Prof. (Dr.) Nagendra Kumar Jha
Professor
Dept. of Applied Eco. and Commerce
Patna University, Patna

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Topic: Risk and Return Analysis

Risk and Return are the two important components which are taken into consideration while investing the money in any activity. It becomes very sensitive when we go to invest this money in business activity or for acquisition of any asset for the longer period. Risk and Return are going to involve in each and every investment activity in a particular Business firm. It is the general observation that when any investor goes to invest their money in any security or in any activity, immediately, it comes in their mind that how much return, they will get in the form of getting interest or dividend at the end of the accounting period or on periodical basis as per the agreement made between the investors and the company. Not only that but at the same time they also need to know about the amount of risk which is involved in the particular activity where they have invested their money or they are going to invest their money. Risk and Return need to be measured or estimated before making investment in any long term activity. This is the general Psychology of the investor that when they feel that the amount of Return will be more than the amount of risk involved in that activity, they will go to think for the investment, otherwise, they prefer to keep their money in their own hand or they go to search other alternatives where they can get better and greater return than the amount of risk.

So far the return is concerned, it is related with the amount of the benefit which we expect in future against the investment. It includes in itself the amount of the benefit which we get by increasing the original amount of the investment because sometimes we feel that the investment which we have made in certain security or shares and debentures, the value of that security will go to increase in future and because of share price appreciation ,there is a question of capital gains .Thus, return includes the amount of the interest or dividend which is payable on periodical basis and the appreciated value or increased value of investment or security as sold in future. However, this value is also adjusted with the time value of money in order to find out the real amount of the benefit against those investment. Whatever may be the situation but it is lear that return is generally expressed in the form of regular payment of interest and dividend and the value of appreciation as made in the value of investment at the time of their sale.

So far risk is concerned, we find that the risk is basically concerned with the amount of loss as occurred due to the change in the amount of Return or in the value of given investment. if the amount of the return as expected earlier at the time of investment is going to be less and the value of investment as expected on date of its maturity is going to be decreased at some higher rate or greater rate, this loss is treated as risk. There are the different types of securities in which the amount of the risk is different but risk is going to be involved in each and every investment. This is the fact that risk provide the returns because it is the general statement that if there is no risk there is not a question of any returne, If the amount of the risk is more, the amount of the return will be more. If the risk level is very poor or low, the amount of the return will be equally very low. This amount of the risk is going to be measured with the help of the statistical tools where we go to use the standard deviation, the coefficient of variation for measuring the amount of risk. Beta is the most important tool for identifying the amount of risk which is involved in the particular investment.

There are two types of risk, one is systematic and other is non systematic risk. Systematic risk is basically known as the market risk which is also known as diversifiable risk, it means that systematic risk cannot be diversified. Systematic risk is going to be affected with the change in the market condition, change in the Nation's economy, change in the fiscal policy of the government, monetary policy of the central government, change in the world energy situation etc. such type of risk affect securities overall and hence cannot be diversified. Its measurement is equally very difficult. Non-systematic risk is also known as diversifiable risk caused by such random events as lawsuits, strikes, successful and unsuccessful marketing programs, winning or losing a major contract and other events that are unique to a particular firm and systematic risk can be eliminated through diversification because these events are random. Their effects on individual securities in a Portfolio cancel out each other.

Thus, not all of the risk involved in holding a security are relevant because part of the risk can be diversified away. what is relevant for the investors is systematic risk which is unavoidable and they would like to be compensated for bearing it. However, they should not expect the market to provide any extra compensation for bearing the avoidable risk as is contended in the Capital Asset pricing model.

So far risk and return analysis are concerned, we are going to compare the risk with return and return with the risk where the purpose is to maximise the return and minimise the risk. We are not going to avoid the risk or ignore the risk because avoidance of risk will go to affect our return. We always welcome the risk ,we always invite the risk because when the risk will come, it will bring the return also and as a financial manager we are basically concerned to maximize the return in order to minimise the risk. Hence, our concentration is on the return not on the risk because when our return is more, we can easily minimise the risk. Thus, risk and return analysis clearly indicates that our movement should be initiated from the way of Return to risk not from the risk to return. We should try our best to minimise the risk in order to to reduce the risk which is possible by diversifying the investment in the different activities or by holding the securities of different natures or by making investment in different business activities, which will help us in diversifying the risk and providing the better and greater return. Thus, risk and return are our prime consideration in the area of taking any investment decision or in ensuring the effective utilisation of the available financial resources for the longer period.