So we get €400 per €1000. With our€3,627 investment, we get a yearly cash flow of €1,450.

Tim: And it starts **right away**. We can use this money next year, and it goes until Year 22.

Sara: Where should I put it?

Fred: Just put it under the last "720." That cash flow in that column is finished this year. We'd better ask the instructor for another cash flow sheet. Mr. Smith!

Tim: It looks like we're going to have over €4,300 to invest for the next year. I'm now ready to take a bigger risk. **How about** you **guys**?

VOCABULARY QUIZ 2

You need to search only four rows up or down to match the correct definition to the word or phrase. In the space provided in the left column, write the definition of the term in your native language.

1. conduct	a) to carry through a certain process
2. thorough	b) very elaborate and detailed
3. carry out	c) a variable; something that will affect the outcome
4. sure way	d) profit
5. return	e) a method that will be 100% successful
6. parameter	f) only
7. exploration well	g) to complete
8. put into	h) share
9. solely	i) to neither gain nor lose
10. stake	j) to earn enough profit to pay for business failures
11. spread risk	k) an oil well drilled in an area where oil has not yet been discovered
12. recover (losses)	l) to invest
13. break even	m) a product that is very popular with consumers
14. hit	n) to invest into something with unknown results
15. R&D	o) to invest in many ventures instead of a few ventures
16. many times over	p) multiplied by a large number
17. excessive	q) customers that could use a certain product or service but have not yet bought it
18. embark	r) too much
19. lines	s) research and development
20. client	t) a customer that has a personal and continuous relationship with the seller
21. potential client	u) different products being manufactured by different processes
22. specifications	v) not to reach the objective
23. fall short	w) lots of money
24. modification	x) well thought out change
25. millions	y) reasonably, between "very" and "somewhat"
26. guarantee	z) technical requirements

27. side benefit	a) a gain that was not actually planned for
28. fairly	b) to eliminate by using some logic
29. come in	c) to be received
30. broke	d) sure way
31. extend	e) to prolong; to make longer in time
32. rule out	f) an advantage
33. pro	g) having no money
34. con	h) far beyond
35. go	i) a series or sequence
36. whereas	j) in comparison to
37. significant difference	k) not soon but not a lot later
38. way past	l) a disadvantage
39. range	m) to last
40. intermediate term	n) in comparison to, in competition against
41. base	o) having enough of a difference to produce a different conclusion
42. versus	p) "indicating the amount"
43. drop	q) to select
44. by	r) to make a conclusion using certain information
45. right now	s) to select one item from a set of items
46. drop dramatically	t) to decrease a lot in a short time
47. go with	u) to decrease significantly
48. earn	v) to be successful but very close to failure
49. pick	w) immediately
50. lots of room	x) having more than enough safety to accomplish something
51. smile a lot	y) to receive something usually from hard work or wise decisions
52. squeak in	z) What do you think about [this]?
53. right away	a) man; plural is often informally used for "people."
54. How about [this]?	b) now or very soon
55. guy	c) "to be in good position"