FACULTY OF COMMERCE AND MANAGEMENT

COURSE: BBA (DM)

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RISK AND RETURN ANALYSIS

Risk and Returns

- After investing money in a project a firm wants to get some outcomes from the project. The outcomes or the benefits that the investment generates are called **RETURNS.**
- Possibility of variation of the actual return from the expected return is termed as **RISK.**

Concept of Risk

- A person making an investment expects to get some returns from the investment in the future. However, as future is uncertain, the future expected returns too are uncertain. It is the uncertainty associated with the returns from an investment that introduces a risk into a project. The expected return is the uncertain future return that a firm expects to get from its project.

Concept of Risk………….

- The realized return from the project may not correspond to the expected return. This possibility of variation of the actual return from the expected return is termed as risk. Risk is the variability in the expected return from a project. In other words, it is the degree of deviation from expected return.

Elements of Risk

There are broadly two groups of elements classified as:

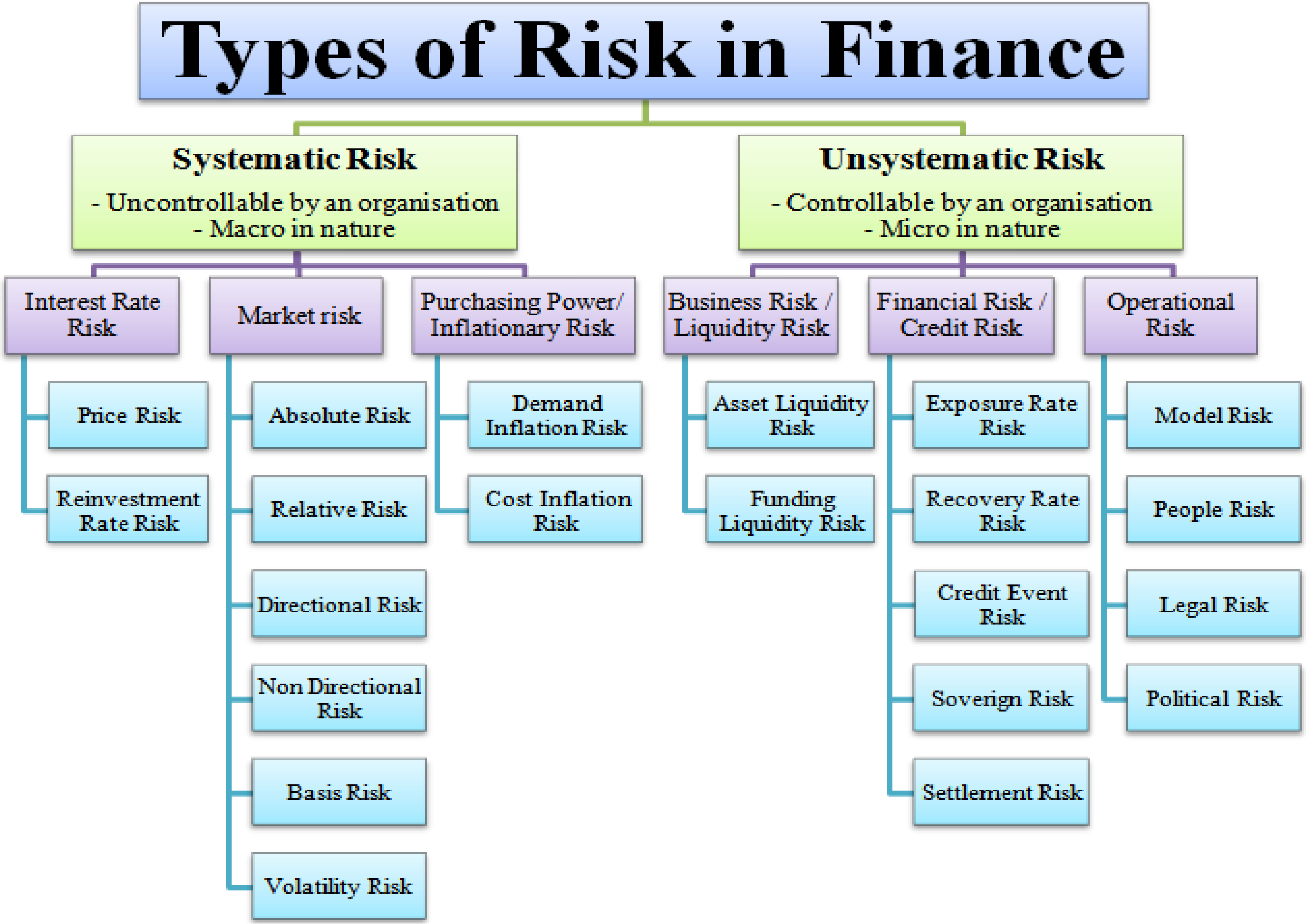
- Systematic risk and
- Unsystematic risk.

Systematic Risk

- Business organizations are part of society that is dynamic. Various changes occur in a society like economic, political and social systems that have influence on the performance of companies and thereby on their expected returns. These changes affect all organizations to varying degrees. Hence the impact of these changes is system-wide and the portion of total variability in returns caused by such across the board factors is referred to as systematic risk. These risks are further subdivided into **<u>interest rate risk, market risk, and purchasing power risk.</u>**

Unsystematic Risk

- The returns of a company may vary due to certain factors that affect only that company. **Examples** of such factors are **raw material scarcity, labour strike, management inefficiency,** etc. When the variability in returns occurs due to such firm-specific factors it is known as unsystematic risk. These risks are subdivided into **business risk and financial risk.**


Types of Risk in Finance
Systematic Risk
- Uncontrollable by an organisation
- Macro in nature
Unsystematic Risk
- Controllable by an organisation
- Micro in nature
Interest Rate Risk
Price Risk
Reinvestment Rate Risk
Market risk
Absolute Risk
Relative Risk
Directional Risk
Non Directional Risk
Basis Risk
Volatility Risk
Purchasing Power/ Inflationary Risk
Demand Inflation Risk
Cost Inflation Risk
Business Risk / Liquidity Risk
Asset Liquidity Risk
Funding Liquidity Risk
Financial Risk / Credit Risk
Exposure Rate Risk
Recovery Rate Risk
Credit Event Risk
Soverign Risk
Settlement Risk
Operational Risk
Model Risk
People Risk
Legal Risk
Political Risk