

RISK MANAGEMENT:

NB to anticipate consumer needs and requirements and implementing financial controls – profit should be reward for risk (staying clear of bankruptcy)

1) Understand Risks to Increase Profits

Two NB factors to consider

1. Ability to see the risks
2. Ability to develop more options than competitors can handle

Recognise the risk and type of risk & what actions to take to manage the risk

By identifying what the customer wants and not their needs fm can develop various value chains and utilise strength of the business thereby differentiating it from competitors

2) Business Risk and Financial Risk

Two types of risks: business risk & financial risk

Business risk

ROA is uncertain, business may be unable to pay its debts

A business with no debt, assets will be financed by equity and will only get ROE

Affected by: Variability in demand/ variability in sales price/ raw material cost fluctuation/ skill to produce innovative products quickly/ degree of fixed costs

Financial risk

Uncertain if business can pay its financial commitments (interest/ lease etc)

When debt and equity is used to finance business

Note: there is no risk on the use of debt – risk lies in inability to pay the interest

Risk of business is carried equally by shareholders of business

ROE will increase but risk carried by shareholders will be higher.

3) Measurement of Nondiversifiable Risk – Beta Coefficient

Total risk of a security can be viewed as consisting of 2 parts: total security risk = nondiversifiable risk + diversifiable risk

Diversifiable risk = asset's risk related to particular business event e.g. strike which can be overcome by diversification

Nondiversifiable risk = risk connected to market conditions e.g. inflation which influences all businesses and cannot be overcome by diversification

Measured by beta coefficient & determines the volatility of a share in relation to the volatility of the market

4) Demand Risk, Competitive Risk & Capability Risk

- Demand Risk = there may be no demand for the product/service or demand for product/service = higher than forecasted
- Competitive Risk = customers may be lost to competitors
- Capability Risk = business not capable of providing a product/service of value to customer or are willing to pay for