Summary

Introduction to Risk

We hope you enjoyed this session on ‘Introduction to Risk’. To reiterate, let us look at what you learnt in this session.

Risk and its Types

You first looked into what risk means. Risk stems from an uncertainty, which leads to a probable loss. While risk can be measured, uncertainty can’t. Under risk, the loss can happen either due to a **peril** or a **hazard**. Perils such as an earthquake or a heart-attack directly cause loss. However, agents such as smoking or pollution, which increase the frequency or severity of the loss, are considered hazards.

Next, you learnt about the various kinds of **financial risks** through the case of Nalin. Risks which can only have a negative or neutral effect are known as pure risks. The risk of death of a family member or a health ailment falls under the category of pure risks. These kind of risks can befall either an individual or a whole business entity. In case a risk affects an individual, it is called personal risk. When a pure risk affects an entire business, such as data theft or fire in a factory, it is known as **commercial risk**.

On the other hand, there are risks that can yield positive effects along with negative and neutral effects. These are called **speculative risks**. Investments in the stock market or businesses are examples of speculative risks.

Commercial risks that can also yield positive effects are known as **enterprise risks**. Launching a new product or hiring a new employee are examples of enterprise risks.

Risks which can be reduced or eliminated by spreading the investments or through diversification are called **diversifiable risks**. These risks can affect a single person or a small group. A diversified portfolio of stocks and bonds can reduce the risk of loss of money. On the contrary, risks which affect large groups, such as entire economies, and cannot be eliminated through diversification are known as **non-diversifiable risks**. One such form of risk, that affects an entire economy and stems from the failure of entities in a system, is called systematic or market risk. The 2008 economic crisis is one such example of the effect of a systemic risk.

Risk Mitigation Strategies

Next, you learnt about the different methods of risk management. The first of these is exercised before the loss from the risk happens. Such strategies are called risk control strategies. Under these strategies, one can avoid a risk, prevent a risk or reduce it, by taking appropriate measures. Further, once the loss happens, risk financing strategies are used. Through risk financing, risk can be retained actively and passively. It can be transferred through contracts and hedged by selling at future speculated rates.

These topics in risk financing form **non-insurance transfers**, where the risk is transferred to a party other than the insurance company.

Moreover, when it comes to risk transfers, the final risk financing strategy is **insurance.**

For most people, insurance is the most important way to mitigate major financial risks. Under insurance, individuals and organisations can transfer pure risks by paying a premium to an insurance provider, in exchange for payment for a possible loss.

You will learn about insurance in-detail in the next session.