Risk management with special reference to investment risks

Business, Risk Management

Risk in holding securities is generally associated with possibility that realized returns will be less than the returns that were expected. The source of such disappointment is thefailureof dividends (interest) or the securities price to materialize as expected. FORCES INFLUENCING INVESTMENT RISKS External Sources of Systematic Risk: In investments, those forces that are external to the firm, uncontrollable and broadly affect large number of securities are called sources of systematic risk. Internal Sources of Unsystematic Risk: Those forces that are internal to the firm, controllable and somewhat peculiar to industries or firms are referred to as sources of unsystematic risk. SYSTEMATIC RISK AND UNSYSTEMATIC RISK Systematic risk refers to that portion of total variability in return caused by factors affecting the prices of all securities.

Economic, political, and sociological changes are sources of systematic risk. Their effect is to cause prices of nearly all individual common stocks and/or all individual bonds to move together in the same manner Unsystematic risk is the portion of total risk that is unique to a firm or industry. Factors such as management capability, consumer preferences, and labor strikes cause systematic variability of returns in a firm. WAYS TO MANAGE INVESTMENT RISKS Market Risk Protection The standard deviation and beta indicate the volatility of the stock. The National Stock Exchange News bulletin provides this information. Looking at the beta values, the investor can gauge the risk factor and make wise decision according to his risk tolerance. Protection against Interest Rate Risk The investors can also buy treasury bills and bonds of short maturity.

Another suggested solution is to invest in bonds with different maturity dates. Protection against inflation The general opinion is that the bonds or debentures with fixed return cannot solve the problem. If the bond yield is 13 to 15 % with low risk factor, they would provide hedge against the inflation. Protection against Business and Financial risk To guard against the business risk, the investor has to analyse the strength and weakness of the industry to which the company belongs. The financial risk should be minimised by analysing the capital structure of the company. Along with the capital structure analysis,. he should also take into account of the interest payment.