A STUDY ON RELATIONSHIP BETWEEN RISK FACTORS AND INVESTMENT WITH REFERENCE TO CORPORATE SECURITIES

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ABSTRACT

Risk is an integral part of investment decision especially in corporate securities. Investments are made by the investors with a view to get higher returns. There is a fair chance of investors' expectations being fulfilled on many occasions. Today the stock market is dominated by generally clueless investors. They are irrational and invest in securities without retrospective analysis of risk factors. Most investors fail in stock market because they let their emotions drive their actions in market. The absence of well laid down risk management system risk appetites can pull down an investor without having an ideas of how and when to come to terms with losses. All these perspective and an environment where risk elements are to be explicitly recognized, measured and accounted for and managed. Investors have to bear a certain degree of risk to earn reasonable return. The value maximization involves both returns and risks and a balance between two.

Key Words: *Risk Factors, Corporate Securities, Risk Management, Speculators, Investors, Investor Protection, Investment Decisions.*

Introduction

A few decades ago investing was the sport of a privileged few. Today it is an essential activity of day to day life of an individual. Investing is a process of investing in financial assets and instruments to gain from capital appreciation like bonus, rights, dividends etc. Properly managed investment in equities will always give higher returns than any other form of investment. At present there is rigorous transformation in the capital market. The professionals are getting into the stock game. A dynamic business environment has made future outcomes in the market unpredictable and risk has become an inherent part of it. Risk has been defined as the volatility of expected future outcomes. The greater the volatility of expected returns, the greater is the risk. The essence of the risk management is to reduce the volatility of these future outcomes.

Investors have to bear a certain degree of risk to earn reasonable returns. The value maximization includes both returns and risks and a balance between two. When the risk is borne the prudence lies in the reduction of the area of uncertainty within which the investor is operating. Because of the growing complexity of operations in the stock market investors would have to rapidly equip themselves with a wide variety of knowledge, intensive skills and appropriate techniques of risk management. Risk management has become imperative for operations in the capital market.

The trading of financial derivatives has received extensive attention, while at the same time it has led to a debate over its impact on the underlying stock market from various facets by the academicians. The researchers all over the world have done research on derivative trading and were able to find out various facts about derivative and its trading. In this literature review efforts have been made to bring into the picture the research done about various issues throughout the world by the researchers. The literature survey and review is presented in four sections: first, the review of studies fundamental to capital market of India; second, the review of studies relating to the testing of capital market efficiency; third, the review of studies concerning the volatility study; last, the review of studies analyzing the causal relation between spot and index futures market.

Review of Literature

Sen Shankar Som and Ghosh Santanu Kumar (2006) studied the relationship between stock market liquidity and volatility and risk. The paper also deals with time series data by applying "Cochrane Orchutt two step procedures". An effort has been made to establish a relation between liquidity and volatility in their paper. It has been found that there is a statistically significant negative relationship between risk and stock market liquidity. Finally it is concluded that there is no significant relationship between liquidity and trading activity in terms of turnover.

Shenbagraman (2004) reviewed the role of some non-price variables such as open interests, trading volume and other factors, in the stock option market for determining the price of underlying shares in cash market. The study covered stock option contracts for four months from Nov. 2002 to Feb. 2003 consisting 77 trading 49 days. The study concluded that net open interest of stock option is one of the significant variables in determining future spot price of underlying share. The results clearly indicated that open interest based predictors are statistically more significant than volume based predictors in Indian context.

All the existing studies found that the Equity return has a significant and positive impact on the FII (Agarwal, 1997; Chakrabarti, 2001; and Trivedi & Nair, 2003). But given the huge volume of investments, foreign investors could play a role of market makers and book their profits i.e., they can buy financial assets when the prices are declining thereby jacking-up the asset prices and sell when the asset prices are increasing (Gordon & Gupta, 2003). Hence, there is a possibility of bi-directional relationship between FII and the equity returns.

Masih AM, Masih R, (2007), had studied "Global Stock Futures: A Diagstinoc Analysis of a Selected Emerging and Developed Markets with Special Reference to India", by using tools correlation coefficients , granger's causality test, augmented Dicky Fuller test (ADF), Elliott, Rothenberg and Stock point optimal test. The Authors, through this paper, have tried to find out what kind of relationship exists between emerging and developed futures markets of selected countries.

Kumar, R. and Chandra, A. (2000), had studied that Individuals often invest in securities based on approximate rule of thumb, not strictly in tune with market conditions. Their emotions drive their trading behavior, which in turn drives asset (stock) prices. Investors fall prey to their own mistakes and sometimes other's mistakes, referred to as herd behavior. Markets are efficient, increasingly proving a theoretical concept as in practice they hardly move efficiently. The purely rational approach is being subsumed by a broader approach based upon the trading sentiments of investors. The present paper documents the role of emotional biases towards investment (or disinvestment) decisions of individuals, which in turn force stock prices to move.

Srivastava, S., Yadav, S. S., Jain, P. K. (2008), had conducted a survey of brokers in the recently introduced derivatives markets in India to examine the brokers' assessment of market activity and their perception of benefits and costs of derivative 50 trading. The need for such a study was felt as previous studies relating to the impact of derivatives securities on Indian Stock market do not cover the perception of market participants who form an integral part of the functioning of derivatives markets. The issues covered in the survey included: perception of brokers about the attractiveness of different derivative securities for clients; profile of clients dealing in derivative securities; popularity of a particular derivative security out of the total set; different purposes for which the clients are using these securities in order of preference; issues concerning derivatives trading; reasons for non usage of derivatives by some investors.

The investors are using derivative securities for different purposes after its penetration into the Indian Capital market. They use these securities not only for risk management and profit enhancement but also for speculation and arbitrage. High net worth individuals and proprietary traders account for a large proportion of broker turnover. Interestingly, some retail participation was also witnessed despite the fact that these securities are beyond the reach of retail investors (because of complexity and high initial cost).

Naresh, G., (2006), studied the dynamic growth of the Derivatives market, particularly Futures & Options and the perceived risks to the financial sector continue to stimulate debate on the proper regulation of these instruments. Even though this market was initially fuelled by various expert teams survey, regulatory framework, recommendations byelaws and rules there is still a debate on the existing regulations such as why is regulation needed? When and where regulation needed? What are reasonable and attainable goals of these regulations? Therefore this article critically examines the views of market participants on the existing regulatory issues in trading Derivative securities in Indian capital market conditions.

Hoque, Kim and Pyun, (2006) tested the market efficiency of eight different Asian emerging markets (Hong Kong, Indonesia, Malaysia, Korea, Singapore, Philippines, Taiwan and Thailand). They took weekly closing prices from April 1990 to February 2004. They used variance ratio test to find out whether these eight markets prove to be mean reverting or not. The basic findings were that five markets (Indonesia, Malaysia, Philippines, Singapore and Thailand), show specific mean reverting and predictive behavior of stock prices while two markets (Taiwan and Korea) show some mean- reverting and unpredictable patterns in the time series.

Gupta and Singh (2006) also made an attempt to investigate the price discovery efficiency of the Nifty futures by considering lengthy time frame and their results showed the evidences that futures market has been an efficient price discovery vehicle.

Statement of the Problem

Investors make investments in corporate securities expecting a fairly reasonable return by the way of capital appreciation and dividend. It is almost impossible to predict the day to day prices of stocks and it is even harder to decide when to buy, hold or sell. Despite much mathematical analysis, there is no way to know the level of risk associated with a scrip. Today stock market is dominated by generally clueless investors. They are irrational and invest in securities without retrospective analysis of risk factors. Most investors fail in stock market because they let their emotions drive their actions in market. The absence of well laid down risk management system risk appetites can pull down an investor without having an ideas of how and when to come to terms with losses. All these perspective and an environment where risk elements are to be explicitly recognized, measured and accounted for and managed. This study facilitates to understand the complications of the operations in the stock market, to resolve their problems and to become more confident, diligent, and flourishing.

Objectives of the Study

1. To study the nature and significance of various corporate securities.
2. To study the role of Securities and Exchange Board of India(SEBI)and stock exchange in protecting the interests of investors and redressing their grievances.
3. To study the criteria for investment.
4. To make recommendations on the basis of the study.
5. To study frequency of investments in securities.
6. To examine criteria of investment.

Research Methodology

The required data for the conduct of the study was collected from primary and secondary sources. Primary data was collected through personal interview with the investors. Stratified random sampling applied. A structured interview schedule is prepared for collecting the information. The Secondary data for the study was collected from the published journals of Cochin Stock Exchange, The Capital Market, Business Line and Economic Times.

For the purpose of the study a sample of 100 investors were selected at random from Kochi city.

Sampling Technique: For the purpose of study 100 respondents were chosen. Convenience sampling has been adopted.

Tools for Analysis: Percentage analysis is the tool used for the study.

Need and Significance of the Study

The study is basically descriptive in nature

Limitations of the Study

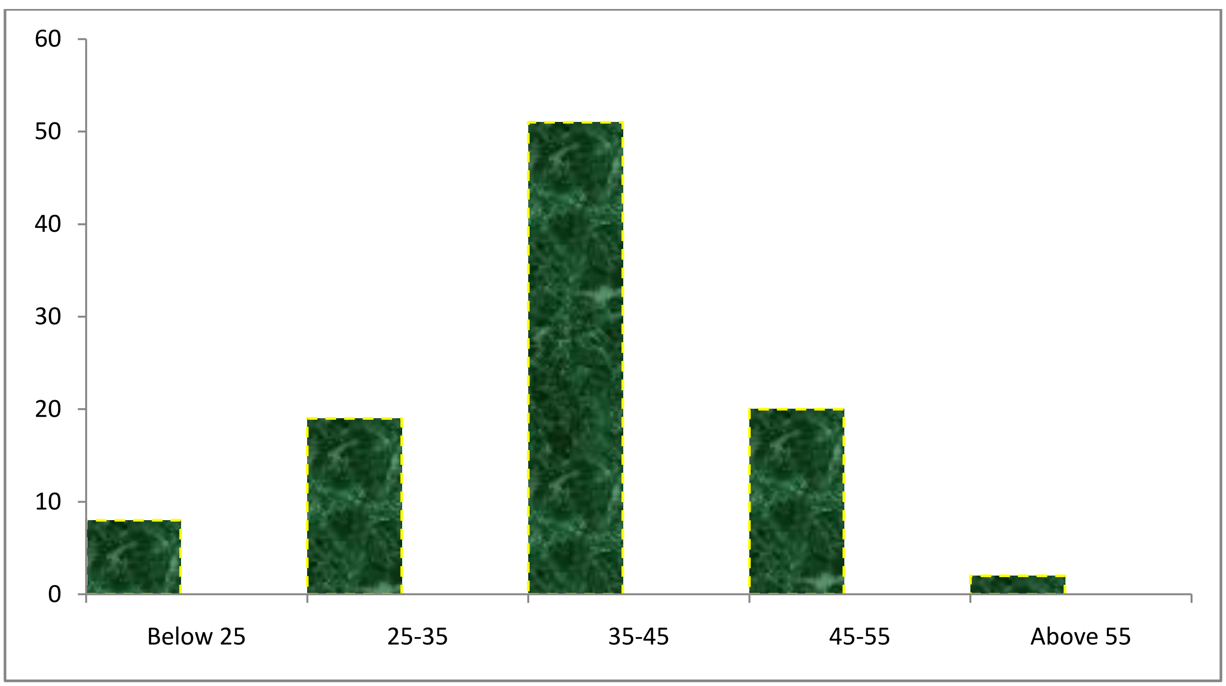
1. Quantification of data is a difficult task.
2. There may be chances of non sampling error.
3. Due to paucity of time only limited samples were taken for study

Data Collection and Analysis

1. Profile of investors

Sl No.	Variables(Age)	No. of respondents
1	Below 25	8
2	25-35	19
3	35-45	51
4	45-55	20
5	Above 55	2
	Total	100

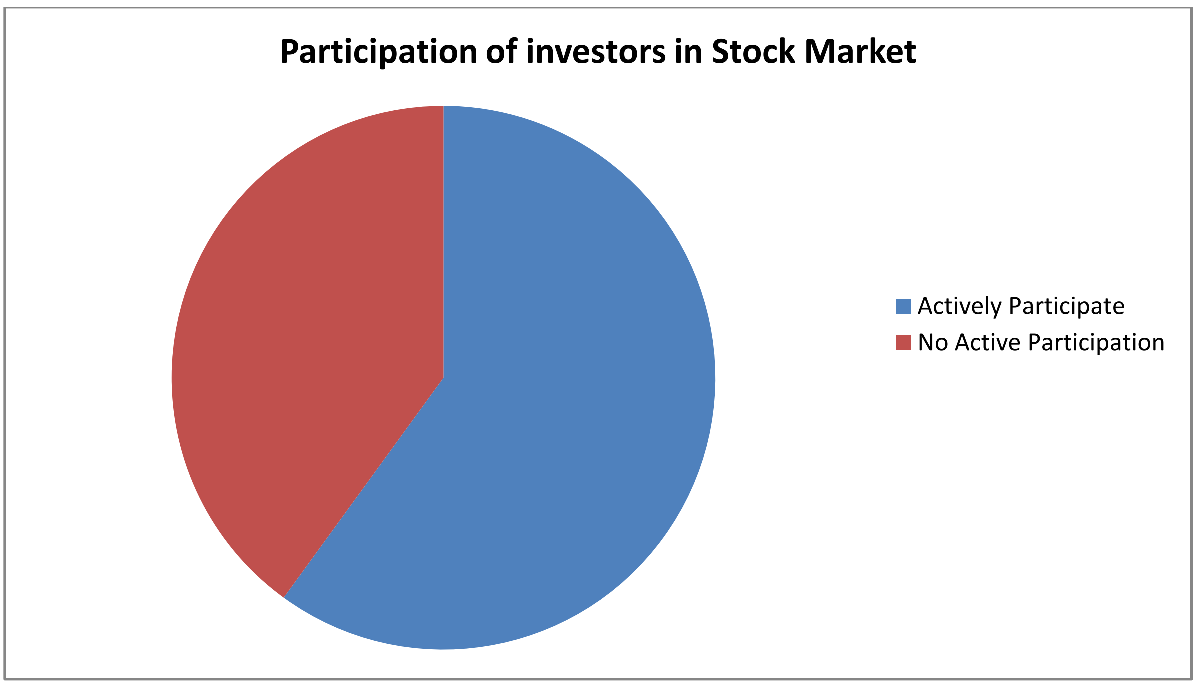
1. Profile of investors



Interpretation – Majority of the investors are coming under the age group of 35-45. Youngsters are reluctant to enter into capital market because of risk involvement.

2. Participation of Investors in the Stock Market

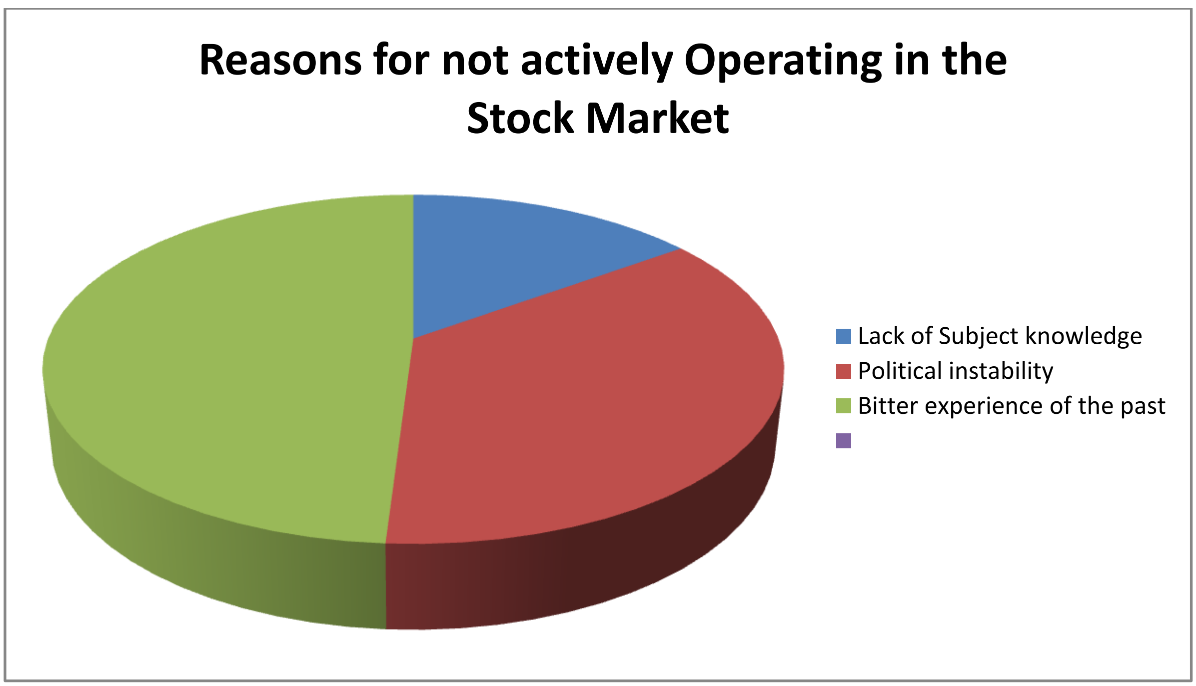
Sl. NO.		No. of Respondents
1	Actively Participate	60
2	No Active Participation	40
	Total	100



Interpretation – 60 respondents are actively participating in capital market operation while 40 respondents are irregular in nature.

3. Reasons for not actively Operating in the Stock Market

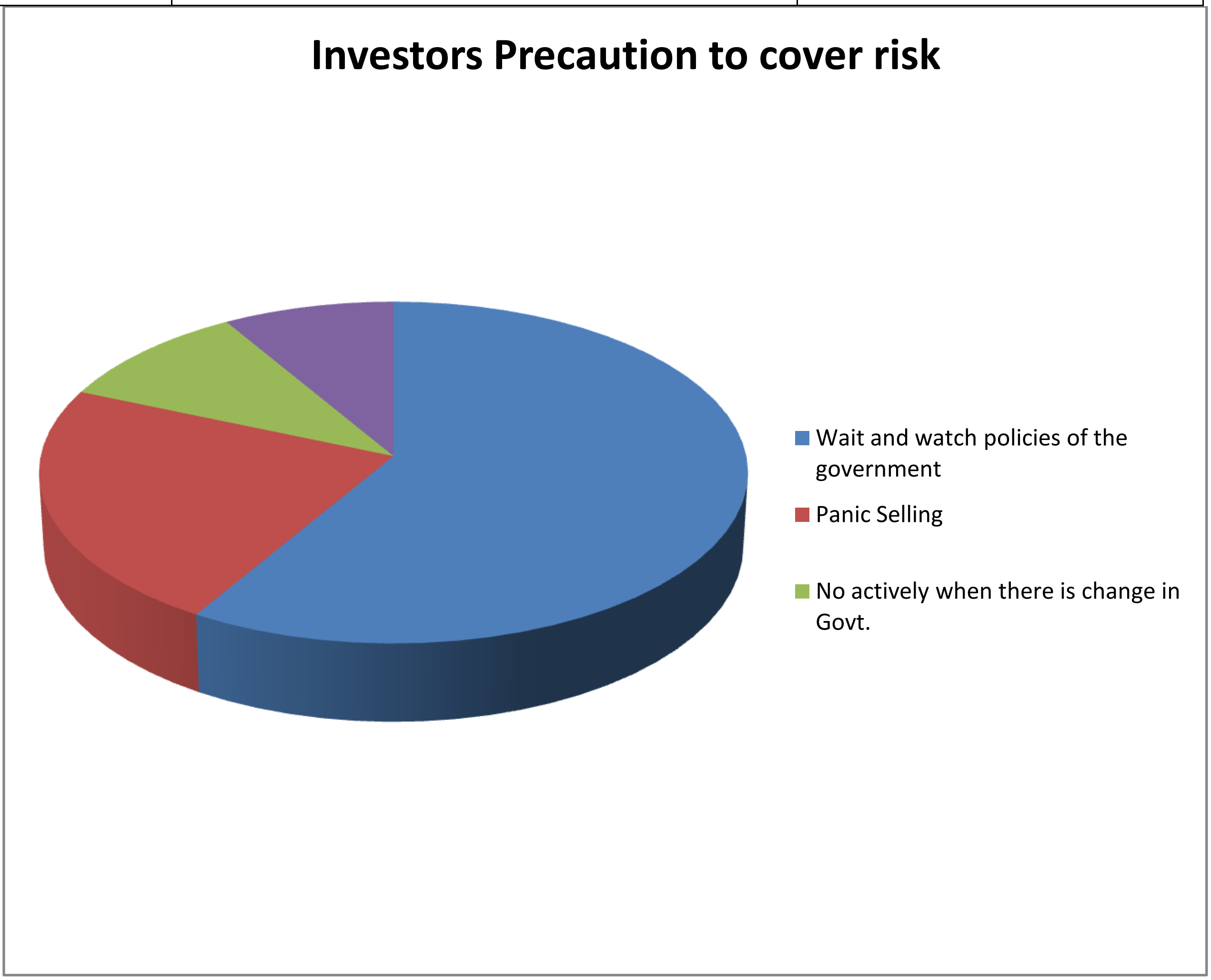
Sl.No.	Reason	Percentage of Repondents
1	Lack of Subject knowledge	15%
2	Political instability	36%
3	Bitter experience of the past	49%



Interpretation – 49% of respondents are worried about their bitter experiences in the past (loss incurred), 36% of respondents are worried about political instability and other are not have any knowledge about investments.

4. Investors Precaution to cover risk

Sl No.	Reasons	No. of Respondents(%)
1	Wait and watch policies of the government	52%
2	Panic Selling	10%
3	No actively when there is change in Govt.	38%

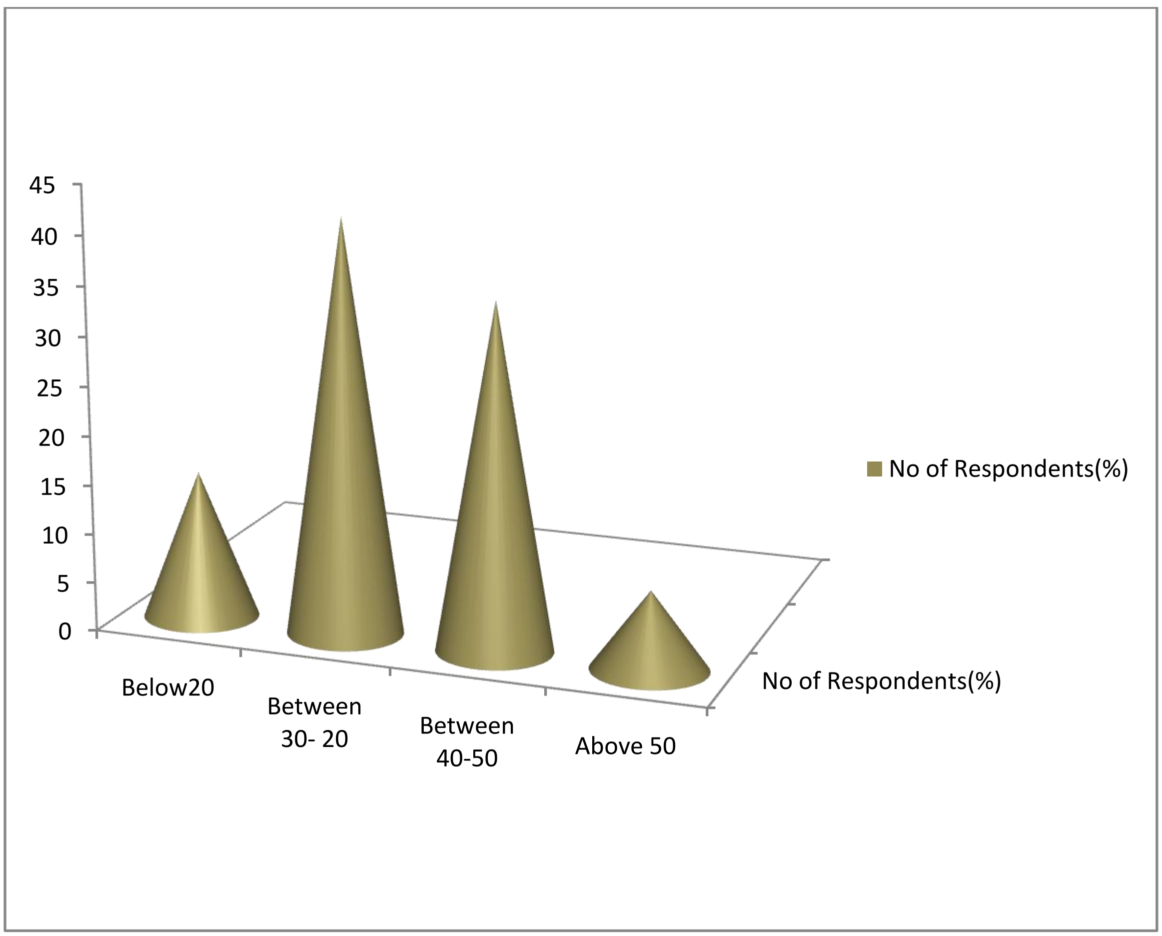


Interpretation – 52% of the respondents are waiting for the policies of Government and 38% of the respondents are not taking into consider whether there is any change in Government or not.

5. Frequency of investments in securities

Sl No	Details	No of Respondents(%)
1	Below20	15
2	Between 30- 20	42
3	Between 40-50	35
4	Above 50	8

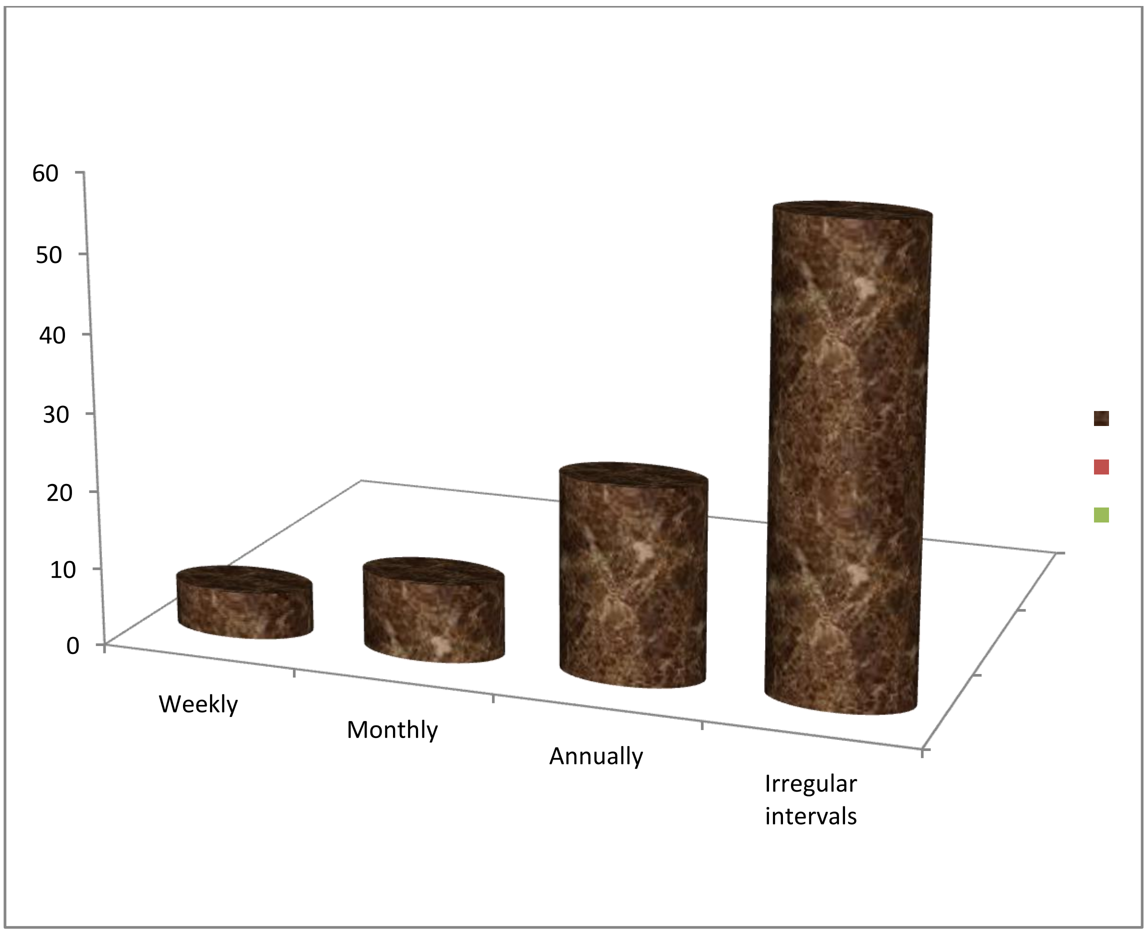
Frequency of investments in securities



Age group between 20-30 are really interested in capital market investment.(42%)

6. Criteria of investment

Sl No	Details	No of Respondents(%)
1	Weekly	6
2	Monthly	10
3	Annually	25
4	Irregular intervals	59



59% of respondents are making investments in irregular intervals. They are not following any proper channel.

Findings of the Study

1. The investors now have to identify and deal with all the risk components, as investors have to be accountable to them in terms of the risk – return implications of their behavior.
2. Majority of the investors are coming under the age group of 35-45.

   Youngsters are reluctant to enter into capital market because of risk involvement.
3. 60 respondents are actively participating in capital market operation while 40 respondents are irregular in nature.
4. 49% of respondents are worried about their bitter experiences in the past (loss incurred), 36% of respondents are worried about political instability and other are not have any knowledge about investments.
5. 52% of the respondents are waiting for the policies of Government and 38% of the respondents are not taking into consider whether there is any change in Government or not.

Conclusion

1. Youngsters in the state of Kerala are reluctant to enter into the capital market, partly because of low income and partly because of their reluctance to enter into risk.
2. The male investors dominate the Capital Market.
3. After incurring losses most of the investors exit the capital market, consequently, the number of experienced investor's declines.
4. Long run investing is the safe and sure path to wealth creation.

5. Those who are fresh to capital market are in favour of following a ‘ wait and watch ‘ policy when there is a crisis.

Suggestions

Based on the findings and conclusions drawn from the study, the following suggestions are feasible for strengthening the capital market, especially the investors.

1. All the existing regulations and fresh regulatory proposals are to reviewed, aiming this goal. It will take time to take stock realities and make drastic measures to ensure safety of investors.
2. Special regulation in needed to book the culprits in the case of vanishing companies.
3. Entrepreneurs setting up new companies should be asked to furnish more details to the regulators, such as photographs etc.
4. There is a strong need for rating of public issues authorized agencies like CRISIL etc
5. Stock Exchange should remove inefficiencies and promote market access to be attractive to investors by improving both the trading and settlement process.
6. Investors should put forward their grievances to the regulatory bodies of redressal.

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