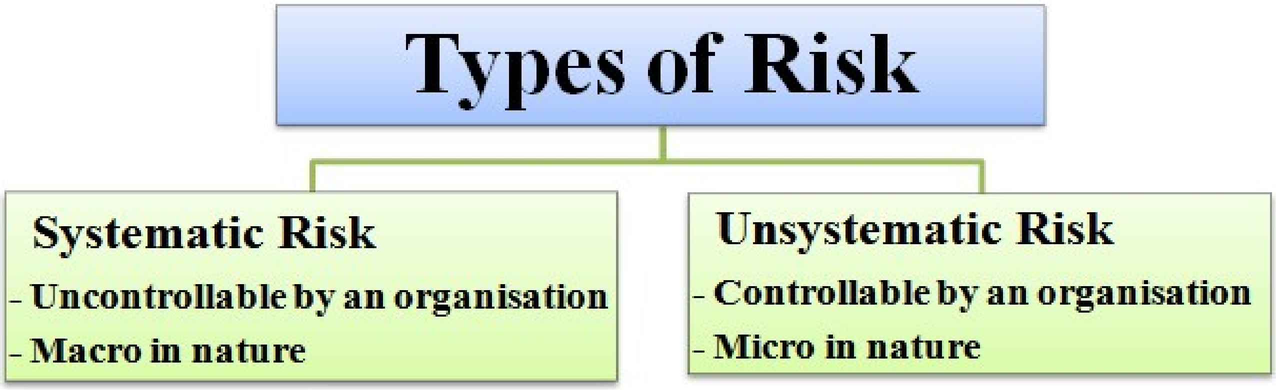
What is Risk?

- Risk simply means the possibility of loss or damage.
- **Risk** is the potential of gaining or losing something of value.
- Values (such as physical health, social status, emotional well-being or financial wealth) can be gained or lost when taking **risk** resulting from a given action , foreseen or unforeseen.
- **Risk** involves the chance an investment's actual return will differ from the expected return.
- Risk measures the uncertainty that an investor is willing to take to realize a gain from an investment.



The meaning of systematic and unsystematic risk in finance:

1. Systematic risk is uncontrollable by an organisation and macro in nature.
2. Unsystematic risk is controllable by an organisation and micro in nature.

1. Systematic Risk:

- Systematic risk is due to the influence of external factors of an organization.
- Such factors are normally uncontrollable from an organization's point of view.
- It is a macro in nature as it effects the large number of organizations operating under a similar stream or same domain.
- It cannot be planned by the organization.

The types of systematic risk are depicted and listed below:

a. **Interest rate risk:**

- Interest-rate risk arises due to variability in the interest rates from time to time.
- It particularly affects debt securities as they carry the fixed rate of interest.

b. **Market risk:**

- Market risk is associated with consistent fluctuations seen in the trading price of any particular shares or securities.
- It arises due to rise or fall in the trading price of listed shares or securities in the stock market.

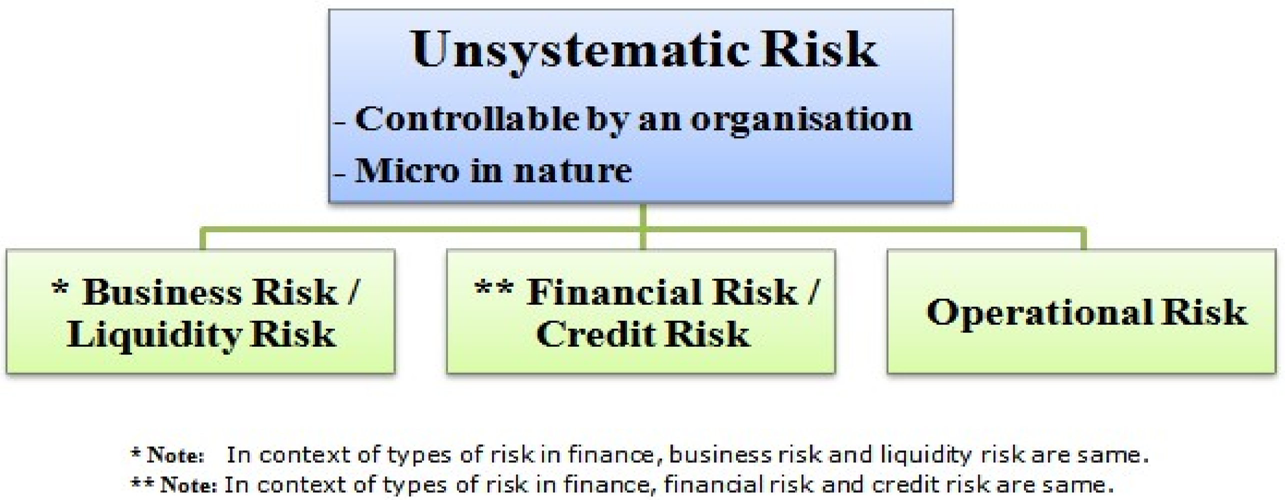
c. **Purchasing power or inflationary risk:**

- Purchasing power risk is also known as inflation risk. It is so, since it originates from the fact that it affects a purchasing power adversely.
- It is not desirable to invest in securities during an inflationary period.

2. Unsystematic Risk:

- Unsystematic risk is due to the influence of internal factors prevailing within an organization.
- Such factors are normally controllable from an organization's point of view.
- It is a micro in nature as it affects only a particular organization.
- It can be planned, so that necessary actions can be taken by the organization to reduce the effect of the risk.

The types of unsystematic risk are depicted and listed below.



a. **Business or liquidity risk:**

- Business risk is also known as liquidity risk.
- It is so, since it originates from the sale and purchase of securities affected by business cycles, technological changes, etc.

b. **Financial or credit risk:**

- Financial risk is also known as credit risk.
- It arises due to change in the capital structure of the organization.
- The capital structure mainly comprises of three ways by which funds are sourced for the projects. These are as follows:

i. Owned funds. For e.g. share capital.
ii. Borrowed funds. For e.g. loan funds.
iii. Retained earnings. For e.g. reserve and surplus.

c. **Operational risk:**

- Operational risks are the business process risks failing due to human errors.
- This risk will change from industry to industry.
- It occurs due to breakdowns in the internal procedures, people, policies and systems.