CHAPTER III  
REVIEW OF THE LITERATURE

The Indian capital market has changed dramatically over the last few years, especially since 1990. Changes have also been taking place in government regulations and technology. The expectations of the investors are also changing. The only inherent feature of the capital market, which has not changed is the 'risk' involved in investing in corporate securities. Managing the risk is emerging as an important function of both large scale and small-scale investors.

Risk management of investing in corporate securities is under active and extensive discussion among academicians and capital market operators. Surveys and research analyses have been conducted by institutions and academicians on risk management. The mutual fund companies in India have conducted specific studies on the 'risk element' of investing in corporate securities.

Grewal S.S and Navjot Grewal1 (1984) revealed some basic investment rules and rules for selling shares. They warned the investors not to buy unlisted shares, as Stock Exchanges do not permit trading in unlisted shares. Another rule that they specify is not to buy inactive shares, ie, shares in which transactions take place rarely. The main reason why shares are inactive is because there are no buyers for them. They are mostly shares of companies, which are not doing well.
A third rule according to them is not to buy shares in closely-held companies because these shares tend to be less active than those of widely held ones since they have a fewer number of shareholders. They caution not to hold the shares for a long period, expecting a high price, but to sell whenever one earns a reasonable reward.

Jack Clark Francis (1986) revealed the importance of the rate of return in investments and reviewed the possibility of default and bankruptcy risk. He opined that in an uncertain world, investors cannot predict exactly what rate of return an investment will yield. However he suggested that the investors can formulate a probability distribution of the possible rates of return.

He also opined that an investor who purchases corporate securities must face the possibility of default and bankruptcy by the issuer. Financial analysts can foresee bankruptcy. He disclosed some easily observable warnings of a firm's failure, which could be noticed by the investors to avoid such a risk.

Preethi Singh (1986) disclosed the basic rules for selecting the company to invest in. She opined that understanding and measuring return and risk is fundamental to the investment process. According to her, most investors are 'risk averse'. To have a higher return the investor has to face greater risks.
She concludes that risk is fundamental to the process of investment. Every investor should have an understanding of the various pitfalls of investments. The investor should carefully analyse the financial statements with special reference to solvency, profitability, EPS, and efficiency of the company.

David L. Scott and William Edward (1990) reviewed the important risks of owning common stocks and the ways to minimise these risks. They commented that the severity of financial risk depends on how heavily a business relies on debt. Financial risk is relatively easy to minimise if an investor sticks to the common stocks of companies that employ small amounts of debt.

They suggested that a relatively easy way to ensure some degree of liquidity is to restrict investment in stocks having a history of adequate trading volume. Investors concerned about business risk can reduce it by selecting common stocks of firms that are diversified in several unrelated industries.

Lewis Mandell (1992) reviewed the nature of market risk, which according to him is very much ‘global’. He revealed that certain risks that are so global that they affect the entire investment market. Even the stocks and bonds of the well-managed companies face market risk. He concluded that market risk is influenced by factors that cannot be predicted accurately like economic conditions, political events, mass psychological factors, etc. Market risk is the systemic risk that affects
all securities simultaneously and it cannot be reduced through diversification.

Nabhi Kumar Jain (1992) specified certain tips for buying shares for holding and also for selling shares. He advised the investors to buy shares of a growing company of a growing industry. Buy shares by diversifying in a number of growth companies operating in a different but equally fast growing sector of the economy.

He suggested selling the shares the moment company has or almost reached the peak of its growth. Also, sell the shares the moment you realise you have made a mistake in the initial selection of the shares. The only option to decide when to buy and sell high priced shares is to identify the individual merit or demerit of each of the shares in the portfolio and arrive at a decision.

Carter Randal (1992) offered to investors the underlying principles of winning on the stock market. He emphasised on long-term vision and a plan to reach the goals. He advised the investors that to be successful, they should never be pessimists. He revealed that though there has been a major economic crisis almost every year, it remains true that patient investors have consistently made money in the equities market. He concluded that investing in the stock market should be an un-emotional endeavour and suggested that investors should own a stock if they believe it would perform well.
L.C.Gupta\textsuperscript{8} (1992) revealed the findings of his study that there is existence of wild speculation in the Indian stock market. The over speculative character of the Indian stock market is reflected in extremely high concentration of the market activity in a handful of shares to the neglect of the remaining shares and absolutely high trading velocities of the speculative counters.

He opined that, short-term speculation, if excessive, could lead to “artificial price”. An artificial price is one which is not justified by prospective earnings, dividends, financial strength and assets or which is brought about by speculators through rumours, manipulations, etc. He concluded that such artificial prices are bound to crash sometime or other as history has repeated and proved.

Yasaswy N.J.\textsuperscript{9} (1993) disclosed how ‘turnaround stocks’ offer big profits to bold investors and also the risks involved in investing in such stocks. Turnaround stocks are stocks with extraordinary potential and are relatively under priced at a given point of time.

He also revealed that when the economy is in recession and the fundamentals are weak, the stock market, being a barometer of the economy, also tends to be depressed. A depressed stock market is an ideal hunting ground for ‘bargain hunters’, who are aggressive investors. Sooner or later recovery takes place which may take a very
long time. He concluded that the investors’ watch work is ‘caution’ as he may lose if the turnaround strategy does not work out as anticipated.

Sunil Damodar (1993) evaluated the ‘Derivatives’ especially the ‘futures’ as a tool for short-term risk control. He opined that derivatives have become an indispensable tool for finance managers whose prime objective is to manage or reduce the risk inherent in their portfolios.

He disclosed that the over-riding feature of ‘financial futures’ in risk management is that these instruments tend to be most valuable when risk control is needed for a short-term, ie, for a year or less. They tend to be cheapest and easily available for protecting against or benefiting from short term price. Their low execution costs also make them very suitable for frequent and short term trading to manage risk, more effectively.

Yasaswy J.N. (1993) evaluated the quantum of risks involved in different types of stocks. Defensive stocks are low risk stocks and hence the returns are relatively low but steady. Cyclical stocks involve higher risks and hence the rewards are higher when compared to the growth stocks. Growth stocks belong to the medium risk category and they offer medium returns which are much better than defensive stocks, but less than the cyclical stocks. The market price of growth stocks does fluctuate, sometimes even violently during
short periods of boom and bust. He emphasised the financial and organisational strength of growth stocks, which recover soon, though they may hit bad patches once in a way.

Donald E Fischer and Ronald J. Jordan\(^{12}\) (1994) analysed the relation between risk, investor preferences and investor behaviour. The risk return measures on portfolios are the main determinants of an investor’s attitude towards them. Most investors seek more return for additional risk assumed. The conservative investor requires large increase in return for assuming small increases in risk. The more aggressive investor will accept smaller increases in return for large increases in risk. They concluded that the psychology of the stock market is based on how investors form judgements about uncertain future events and how they react to these judgements.

R.Venkataramani.\(^{13}\) (1994) disclosed the uses and dangers of derivatives. The derivative products can lead us to a dangerous position if its full implications are not clearly understood. Being off-balance sheet in nature, more and more derivative products are traded than the cash market products and they suffer heavily due to their sensitive nature.

He brought to the notice of the investors the ‘Over the counter product’ (OTC) which are traded across the counters of a bank. OTC
products (e.g., Options and futures) are tailor made for the particular need of a customer and serve as a perfect hedge. He emphasised the use of futures as an instrument of hedge, for it is of low cost.

K.Sivakumar. 14 (1994) disclosed new parameters that will help investors identify the best company to invest in. He opined that Economic Value Added (EVA) is more powerful than other conventional tools for investment decision making like EPS and price earning ratio. EVA looks at how capital raised by the company from all sources has been put to use. Higher the EVA, higher the returns to the shareholder. A company with a higher EVA is likely to show a higher increase in the market price of its shares.

To be effective in comparing companies, he suggested that EVA per share (EVAPS) must be calculated. It indicates the super profit per share that is available to the investor. The higher the EVAPS, the higher is the likely appreciation in the value in future. He also revealed a startling result of EVA calculation of companies in which 200 companies show a negative value addition that includes some blue chip companies in the Indian Stock Market.

Pattabhi Ram.V.15 (1995) emphasised the need for doing fundamental analysis and doing Equity Research (ER) before selecting shares for investment. He opined that the investor should look for value with a margin of safety in relation to price. The margin of safety is the
gap between price and value. He revealed that the Indian stock market is an inefficient market because of the absence of good communication network, rampant price rigging, the absence of free and instantaneous flow of information, professional broking and so on. He concluded that in such inefficient market, equity research will produce better results as there will be frequent mismatch between price and value that provides opportunities to the long-term value oriented investor. He added that in the Indian stock market investment returns would improve only through quality equity research.

Philippe Jhorion and Sarkis Joseph Khoury (1996) reviewed international factors of risks and their effect on financial markets. He opined that domestic investment is a subset of the global asset allocation decision and that it is impossible to evaluate the risk of domestic securities without reference to international factors. Investors must be aware of factors driving stock prices and the interaction between movements in stock prices and exchange rates. According to them the financial markets have become very much volatile over the last decade due to the unpredictable speedy changes like oil price shocks, drive towards economic and monetary unification in Europe, the wide scale conversion of communist countries to free market policies etc. They emphasized the need for tightly controlled risk management measures to guard against the unpredictable behaviour of financial markets.
S. Rajagopal (1996) commented on risk management in relation to banks. He opined that good risk management is good banking. A professional approach to Risk Management will safeguard the interests of the banking institution in the long run. He described risk identification as an art of combining intuition with formal information. And risk measurement is the estimation of the size, probability and timing of a potential loss under various scenarios.

Charles P. Jones (1996) reviewed how to estimate security return and risk. To estimate returns, the investors must estimate cash flows the securities are likely to provide. Also, investors must be able to quantify and measure risk using variance or standard deviation. Variance or standard deviation is the accepted measure of variability for both realised returns and expected returns. He suggested that the investors should use it as the situation dictates.

He revealed that over the past 12 years, returns in stocks, bonds, etc. have been normal. Blue chip stocks have returned an average of more than 16% per year. He warned that the investors who believe that these rates will continue in the future also, will be in trouble. He also warned the investors not to allow themselves to become victimised by "investment gurus".

V. T. Godse (1996) revealed the two separate but simultaneous processes involved in risk management. The first
process is determining risk profile and the second relates to the risk management process itself. Deciding risk profile is synonymous with drawing a risk picture and involves the following steps.

1. Identifying and prioritising the inherent risks
3. Establishing standards for each risk component
4. Evaluating and controlling the quality of managerial controls.
5. Developing risk tolerance levels.

He opined that such an elaborate risk management process is relevant in the Indian context. The process would facilitate better understanding of risks and their management.

Aswath Damodaran\textsuperscript{20} (1996) reviewed the ingredients for a good risk and return model. According to him a good risk and return model should-

a. Come up with a measure for risk that is universal

b. Specify what types of risks are rewarded and what types are not.

c. Standardise risk measures, to enable analysis and comparison.

d. Translate the risk measure into an expected return.
He opined that a risk measure, to be useful, has to apply to all investments whether stocks or bonds or real estate. He also stated that one of the objectives of measuring risk is to come up with an estimate of an expected return for an investment. This expected return would help to decide whether the investment is a 'good' or 'bad' one.

Basudev Sen (1997) disclosed the implications of risk management in the changed environment and the factors constraining the speed of risk management technology up-gradation. He opined that the perception and management of risk is crucial for players and regulators in a market oriented economy. Investment managers have started upgrading their risk management practices and systems. They have strengthened the internal control systems including internal audit and they are increasingly using equity research of better quality.

He observed that risk measurement and estimation problems constrain the speed of up-gradation. Also, inadequate availability of skills in using quantitative risk management models and lack of risk hedging investments for the domestic investors are major constraints. He concluded that with the beginning of a derivative market, new instruments of risk hedging would become available.
Bhalla V.K. (1997) reviewed the various factors influencing the equity price and price earnings ratio. He is of the opinion that equity prices are affected primarily by financial risk considerations that, in turn, affect earnings and dividends. He also stated that market risk in equity is much greater than in bonds, and it influences the price also.

He disclosed that many analysts follow price earnings (P/E) ratio to value equity, which is equal to market price divided by earnings per share. He observed that inflationary expectations and higher interest rates tend to reduce P/E ratios whereas growth companies tend to have higher P/E ratios. He suggested that an investor should examine the trend of P/E ratios over time for each company.

Ghosh T.P. (1998) reviewed the various types of risks in relation to the different institutions. He opined that ‘Managing risk’ has different meanings for banks, financial institutions, and non-banking financial companies and manufacturing companies. In the case of manufacturing companies, the risk is traditionally classified as business risk and financial risk. Banks, financial institutions and non-banking financial companies are prone to various types of risks important of which are interest rate risk, market risk, foreign exchange risk, liquidity risk, country and sovereign risk and insolvency risk.
Suseela Subramanya (1998) commented on the risk management processes of banks. She revealed that banks need to do proper risk identification, classify risks and develop the necessary technical and managerial expertise to assume risks. Embracing scientific risk management practices will not only improve the profits and credit management processes of banks, but will also enable them to nurture and develop mutually beneficial relationships with customers. She concluded that the better the risk information and control system the more risk a bank can assume prudently and profitably.

Terry J. Watsham (1998) discusses the nature of the risks associated with derivative instruments, how to measure those risks and how to manage them. He stated that risk is the quantified uncertainty regarding the undesirable change in the value of a financial commitment. He opined that an organisation using derivatives would be exposed to risks from a number of sources, which are identified as market risk, credit or default risk, operational risk and legal risk. He revealed that there is ‘systemic risk’ that the default by one market participant will precipitate a failure among many participants because of the inter-relationship between the participants.

Ghose T.P. (1998) reviewed VAR (Value at Risk). There are two steps in measuring market risk, the first step is computation of the
DEAR, (The Daily Earning at Risk) the second step is the computation of the VAR. He also reviewed the measurement of price sensitivity. He stated that price sensitivity could be measured by modified duration (MD) or by cash flow approach.

Mall C.P. and Singh J.P.\textsuperscript{27} (1998) emphasised the importance of diversification and introducing flexibility to reduce risk. They stated that diversification reduces risks on the one hand and increases the possibility of large gains on the other. They also reviewed insurance as a way-out for reducing the risk. The immense schemes help transfer of risks to the insurance companies, especially applicable in agricultural business.

Avijit Banerjee\textsuperscript{28} (1998) reviewed Fundamental Analysis and Technical Analysis to analyse the worthiness of the individual securities needed to be acquired for portfolio construction. The Fundamental Analysis aims to compare the Intrinsic Value (I.V) with the prevailing market price (M.P) and to take decisions whether to buy, sell or hold the investments. The fundamentals of the economy, industry and company determine the value of a security. If the I.V is greater than the M.P., the stock is under priced and should be purchased.

He observed that the Fundamental Analysis could never forecast the M.P. of a stock at any particular point of time. Technical Analysis removes this weakness. Technical Analysis detects the most
appropriate time to buy or sell the stock. It aims to avoid the pitfalls of wrong timing in the investment decisions.

He also stated that the modern portfolio literature suggests 'beta' value $\beta$ as the most acceptable measure of risk of a scrip. The securities having low $\beta$ should be selected for constructing a portfolio in order to minimise the risks.

Juan H Pujadas 29 (1999) commented on the models of measuring risks. He opined that the models of measuring risk are only as good as the assumptions underlying them. They are not realities, but models.

Commenting on default risk in India, he stated that many defaults are not reported. He is of the opinion that default risks are not handled properly.

Ashutosh Bishnoi 30 (1999) commented on the risk involved in the gilt funds. He argued that the gilt funds are not risk free and investors should watch out for interest rate and management risk. Whenever one invests, the return on investment represents a risk premium. The general rule is the higher the risk; the higher will be the risk premium. Logically, 'zero risk' investments should carry zero or near zero returns. Obviously, the gilt funds, having an approximately
11% annual return must carry reasonable risk. He also commented on the effect of short-term volatility on the retail investors. The retail investors in any market find it difficult to live through the short-term volatility. He concluded the article by suggesting that in the gilt market the way to minimise the impact of volatility is to invest more when the market falls.

Suresh G Lalwani \(^{31}\) (1999) emphasised the need for risk management in the securities market with particular emphasis on the price risk. He commented that the securities market is a ‘vicious animal’ and there is more than a fair chance that far from improving, the situation could deteriorate.

Seema Shukla \(^{32}\) (1999) is of the view that the risk can be managed whether it be political, commercial or technological. But ‘mathematical risk management’ has not yet been fully applied across all sectors of companies, the concept is still evolving world-wide.

She commented that risk management comes into focus due to the uncertainty that prevails in the business environment. It has developed more in countries whose economies are deregulated and privatised, as opposed to economies like India, which are in the process of opening up. However, once risks are identified, they are
measured and managed. She concluded that the risk function has to form the basis for decision-making.

Indu Salian\textsuperscript{33} (1999) reviewed risk management of the financial sector. She opined that managing financial risk systematically and professionally becomes an important task, however difficult it may be. All risks are to be monitored within reasonable limits. He revealed that tested risk control systems are today available virtually off the shelf and can be made universally applicable with a little bit of judgement and modification.

While discussing on financial sector reforms introduced in 1992-93 and its effect on risk management, he revealed that reforms would necessarily have transition risks and volatility. And margins will get squeezed and the cushion to absorb risk will get reduced. Then management of risk requires strong risk control. He concluded that if we are able to manage the transition phase of the reforms and upgrade our infrastructure for improved risk management capabilities, we are certain to come out ahead.

Seema Shukla \textsuperscript{34} (1999) disclosed the changing face of risk by comparing the old paradigm and the new paradigm. The old paradigm is that risk assessment is an AD-HOC activity that is done whenever managers believe there is a need to do it. But the new
paradigm is that risk assessment is a continuous activity. The old pattern of risk management was to inspect and detect business risk and then react. But the new pattern is to anticipate and prevent business risk at the source and then monitor business risk controls continuously.

She distinguished between business risks and financial risks. In managing the business risk, one looks at the risk reward profile to maximise reward based on the risk appetite. She opined that one can run a business by minimising financial risk, but the business risk itself could be high. She clears the air by stating that business risk is technology risk, political risk, geography risk, the changing preference of customers, economic risk, etc. whereas financial risk is currency risk, interest rate risk, commodities risk etc. To manage these risks, the first step is to identify the risks and determine the source of those risks. There is no way to manage something that cannot be measured, so the next step involves getting a measure of the significance and likelihood of occurrence. She concluded by emphasising the need to prioritise the risks, as it is impossible to throw resources on all kinds of risks.

Arun Jethmalani \(^{35}\) (1999) reviewed the existence and measurement of risk involved in investing in corporate securities of shares and debentures. He commended that risk is usually determined based on the likely variance of returns. It is more difficult to compare
risks within the same class of investments. He is of the opinion that the investors accept the risk measurement made by the credit rating agencies, but it was questioned after the Asian crisis. Historically, stocks have been considered the most risky of financial instruments. He revealed that the stocks have always outperformed bonds over the long term.

He also commented on the ‘diversification theory’ concluding that holding a small number of non-correlated stocks can provide adequate risk reduction. A debt-oriented portfolio may reduce short-term uncertainty, but will definitely reduce long-term returns. He argued that the ‘safe debt related investments’ would never make an investor rich. He also revealed that too many diversifications tend to reduce the chances of big gains, while doing little to reduce risk. Equity investing is risky, if the money will be needed a few months down the line. He concluded his article by commenting that risk is not measurable or quantifiable. But risk is calculated on the basis of historic volatility. Returns are proportional to the risks, and investments should be based on the investors’ ability to bear the risks, he advised.

A.Selvaraj (1999) reviewed the strategies for combating risk. A risk management programme should encompass all parts of the organisation and all types of potential risks. Risk management is essential and one should be aware of how to strategically organise an
effective programme. He revealed that to safeguard a business against risk, it is necessary to know the various kinds of risks that the business faces. There are risks in everything and the degree of risk may vary.

He recommended certain strategies for combating risks. When risks must be born, prudence lies in the reduction of the area of uncertainty within which a business is operating. He opined that since most of these risks proceed largely from ignorance, they could be avoided by understanding them properly.

Mukul Gupta (1999) described the risk management framework as the building blocks for Enterprise Risk Management (ERM). ERM is the systems and procedures designed to deal with multiple types of risks. The objectives of ERM are to obtain information and analyse data so that uncertainty is turned into quantifiable risk and appropriate management action can be taken to mitigate the risk.

He opined that it is necessary to understand the three main building blocks to the risk measurement and management process that are Analytics, Business process and Technology. By analytics is meant the capability of developing the mathematical tools to measure various forms of risks. By processes is meant the knowledge of business opportunities and the way business is conducted. Technology is the experience in implementing the hardware and software required to
facilitate the risk management information system. He concluded that a successfully implemented E.R.M could be used both for a defensive or an offensive approach.

R.B.I Guidelines for Risk Management system in banks\textsuperscript{38} (1999) broadly cover management of credit, market and operational risks. According to the guidelines, the management of credit risk should receive the prime attention of the top management. The guidelines also mention that it would be desirable to adopt international standards on providing explicit capital cushion for the market risk to which banks are exposed.

Rajagopala Nair and Elsamma Joseph \textsuperscript{39} (2000) revealed the various risks experienced by investors in corporate securities and the measures adopted for reducing risks. They opined that calculated risk might reduce the intensity of loss of investing in corporate securities.

As per their study, many investors are holding shares of those companies that are non-existent at present. They opined that investors may accept risks inherent in equity, but they may not be willing to reconcile to the risk of fraud. Promoters should not be allowed to loot the genuine investors by their fraudulent acts.
They observed that political uncertainties and frequent changes in the govt. have put the investors in an embarrassing state of mind. They stated that most of the investors follow the policy of 'wait and watch' the political situation before making an investment decision.

Akash Joshi\(^{(2000)}\) reviewed the utility of derivatives in reducing risks. He opined that derivatives allow an investor to hedge or reduce risks. But they tend to confound investors due to their esoteric nature. The leverage that the derivatives offer to any trader, investor or speculator is tremendous. By the use of derivatives the volatility of the market also gets neutralised. He concluded the article by stating that while the discerning one stands to gain from it, a person who fails to read it right could land up burning his fingers.

Charls Schwab\(^{(2000)}\) revealed very practical, authoritative and easy-to-follow tips and suggestions for good investment in the stock market. According to him growth is the heart of successful investment. He suggested that before investing, one should be clear about the goal. He opined that the biggest risk is not in investing but in doing nothing and watching inflation eating away the savings. A very useful suggestion of the author is not to draw upon the income from investment but to reinvest it. A low risk approach will yield low
return. So the author urged the investor to be aggressive, subject to his personal limits.

CRISIL Report on Risk Management\textsuperscript{42} (2000) stated that the loss potential from market risk will increase in the absence of strong risk management tools. The banks which adopt a pro-active approach to upgrading risk management skills which are currently unsophisticated as compared to internationally best practices, would have a competitive edge in future. The report commented that in the increasingly deregulated and competitive environment, the risk management strategies of banks would hold the key to differentiation in their credit worthiness.

Raghavan R.S. \textsuperscript{43} (2000) reviewed the need for a risk management system, which should be a daily practice in banks. He opined that bank management should take upon in serious terms, risk management systems, which should be a daily practice in their operations. He is very much sure that the task is of very high magnitude, the commitment to the exercise should be visible, failure may be suicidal as we are exposed to market risks at international level, which is not under our control as it was in the insulated economy till sometime back.
Suresh.G.Lalwani and Ravindra Gersappa (2000) emphasised the need for a greater consciousness of the risks attached to a fixed income securities portfolio, as the market in a situation of crunch can suddenly turn illiquid. Some concrete steps to put in place a mechanism to evaluate and seek to control the market risk would be necessary. They opined that the pursuit of profits often leads to a degree of recklessness that conveniently disregards the direct correlation between risk and profits. They concluded that a risk management mechanism could be looked as a tool to instil discipline in any trading activity. It is a surveillance tool for constant monitoring of the market prices so as to forewarn against the unacceptable levels of risk on positions maintained.

Raghavan.R.S. (2000) commented on the risk perceptions and the risk measure parameters. He opined that risk measures are related to the return measurements. While risks can only be contained and cannot be eliminated altogether, there is no doubt that some risks have to be taken to get adequate returns. Returns can be increased or made quicker by taking more financial and operating risks. But the environmental risks typically do not increase returns but serve as constraints on return and risk decisions. He concluded that the process...
of retaining the levels of risks within the desirable levels must be practiced in the daily operations.

Vijay Sood\textsuperscript{46} (2000) revealed the risks faced by banks and financial institutions and the degree of risk faced by them. According to him, risk management is gathering momentum at a time when there is increasing pressure on banks and F.I.S to better manage their assets and improve their balance sheet. He opined that the greater the volatility of expected returns, the higher is the risk. The essence of risk management is to reduce the volatility.

Report by the I.E.S\textsuperscript{47} (The Investigation Enforcement and Surveillance) Department of the SEBI (2000) states that in spite of some instances of high volatility, the Indian markets have remained stable and safe. It is observed that the Indian securities market has been witnessing a downtrend and instances of volatility. But the downtrend and the fall in the sensex are in consonance with the fall in the indices of the major capital markets around the world. According to the Report, the downtrend in the sensex could be attributed to-

1. Rise in the oil prices in the global markets leading to increase in oil pool deficit.

2. Downward pressure on the Indian Rupee.
3. Fears of economic slow down as indicated by the key economy indicators.

4. Revival of competitive economies such as Malaysia and possibility of shifting some foreign investments to these countries etc.

The report concluded that the risk containment measures along with the proactive measures taken by the SEBI from time to time has ensured that the level of safety remained adequate and there were no constraints on the settlement process.

Jayanth M Thakur (2000) disclosed the implications of derivatives. The use of derivatives can be for safeguarding oneself against risks. It is widely recognised by all including the SEBI committee on derivatives that a substantial degree of speculative activity in a market for derivatives is necessary and without this, a good market in derivatives cannot function.

He revealed that the basic purpose of providing a system for trading in derivatives is to enable a person to protect himself against the risk of fluctuations in the market prices. This is known as hedging. But he argued that it might lead to the bankruptcy of the grantor of an option to buy as he takes a huge risk since the price could go upward to an unlimited extent and still he would have to deliver the shares.
This is one of the important reasons that the derivatives are criticised. He concluded the article by suggesting that the objective of the Regulator would be to provide protection to all concerned.

Mitra S.K. (2000) commented on the increasing volatility of the bourses, which forces an investor to shift away from the equity market. He observed that analysts profess to the investors the virtue of long-term time horizon for the equity investment. But sharp volatility has become a feature of the capital market worldwide, resulting in frequent, sharp, downward corrections. In this scenario it is proving difficult to convince the investors to think long-term.

He opined that the risk of obsolescence and failure have increased enormously in the highly valued economy companies, resulting in huge loss on investments. Investors with long outlook are real losers in this new paradigm of stock market gambles. He argued that, in this scenario, investors are shifting away from the equity market to cash and debt. Long-term vision in the equity investments has given way to short term trading.

Ajay Jaiswal (2001) evaluated the implications of 'Equity Risk Premium'. He opined that investors look for a certain level of return for assuming the 'risk of equities volatile return'. This level can
be measured through the equity risk premium. Equity risk premium is the sum of the dividend yield and earnings growth less current bond annual yield. He observed that the risk premium rose very sharply towards the end of the last decade. The expectations of the earnings growth had moved up dramatically since 1998. But in the last year we saw a fall of the long-term growth expectations. He opined that a downturn is associated with a fall in the profitability of the corporate sector. He argued that the equity investments are not for the weak hearted, as the equity holders cannot escape the impact of the movements in the capital market. We are headed for a period of lower returns to the investors. He concluded that the scaling down of the return expectations would reduce the chances of wild swings. And this would be better for the health of the bruised equity investors.

Gerela.S.T. and Balsara.K.A. (2001) reviewed the risk management system at the Bombay Stock Exchange. They reported that the BSE has strengthened the risk management measures to maintain the market integrity. The introduction of the modified carry forward system, coupled with the BOLT (Bombay Online Trade) expansion to cities all over India has led to a significant increase in the liquidity and volumes at the exchange. As a consequence, the risk management function at the BSE has assumed greater importance.
order to maintain the market integrity and to avert payment defaults by the members, the exchange has strengthened its risk management system by taking the following measures:

1. All members are required to maintain the base minimum capital of Rs.10 lakh with the exchange.

2. As a risk management measure the exchange places trading restrictions on the members.

3. The exchange has prescribed a ceiling on the gross exposure of the members.

4. The exchange collects from the members, daily margin, additional volatility margin, incremental carry forward margin, etc.

5. The exchange has constituted a risk management committee to put in place a long-term risk management policy.

Melwyn Reo (2001) reviewed the various risks to which the Indian corporates are exposed to and also the corporate risk management policies. He opined that the corporates need to focus on their primary business risks and hedge risks arising from commodity price movements. An appropriate level of risk for a corporate is dependent on how much business and financial risk it is exposed to. A corporate with volatile cash flows and high operational risk may find it appropriate to take on less market risks. A corporate which is exposed
to a relatively lower business risk may feel more comfortable in taking on more unhedged financial risk. Ultimately, the corporate may decide to fix the total risk appropriate to it as some percentage of its capital base or the expected earnings.

He opined that the corporates, despite their unlimited life span have limited tolerance to price volatility. The commodity price exposure should be fully hedged because corporates face enough business risk and cannot afford to add further risks. Since all corporates are exposed to commodity price risk, they should maintain a Board approved policy and procedures that outline its risk management strategy. He concluded the article by stating that the underlying objective in any risk management policy should meet the aspirations of the equity holders.

The Economic Times Investors’ year Book\(^5\) (2000-01) commented on the “Paperless World” and described what makes dematerialisation the preferred choice and how it reduces risk. The dematerialised trading was introduced in India in 1996 to reduce pains and risks in settlement through the loss of share certificates in transit, bad deliveries, delays in transfer and forged/fake/stolen certificates. It helps in doing away with the risk of loss in transit by directly crediting the account with bonus shares and rights. There is no risk of bad
delivery because the ownership status is clearly captured in the Depository’s computers.

Rukmani Viswanath 54 (2001) reported that the Primary Dealers in Govt. securities are working on a new internal risk management model suited for the Indian market conditions. The attempt is to lay down general parameters for risk perception. The Primary Dealers Association of India (PDAI) is formulating a set of prudential norms for ‘risk management practices’. While internationally the principles of risk management may be the same everywhere, the Association is of the view that they have to identify the relevant issues and apply those principles in the Indian context. It strongly argues that it must work on a model that can help to manage liquidity and interest rate risk. While the existing RBI guidelines on risk management cover mainly statutory risk, the PDAI hopes that its new risk management model will be able to perceive ‘real risk’. These new norms are expected to help gauge several issues like, whether a fall in the prices of securities or yields is a temporary or permanent situation etc. The areas the new norms are likely to address are the assessment of the liquidity situation and envisaging investor appetite for a specific instrument and their appetite for risk. According to the govt. securities dealers, these norms are expected to help them hedge
their risks better. The primary dealers are looking forward to these norms to help them manage their internal risks.

The review of literature reveals that recently no study has been undertaken in Kerala on risk management in investment in corporate securities. Scholars have contributed much to the theories related to risks like risk return relationship, expected value, risk and uncertainty, attitude towards risk, EVA (Economic Value Added) etc. But there is lack of studies on the objectives behind investment in corporate securities, the types of shares that the investors like to invest in, the precautions they take against risks, how they manage a crisis while operating in securities market, the gender differences in handling risks, etc.

From the review of literature it is obvious that emotions rule the market, but whether emotional buying and selling are influenced by factors like experience in the stock market operations remains to be answered. Though it is generally accepted that fund is diverted from the stock market to other avenues of investment, studies are to be conducted to reveal whether funds are diverted or not and the reasons for diverting the funds and whether funds are diverted both from the primary market and secondary market etc. The effect of volatility on diversion of funds is also to be enquired into.
Investors select a particular type of share like growth share, income share etc. according to their preferences, but the question whether experience in stock market operations has any influence on the type of share they select is to be explored.

The review of literature has brought to light that there exists wild speculation in Indian stock markets. But whether speculation leads to diverting funds from the stock market or not raises a big question mark.

There are theories like the Fundamental analysis, Technical analysis etc. to evaluate the securities. To what extent these theories are applied is another question to be resolved.

Keeping in mind, these unresolved, inadequately explained and insufficiently explored issues, the present study has been undertaken.
Foot Notes


