



STUDY NOTE - 8

INTERNATIONAL FINANCE

SECTION - 1

RISK ASSESSMENT AND MANAGEMENT

This Section includes

- **Minimization of risk**
- **Risk defined**
- **Risk mapping**
- **Financial risk**

1.1. MINIMIZATION OF RISK

1.1.1 Organizations are exposed to two major types of risks namely, business risk and finance risk. Business risk arises due to industry, economy, credit and political factors, causing volatility in sales. Finance risk can be either price risk, interest rate risk or foreign exchange risk.

1.2. RISK DEFINED

1.2.1 Risk is an uncertain future outcome that will either improve or worsen our position. There are three key points to be observed:

- Risk probabilistic
- Risk symmetrical-the outcome may be either favorable or unfavorable
- It involves change

1.2.2 In risk management, we are mainly concerned with ensuring that the downside risk is not catastrophic. Therefore, risk mitigation has to be the main function of senior management team in any organization.

1.3. RISK MAPPING

An organization's attitude towards the various forms of risk to which it is exposed should be a direct interpretation of its strategy. Strategy itself must address the appetite and capacity for risk within the business and the systems and actions of the organization regarding risk should



seek to attain the goals envisaged by the strategy. The process of assessing for the organization as a whole the types and degree of risk to which it is exposed is known as risk mapping.

1.4. FINANCIAL RISK

1.4.1 The following six major headings suggest themselves within the financial category

1. Credit risk
2. Cash flow risk
3. Foreign exchange risk
4. Interest rate risk
5. Commodity price risk
6. Gearing-financial and operational risk

‘Risk’, ‘Peril’ and Hazard’

‘Peril’ is the cause of a loss; (eg. Fire) and

‘Hazard’ is the factor that may create loss (eg. Wrong wiring, improper construction etc)

‘Risk’ is the possibility of a loss due to the above factors;

Degree of risk is not an absolute, independent amount.

It is related to

- level of information available;
- degree of information available;
- interpretation of the information and
- the perception of the entity as to the future outlook—
 - Two different entities might interpret them differently;
 - better the interpretation, lesser the risk;