Financial Derivatives and Risk Management: Retail Investors’ View

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“Risk management defined as a systematic process for the identification and evaluation of pure loss exposures faced by an institution/individual and for the selection and implementation of the most appropriate techniques for treating such exposures” 10. There are various kinds of risk management developed as changes in time and type of risk. Risk and time can be perceived to be related to each other as risk varies with time. Hence the time factor is important in risk management. A right decision at the right time is vital to save us from a huge risk of loss particularly when irreversible decisions are made11. The risk management is the process of measuring, or assessing risk and then developing strategies to manage the risk. In ideal risk management, a prioritization process is followed where by the risks with the greatest loss and the greatest probability of occurring are handled first, and risks with lower probability of occurrence and lower loss are handled later. In practice the process can be very difficult, and balancing between risks with a high probability of occurrence but lower loss vs. a risk with high loss but lower probability of occurrence can often be mishandled. Risk management also faces a difficulty in allocating resources properly. This is the idea of opportunity cost. Resources spent on risk management could be instead spent on more profitable activities. Again, deal risk management spends the least amount of resources in the process while reducing the effects of risks as much as possible.