Risk and return concept

Module-I MBA II SEM

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Meaning of Risk:

- Risk may be defined as the possibility of suffering an injury or loss.

- In the context of ‘Business or financial world’, it represents the uncertainty associated with an investment.
- in other words risk is the possibility that the actual return on an investment may be different from the expected return.

- An important concept in this regard is the idea that an investment carrying a higher risk has the potential of an yield.

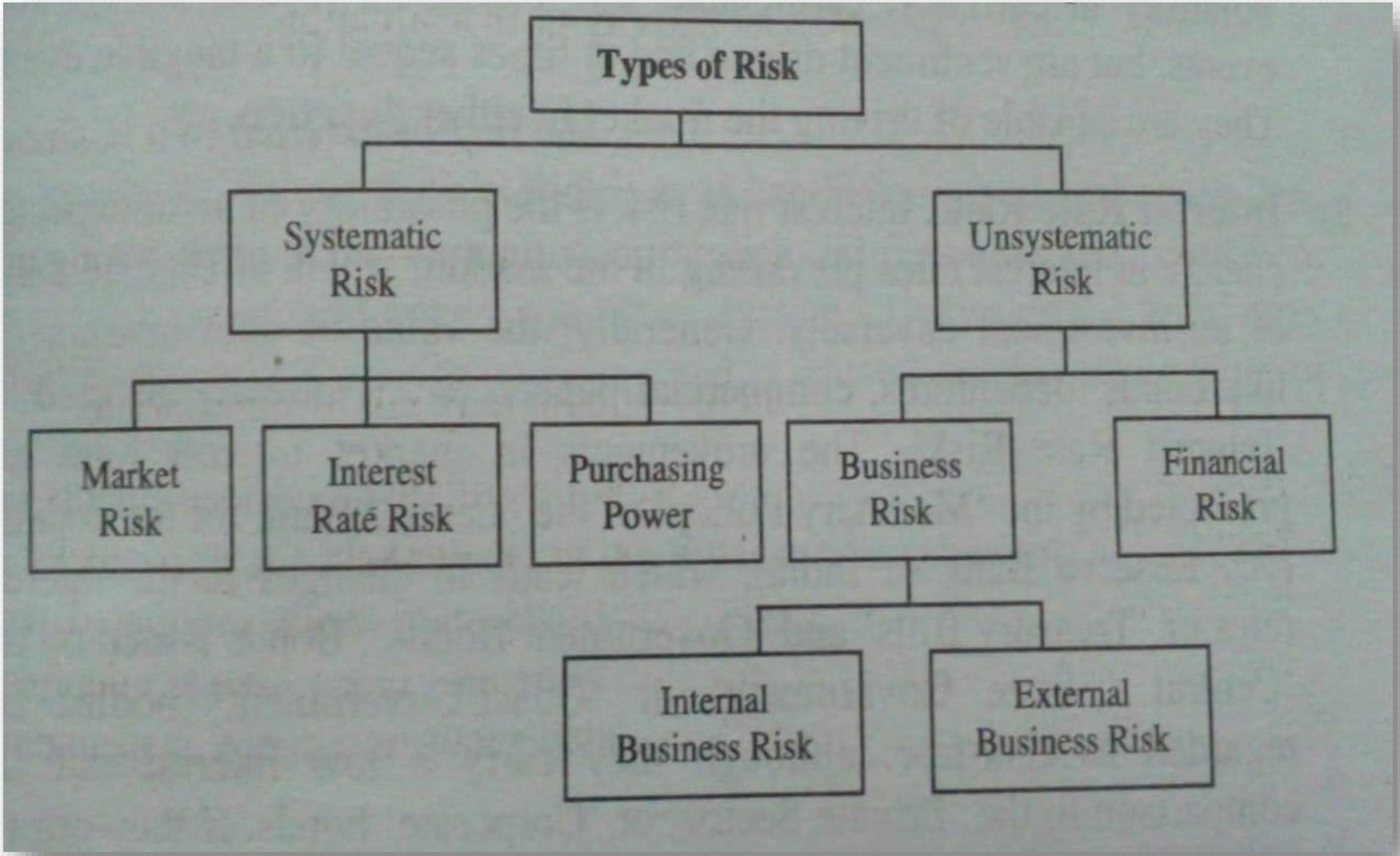
- Another way of defining risk is “ The threat or probability that an action or event may impact (adversely or beneficially) an organization’s ability to achieve its objectives”.

- “ The probability that an investment’s actual return would be different from the expected return, including the ultimate risk of losing all of the original investment”.
- Risk is ‘ uncertainty of result’, either from pursuing a future positive opportunity, or an existing negative threat in an effort to meet a current goal.

Causes of Risk:

- Wrong Decision
- Wrong Timing
- Nature of Instruments
- Creditworthiness of issuer
- Maturity period or Length of Investment
- Amount of Investment
- Method of Investment
- Terms of Lending
- Nature of Industry
- National and International Factors

Types of Risk



1. Systematic Risk-

- Components:

- 1. Market Risk
- 2. Interest Rate Risk
- 3. Purchasing Power Risk

2. Unsystematic Risk-

- Components:

- 1. Business Risk
- A. Internal Business Risk
- i. Sales variation
- ii. Research & Development (R&D)
- iii. Personnel Management
- iv. Fixed Cost
- v. Single Product

- B. External Business Risk

- i. Social and Regulatory Factors
- ii. Political Risk
- iii. Business Cycle

- 2. Financial Risk

- A. Credit Risk
- B. Currency Risk
- C. Country Risk

- i. Political Risk
- ii. Regulatory Risk
- iii. Economic Risk

Measurement of Risk

- RANGE
- VARIANCE & STANDARD DEVIATION
- COEFFICIENT OF VARIATION

RETURNS

- The driving force behind an investment by any investor is, obviously, to have maximum possible level of return, which poses various limitations including the risk associated with the investments.

- Return is a form of reward and a motivator, which encourages an investor for making the investment. The significances of returns in any investment decision can be determined from the following factors;

Turns also facilitates the asses

- 1. it helps potential investors in making comparison of returns expected from alternative investment opportunities.
- 2. measurement of historical (past) returns places the investors in a position to take stock of better performance in the areas of investment.
- 3. measurement of historical returns also facilitates the assessment of future returns.

Returns

- Components
- 1. Current Returns
- 2. Capital Returns/ Gains
- ***Total Returns = Current Returns + Capital Returns***

Types of Returns

- 1. Realised Return

- 2. Expected Return

Measurement of Returns

- 1. Traditional Method:
- Bonds
- Stocks or Shares
- 2. Modern Method:
- Holding Period Yield (HPY)
- Return & Statistical method
- A. Central Tendency
- B. Measure of Dispersion

Major Risk-Return decision areas:

- 1. Financial analysis and control
- 2. Budgeting and profit planning
- 3. Capital budgeting
- 4. Financial planning
- 5. Cost of capital
- 6. Working capital management

THANK YOU CLASS…

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