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AN OVERVIEW OF BUSINESS RISK

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Abstract

Every business organization involves some element of risk. Risk implies uncertainty of profits or danger of loss due to some unforseen events in the future. An entrepreneur may encounter risks in every area or function of a business. Thus, business risks may take place in a variety of forms. Though risks are universal, but all business enterprises do not face same type and degree of risks. They may vary according to the nature and size of a business. Hence researcher has taken up a study entitled "AN OVERVIEW OF BUSINESS RISK". This paper is designed in such a way as to provide all the required inputs for a sound understanding of the Business Risk framework. This paper is totally based on secondary data.

Keywords: Business Risk, Factors Influncing On Business Risk, Managing Business Risk

INTRODUCTION

We are all faced with risk in our everyday lives. And although risk is an abstract term, our natural human understanding of the tradeoffs. For example- in our personal lives, we intuitively understand the difference between a cost that already been budgeted for (in risk parlance, a predictable or expected loss) and an unexpected cost (at its worst, a catastrophic loss of a magnitude well beyond losses seen in the course of normal daily life).

In particular, we understand that risk, is not synonymous with the size of a cost or of a loss. After all, some of the costs we expect in daily life are very large indeed if we think in terms of our annual budgets: food, fixed mortgage payment, college fees and so on. These costs are big, but they are not a threat to our ambitions because they are reasonably predictable and are already for in our plans.

Business is mainly run to earn profit. However, there is always a change of suffering loss it. This danger of loss from unforseenable events in future in business is name as business risk. Business risk is an essential element of business. It cannot be avoided but it can be minimized by taking timely suitable measures by the businessman.

Risk means that there is a chance that you won't receive a return on your investment. It is an exposure to danger to your bottom line. When you are in business, you need to consider the kinds of events that could pose a risk to your business and take steps to mitigate them.

The term business risk refers to the possibility of inadequate profits or even losses due to uncertainties. Every business organization contains various risk elements while going the business. Business risks implies uncertainty in profits or danger of loss and the events that could pose the risk due to some unforeseen events in future, which couses business to fail.

These risk are inevitable in a business and cannot be eliminated completely but they can be controlled through proper preventive and corrective measures of risk management of risk involves-

1)Identification of the risks 2)Evaluation of the

risks

3)Choice of the right method for handling of risks 4)Evaluating the

aftermath of the chosen method

Hence, an entrepreneur can face the risks effectively by anticipating their nature and causes and adopting appropriate techniques in order to minimize their negative consequences.

Also, gains in a business are inseparably linked to these inherent risks. In other words, "no risks, no gains" is a fundamental principle of a business. Hence, high profits of the big business houses are the rewards for successful

CALCULATION OF BUSINESS RISK:

Business risk is a combination of two factors such as operating risk and financial risk. To calculate operating risk of business we use the degree of operating leverage.

Business risks are of a diverse nature and arise due to innumerable factors. These risks may be broadly classified into two types, depending upon their place of origin.

1)Internal Risk 2)External Risk

INTERNAL RISK:

Internal risks are those risks which arise from the events taking place within the business enterprise. Such risks arise during the ordinary course of a business. These risks can be forecasted and the probability of their occurrence can be determined. Hence, they can be controlled by the entrepreneur to an appreciable extent.

The various internal factors giving rise to such risks are-1)Human factors
2)Technological factors 3)Physical factors

1) HUMAN FACTORS:

Human factors are an important cause of internal risks. They may result from strikes and lock-outs by trade unions, negligence and dishonesty of an employee; accidents or deaths in the industry; incompetence of the manager or other important people in the organization, etc. Also, failure of suppliers to supply the materials, or goods on time or default in payment by debtors may adversely affect the business enterprise.

2) TECHNOLOGICAL FACTORS:

Technological Factors are the unforeseen changes in the techniques of production or distribution. They may result in technological obsolescence and other business risk. For example-if there is some technological advancement which results in products of higher quality, then a firm which is using the traditional technique of production might face the risk of losing the market for its inferior for its quality product.

3) PHYSICAL FACTORS:

Physical factors are the factors which result in loss damage to the property of the firm. They include the failure of machinery and equipment used in business; fire or theft in the industry; damages in transit of goods; etc. It also includes losses to the firm arising from the compensation paid by the firm to third parties on account of intentional or unintentional damages caused to them.

EXTERNAL RISKS FACTORS:

External risk those risks which arise due to the events occurring outside the business organization. Such events are generally beyond the control of an entrepreneur. Hence, the resulting risks cannot be forecasted and the probability of their occurrence cannot be determined with accuracy.

The various external factors which may give rise to such risks are-
1)ECONOMIC FACTORS
2)NATURAL FACTORS
3)POLITICAL FACTORS

1)ECONOMIC FACTORS:

Economic factors are the most important causes of external risk. They result from the changes in the prevailing market conditions. They may be in the form of changes in tastes and preferences of the consumers and changes in income, output or trade cycles. The condition like increased competition for the product, inflationary tendency in the economy, rising unemployment as well as the fluctuation in world economy may also adversely affect the business enterprises. Such risks which are caused by changes in the economy are known as ‘dynamic risks’. These risks are generally less predictable because they do not appear at regular intervals. Also, such risks may not necessarily result in losses to the firm because they may also contain an element of gain for the firm. For instance, due to market fluctuations, a well known product of a firm, may either lose its demand or may occupy a larger market share.

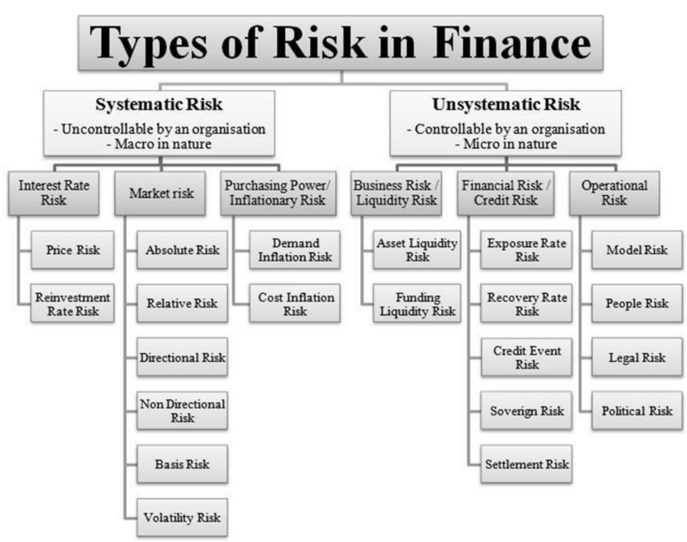
2) NATURAL FACTORS:

Natural factors are the unforeseen natural calamities over which an entrepreneurs has very little or no control. They result from events like earthquake, flood, famine, cyclone, lightening etc. such events may cause loss of life and property to the firm or they may spoil its goods. For example-Gujarat earthquake caused irreparable damage not only to the business enterprises but also adversely affected the whole economy of the state.

3) POLITICAL NATURES:

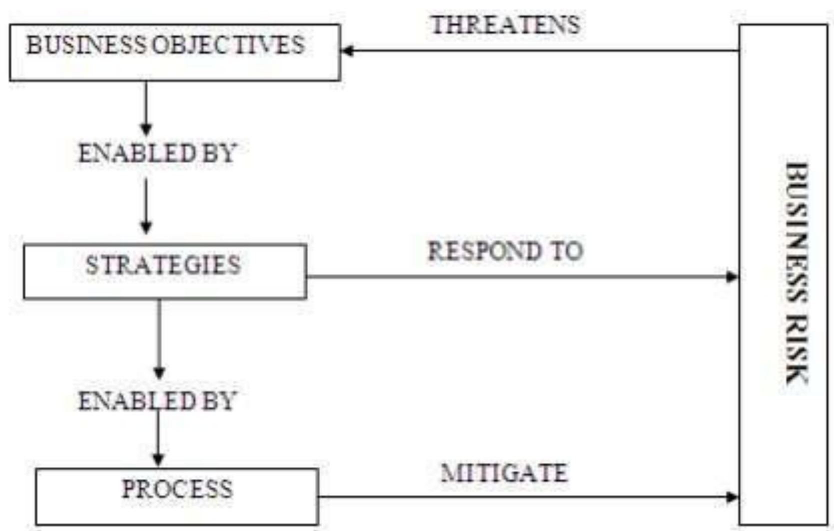
Political factors have an important influence on the functioning of a business, both in the long and short term. They result from political changes in a country like faller change in the government, communal violence or riots in the country, civil war as well as hostilities with the neighbouring countries. Besides, changes in government policies and regulations may also affect the profitability and position of an enterprise. For instance, changes in industrial policy and trade policy annual announcement of the budget amendments to various legislations, etc. may enhance or reduce the profits of a business enterprise.

Thus, business risk takes a variety of forms. In order to face such risk successfully, every businessman should understand the nature and causes of these risks as well as the various measures which must be taken in order to minimize them.



IDENTIFYING AND ANALYZING BUSINESS RISKS:

It is important for an organization to identify the business risks that exist in the environment in which operates. To identify those risks. Organization must review their external environment. External business risks stem from economic, political, social, environmental, technological and other external conditions, for eg- many research institutions face risks with respect to technology and customers demand. The electronic media in which research materials can be made for faster search tools and for remote access to research materials. A library's ability to meet this demand and remain a well respected institution is a business risk. An organization cannot fully understand its business risks unless it also understands its business objectives, strategies and process. Following figure illustrates these interrelationships



As can be seen in the figure, the business objectives of an organization are continually threatened by risks. To respond to these risks, management develops strategies that enable the organizations to meets its objectives and which business processes are necessary to meet management's objectives and which processes require controls to mitigate business risks.

Risk is inherent in operating a business or running a program, an organization cannot eliminate business risks. Management has to decide how much risk is acceptable and to create structure to keep those risks within appropriate limits. The key to business risk management is achieving a proper balance of risk and control.

MANAGING BUSINESS RISK:

After identifying and analyzing business risks, management decides how these risks should be managed. This requires comparing the costs of reducing business risks against the costs of potential loss from risks. There are four categories of possible responses to business risks- accept, transfer, avoid, and reduce. The first three are passive response is active. The four categories may be defined as follows-

1)Accept- Accepting a business risk means doing nothing to avoid it. This response is based on a conscious decision that the costs of other responses outweigh the potential benefits or that the risk is acceptable.

2)Transfer- Transferring the business risk to another party alleviates management's responsibility for managing it. Examples of this response are buying insurance and outsourcing.

3) Avoid- Avoiding the business risk is a decision to change a business objective because no other response can reduce the business risks to an acceptable level in a cost effective manner.

Reduce- Reducing the business risk means reducing either the likelihood of its occurrence or the magnitude of its impact. Management is usually establishes an effective control environment to reduce business risks.

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