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Review Article

AN ANALYSIS OF RISK THAT ARE RUN BY THE FINANCIAL MARKETS

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A R T I C L E I N F O

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A B S T R A C T

This paper deals with the analysis of risk that is run by the financial markets. Firstly we need to understand what a financial market is. Financial market is a broad term which describes a market place where people trade their financial securities including bonds, currencies and equities, and precious metals and agricultural products. It also includes commodities, and other fungible items of value at very low transaction cost and also at prices that affect the supply and demand. The status of the financial market depends upon the transaction of trade on the basis of which financial market can be classified as small depending upon low activity and big which trades in billions, trillions etc. for example small financial market can be of an individual person with low capital, securities or investment whereas the example for large market if foreign exchange market. In a financial market lot of risks are involved. The risks mostly relate to the inflation and deflation in the asset value in a market. The risk may range between minimum losses to a maximum loss depending upon the type of risk involved. Thus to sum up, the financial risk in a market is always not stable and it fluctuates often which decides the risk factor in a financial market. One has to bear in mind that sometimes, inflation of the asset value in the financial market may benefit some businessman and on the other hand the same inflation on the asset value may be of disadvantage to another businessman. So also is the deflation rate and vice-versa. The financial market also depends upon the partnership in a company, the buyer, the seller, the customer / client and also the person who is involved in the contract of supply of goods or products. If the trade between the entire above are not smooth and if there is a shortfall or changeover of any one of the above, it would normally cause a setback in the financial market and thereby it is a risk, as every time one has to expect the unexpected in a financial market. On the whole, a careful observation and study of the types of risks involved in a financial market, would enable a person to invest better in the market for capital gains.

INTRODUCTION

The term financial marketing itself reveals that it is related to the funds i.e. either by way of transfer from surplus to deficit or general pooling of funds in the market for capital gain. This is normally operated through various financial institutions, banks and other fiscal related corporate offices through which these funds are channelized and financial transaction takes place either by an individual to the other party be it an office, a company, a bank or such other organizations which deal with such trade or transactions. It can also be a joint venture, wherein two or more partners invest their money in the financial market. It is more so observed that in the individual dealing the entire responsibility and risk will be the burden of the concerned individual. On the other hand if two or more partners are involved the risk and responsibility will be shared. The onus of avoiding financial risk in the market will be well taken care of by the individual. However, the joint or partnership deal will thrive only if all the partners jointly put forth their earnest efforts and are financial market risks. It may not be out of place to mention in this context, that sometimes even with all the general intelligence and constantly watching the financial market inflation, deflation etc., or any other factors, it occasionally occurs that there will be a financial setback due to unknown reasons, which will only prove to the investors to study the same and improvise their transactions or trade in investing or pooling their funds. It only serves as another experience for the investors. In spite of all the above, there are various risks associated with financial markets which are explained below. The major risks that are associated with the financial markets depend upon the classes of assets and different classes of assets have different kinds of risk involved in the financial market. The various types of risk can be broadly classified as the counterparty risk, default risk, uncertainty, risks involved due to the fluctuation in the interest rate in the financial market, volatility which depends mainly on the value of the asset.

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Indian Financial Market

India Financial market is one of the oldest in the world and is considered to be the fastest growing and best among all the markets of the emerging economies. The history of Indian capital markets dates back 200 years toward the end of the 18th century when India was under the rule of the East India Company. The financial market in India today is more developed than many other sectors because it was organized long before with the securities exchanges of Mumbai, Ahmadabad and Kolkata were established as early as the 19th century. By the early 1960s the total number of securities exchanges in India rose to eight, including Mumbai, Ahmadabad and Kolkata apart from Madras, Kanpur, Delhi, Bangalore and Pune. Today there are 21 regional securities exchanges in India in addition to the centralized NSE (National Stock Exchange) and OTCEI (Over the Counter Exchange of India)[1]. The corporate sector wasn't allowed into many industry segments, which were dominated by the state controlled public sector resulting in stagnation of the economy right up to the early 1990s. Thereafter when the Indian economy began 'liberalizing' and the controls began to be dismantled or eased out, the securities markets witnessed a flurry of IPOs that were launched. This resulted in many new companies across different industry segments to come up with newer products and services.

A remarkable feature of the growth of the Indian economy in recent years has been the role played by its securities markets in assisting and fuelling that growth with money rose within the economy. This was in marked contrast to the initial phase of growth in many of the fast growing economies of East Asia that witnessed huge doses of FDI (Foreign Direct Investment) spurring growth in their initial days of market decontrol. During this phase in India much of the organized sector has been affected by high growth as the financial markets played an all-inclusive role in sustaining financial resource mobilization. Many PSUs (Public Sector Undertakings) that decided to offload part of their equity were also helped by the well-organized securities market in India. The launch of the NSE (National Stock Exchange) and the OTCEI (Over the Counter Exchange of India) during the mid-1990s by the government of India was meant to usher in an easier and more transparent form of trading in securities. The NSE was conceived as the market for trading in the securities of companies from the large-scale sector and the OTCEI for those from the small-scale sector. While the NSE has not just done well to grow and evolve into the virtual 'backbone' of capital markets in India the OTCEI struggled and is yet to show any sign of growth and development. The integration of IT into the capital market infrastructure has been particularly smooth in India due to the country's world class IT industry. This has pushed up the operational efficiency of the Indian stock market to global standards and as a result the country has been able to capitalize on its high growth and attract foreign capital like never before.

Potential of India Financial Market

India Financial Market helps in promoting the savings of the economy - helping to adopt an effective channel to transmit various financial policies. The Indian financial sector is well-developed, competitive, efficient and integrated to face all shocks. In the India financial market there are various types of financial products whose prices are determined by the numerous buyers and sellers in the market[2]. The other determinant factor of the prices of the financial products is the market forces of demand and supply. The various other types of Indian markets help in the functioning of the wide India financial sector.

Risks Involved in Financial Markets

A detailed study of the various types of risk has been summarized and the gist of the same is furnished below:

Counterparty Risk

The term Counterparty itself suggests that two parties are involved. Thus there would be exchange of cash flows or funds between one parties to another. These exchanges or transactions are based mainly depending upon the interest rates. In such cases an agreement is mandatory and sometimes the credit is also swapped to the other. Sometimes the financial crisis occurs due to the counterparty risk and hence when the cash flows are involved, a careful analysis of the financial market has to be made, else it would definitely lead to a great financial crisis.

Default risk

As the name suggests, the risk involved in this is by being a defaulter i.e. by not complying with the terms and conditions of an agreement or bond, after borrowing some amount of money from the lender at a specified interest rate. The due dates of payment of money to the lender will not be complied with by the borrower by which he or she becomes a defaulter. Sometimes the borrower ceases to pay the amount which leads to default in the payment. The borrower thus becomes a defaulter in the payment of the outstanding amount to the lender. In general, if the interest specified in the agreement or bond between the borrower and the lender is negligible or lesser interest, the question of non-payment by the borrower to the lender does not arise, as it is only a paltry amount. On the other hand, a higher possibility of default risk occurs only in a larger amount of interest drawn in the agreement which leads the borrower to default on his or her own loan obligations by not paying the lender his or her outstanding amount and hence the investors must be very much aware of this default risk involved in the financial market which cannot be ignored. In this case, either an individual or a company will not be in a position to pay off the debts and would be a defaulter.

Interest Rate Risk

The interest rate risk is yet another risk in the financial market or the bond market. This risk depends upon the increase in the interest rate or the decrease in the interest rate in the financial market. In this type of risk, the price of bonds decreases with an increase in the interest rates. In short, the risk involved is mainly due to the fluctuation in the interest rate in the financial market, which has to be considered by a careful study of the financial market as there would not be a uniform interest rate and the same has to be checked time and again to avoid this interest rate risk.

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[1] www.ukessays.com accessed on 10th September,2017

[2] www.ukessays.com accessed on 10th September, 2017

Volatilityrisk

The Volatility risk is yet another risk in the financial market and is considered to be one of the major risk factor for all markets. Volatility in general is the instability or uncertainty which depends in the change of an asset's value. If the level of volatility is low it has negligible or lesser change in the value of the asset. On the other hand, the higher level of volatility only indicates larger changes in the value of the asset. The value of the asset does not have a uniform change and it may be in the uptrend or in the downtrend and hence there is no uniform direction of change in the value of the asset. Hence, the volatility risk cannot be assessed as such.

Financial marketing-risks and overcoming risks

The salient features of financial marketing, the analysis of it and the various risk factors in financial marketing have been enumerated above. Now, let us explore the possibility of avoiding risks in the financial marketing by diversifying the funds. By the process of diversification of the funds, the various risks involved in the financial marketing can be minimized to a larger extent. A detailed study of the various forms and the process of diversification is discussed below.

Diversification

The various types of risks involved in the financial marketing can be regulated to a larger extent and the process of regulating or minimizing the risk is called as diversification. For example, the yield obtained from various valued assets may not be properly related and hence there would be a difference due to which the yields would mostly be negative[3]. Such variation and improper correlation is inversely proportional for a business. In short, what is factor, which is favorable for a business firm may not be favorable for the other firm. Increase in the price of any commodity in the market may be in favor of a company that produces it; on the other hand it would negatively impact the business of a company that utilizes it and that which is very essential for its existence. To describe it further, in case the price of petrol increases in the market, it favors only the company that produces it but it negatively impacts the business of other companies whose main dependence is only based upon fuel. Further, it also impacts the individuals or the customers in short, who has to use the petrol mandatorily for their vehicles. So in spite of the increase of price in the market, no other option is left to the buyers other than to purchase it and use it mandatorily irrespective of the price as they have to keep going. Hence it is observed that in the process of diversification the main issue is only the relationship between the valued assets, and as and when there is a lower correlation or relationship between the assets, then the benefits will increase. However, this factor cannot be taken for granted in every aspect and this cannot be made as a rule for other aspects as well. This process may not prove to be true with certainty in the future and it always has an uncertain future.

Sometimes this will also cause severe financial stress in the market and it cannot be believed that the diversification would protect the persons involved in financial marketing against any risks in the market. This can be overcome, by analyzing and studying the correlations which is the most important and one of the major factors of diversification. This keeps changing and it is not a constant and a balance has to be maintained in the transactions which related to both buying and selling. In spite of all the detailed and careful analysis done, sometimes due to unforeseen circumstances and conditions, the assets may decline in the financial marketing which leads to the losses due to poor decisions taken in unexpected and unforeseen correlations. Thus in a nut shell it can be said that diversification too has costs. The marketing challenges that are being faced by the financial services companies are different from those facing other marketers such as the banks, insurance companies etc. which also face marketing challenge but such companies face unique marketing challenges which are of a different nature as compared to other industries. In both the aforesaid types, by understanding the requirement of the customers and keeping their benefit ahead of everything and prioritizing them will benefit the businesses and the businessman or firms are likely to be far ahead of their competitors in the market.

Regulation of Financial Marketing

The Financial Services can be regulated in the marketing by giving greater focus and attention to the needs of the customers. By putting the customers in the first place the financial marketing can be regulated and the financial risk in the marketing can be avoided to a larger extent. By regulating and finding out the needs of the customers, it should also take care and be assured that the products being marketed by the companies are affordable to a middle class member of the society[4]. While doing so, the companies should not sell cheap and outdated products which will only bring a heavy loss to the companies, as the customer always require branded and standard products at a moderate rate that will suit their budget. Thus on the point of the customers eye, their vision focuses both on the durability based on the brand of the product and so also on its price. Hence, the companies which put the customers first are benefited though it may be slow and the companies which focus only on its welfare and benefit will only suffer from great financial loss and shall face financial crisis. Such a method of operation makes the customer confident and the customer feels protected and once a company gets its assent from the customer then there would only be non-stop profit for the company and the company establishes its name in the financial market.

In addition to the above, the customers themselves will recommend the product to others and this also will add to the benefit for the companies in an indirect way and in such a manner the financial risk will be minimized and such companies will thrive in the positive direction without looking back at any point of time. These companies will always experience an upward trend only. As far as the customers are concerned, such a move from the company for the benefit of the customers will only build faith, loyalty and trust for the customer in respect of the particular company. The company should also be careful of the duplicate products sold in its name to tarnish the image and prospective of the company and should be a watchdog over such possibilities. In order to continue to maintain the trustworthy relationship between the company and the customer, the company has to see that it continues to give the same service to the customers though circumstances change for the better or for the worse.

[3]economictimes.indiatimes.com accessed on 10th September, 2017

[4]www.governancexborders.com accessed on 10th September, 2017

Once the customer enjoys the benefits of the product, then in any of the dire circumstances also the customer will wait to get his product as the customer is wholly satisfied with the company and becomes dependent with the products of the company and the customer will also explore the possibilities and feasibility of other products of the same company. Any change in the company which is analyzed and based on the wishes or intentions of the customer will give the company an insight to provide the right and assured service at the right point of time to the customers at large. By doing so, in the long run, the companies which give products that suit the taste of the customers will definitely be a profit making company and such companies will also be able to predict the wants of the customers efficiently.

The customer-company experience is the biggest and the key factor to maintain a profitable relationship and it ensures loyalty on the part of the customer and retention of standard products by the company. In such a way both the customer and the company are satisfied which provides a positive growth for the company by the customer. So in case there is an increase in the price of a product due to some other factors in the financial market, a customer who is used or habituated to such a product will understand the increase in price in the market and go for the same product irrespective of the price as a bond of company – customer has already been built up which shall not be destroyed by the increase in price, as the customer has already used the product and enjoyed its benefits and his experience will not make him to try another product in spite of increase in price or any other factors such as shortage of it in the market i.e. even if the product is in high demand in the market the customer will wait till he procures the product.

CONCLUSION

To conclude it can be said that market risk is only the possibility for an investor to experience the losses due to the factors that affect the financial market which includes changes in the interest rates, inflation, deflation, natural disasters, unforeseen circumstances such as political turmoil, terrorist attacks, war etc. Though the risks involved in financial marketing cannot be eradicated completely and it cannot be eliminated completely through diversification, yet it can be reduced to a larger extent by analyzing and studying the overall performance of the financial markets, keeping in view of the customer satisfaction. The risk management method involved in this case comes with certain assumptions and presumptions which cannot be accurately calculated and the correctness factor in this is limited, i.e. 100% correctness cannot be assured. This may prove to be true for short term investments and for long term investments it may provide very less accurate measurements because long term investments are more prone and exposed to changes in the monetary policies and the changes in the interest rates than the short – term investments in the financial market. It has also been observed that the financial uncertainty faced by an investor or the company risk can be made negligible or mitigated through the process of diversification, by purchasing securities in additional companies and uncorrelated assets and the investors can also limit the company's exposure to the upward and downward trend in the performance of a company.

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