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Hedging the Investment Related Risks

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ABSTRACT

Risk management is the first and foremost step before any investment is made. The idea behind having a risk management plan is not to completely avoid the associated risks as the risks are bound to be there where an investment is being made but it is the need to come up with a plan to maximize the returns and reduce the impact of the risks involved. Investment risk management is a highly complex and ambiguous process, which involves several steps, and varies from individual to individual, business to business, corporate to corporate and enterprise to enterprise. A highly meticulous practical framework must be put in place in order to address the challenges that arise during an investment.

Keywords: *Risk hedging, risk management, investment risks, investment avenues*

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INTRODUCTION

There is no denying the fact that the higher the risks, the better the returns. So, it depends on factors like the objective of the investment, age and income of the investor, etc. High-risk investments generally mean that the VAR (value at risk) is extremely high and the loss could be substantial if things were to go south. Whereas, low risk investments may give less profit but there is less risk involved and the losses are bearable by the investors. There are various investment avenues available in the market such as shares, debentures, bonds, mutual funds, insurance, bank deposits, commodities, precious metals, provident funds, etc., and some avenues are extremely risky, and some are less risky. It is because of the volatility and unambiguity of the stock market that makes the investors prone to risk. There is no rulebook available that can guide them how to shield themselves from any potential risk. Yet, there are a few ways to anticipate and hedge the risks by a thorough and extensive research.

INVESTMENT BY DIFFERENT SECTIONS OF THE SOCIETY

Broadly speaking, most women are not interested to take high risk and are willing to invest in safe and secure avenues of investment whereas the investors are giving more dependency to their own opinion as well as their husband's opinion. People those are uneducated or less educated mostly prefer to invest in less risky or risk-free avenues. Unmarried people mostly invest in those avenues which are risky in terms of VAR (Value at risk). Investment is one of the major issues in the middle-class society, but small class savings are mainly incurred on the future expenses. Here, we mainly focus on the importance and understanding of the investment pattern as well as the implications on investors and study the process in relation to different kinds of investors.

Factors affecting the degree of Risks Involved

There are no ways for an individual to predict whether an investment is foolproof and will yield returns. However, with the following techniques, the impact can be ameliorated.

- Term of the investment
- Thorough study of the market at the time of investing
- Investing in the established players

Investment risk management does not necessarily mean higher output, but it definitely is inversely proportional to the expected profits. If the idea of the investment is to multiply the assets, then by hedging we are reducing the potential output.

For example, in case of an organization/company, if it makes energy drink then it has to ensure a smooth and uninterrupted availability; supply of the ingredients and, in order to achieve the targeted returns, the company may have to have future contracts with the sugarcane producers. Suppliers not to increase the price during the contract as any fluctuation in the price of the ingredients will increase the risk of either less production or meager profits.

RISK MANAGEMENT PROCESS

Broadly, the risk management process can be described in the following steps.

- Identify—Identify and list all the potential risks involved in a project or business or the selected investment.
- Analyze—Determine probability and implications of the identified risks and analyze their impact to lessen their effect on the project goal and the business objective.
- Assess—Once the implications and probability have been determined, assess and analyze the impact of the risk by a thorough and extensive study and research on the risks.
- Prepare—Rank all the risks in the order of magnitude and prepare a preventive plan to avoid the unwanted consequences particularly for the ones on the top of the list. Also, work on the strategy to mitigate the impact and finally come up with a contingency plan for an immediate remedial action.
- Monitor—Risk management is not a onetime exercise, in fact it must be monitored on a regular basis. Regular modifications need to be incorporated to have a more robust process in place.

CONCLUSION

With any kind of investment, there is a certain degree of risk attached. However, that degree can be less or more depending on the kind of investment, what time the investment is being made and the term of the investment. Also, a thorough preparation before the investment is made by an individual or a corporate or an enterprise, and having a solid risk management process in place, the degree and the repression of the potential risks may be controlled.

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