E-CONTENT PREPARED BY

Dr. Deep Banerjee

Assistant Professor

Department of Commerce
Durgapur Government College, Durgapur, West Bengal

(*Affiliated to Kazi Nazrul University, Asansol, West Bengal*)

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E-Content prepared for students of

B.Com. Honours and Honours and Programme (Semester-6th) in Accounting

Name of Course: Financial Management

Topic of the E-Content

Risk Analysis

Risk Analysis: An Alternative Approach

- Risk

Business Risk + Financial Risk → Risk

Business Risk

Business Risk is caused by

- Economy-specific factors : fluctuations in foreign exchanges, competition, concentration of revenues, inflation, imports, restrictive regulations etc.

- Industry-specific factors : special status enjoyed by the industry, growth prospects in the market for the products of the industry.

- Company-specific factors :cost structure, liquidity, managerial efficiency, culture, values etc.
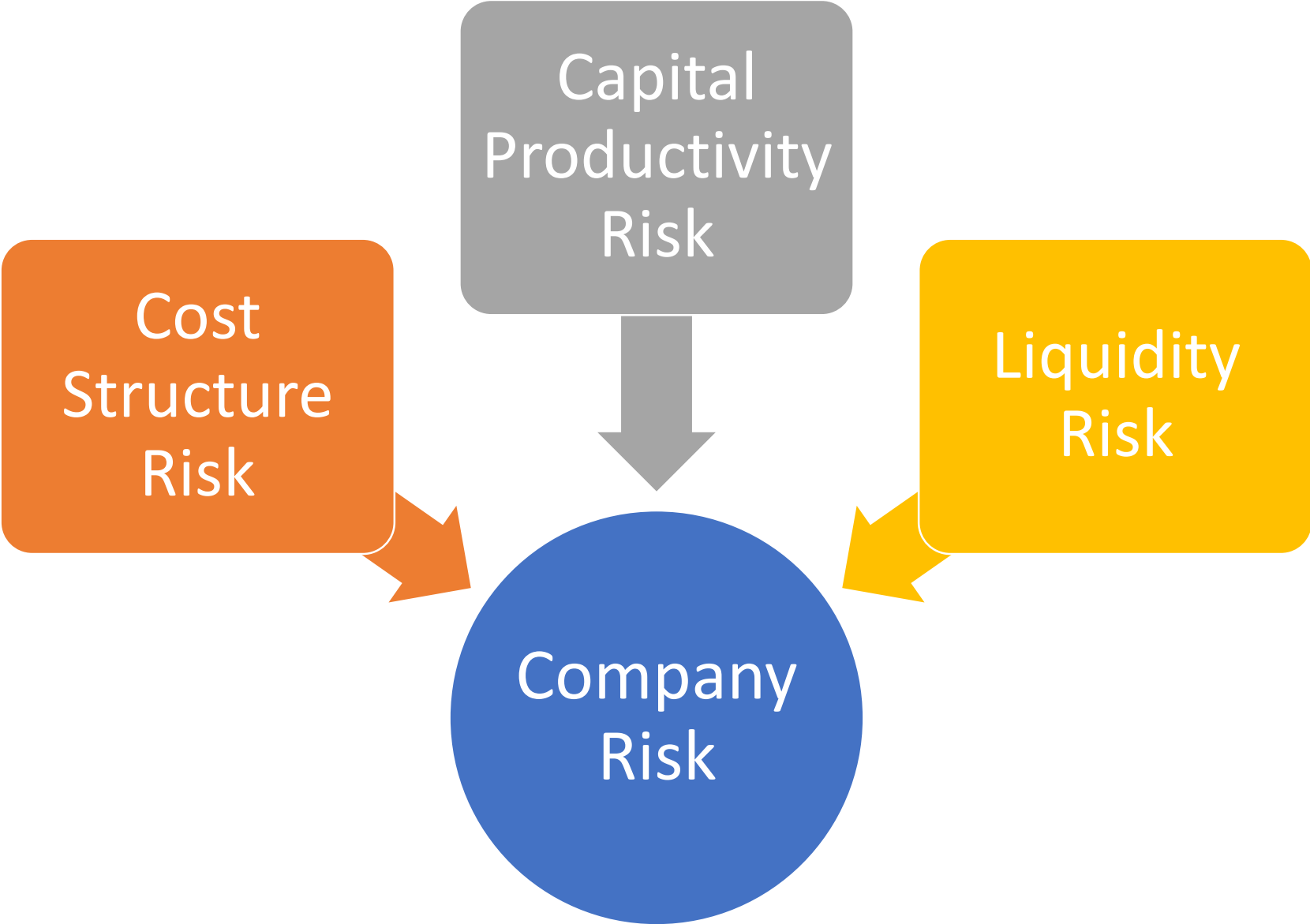
Business Risk

Economy Risk

Industry Risk

Company Risk

- Financial Risk

Relationship between Business Risk and Financial Risk

- Relationship between Risk and Return

Relevance of Risk Analysis

- To understand the relative position of the company within the given pattern of industry risk that in turn reflects capability to achieve stability.
- To make risk-return trade-off.
- To realign the capital and capital structure, working capital policies and cost structure.
- To revise capital structure.

Risk: Non-statistical Measures

- Business Risk
- FATA
- DOL

- Financial Risk
- DER
- DFL

Risk: Statistical Measures

- BR = C.V. of Operating Profit or Operating Profit Ratio or Operating Profit to Capital Employed Ratio.
- TR = C.V. of Earnings available to Owners' Equity or ROE
- FR= TR − BR
- CSR = C.V. of Fixed Cost to Total Cost Ratio
- CPR= C.V. of Capital Turnover Ratio
- LR = C.V. of Current Ratio

Alternative Approach to Risk Measurement

Ginni's Coefficient

Ginni's Coefficient of Mean Difference

5,11,18,25,41

41-5= 36   25-5= 20   18-5= 13   11-5=6

41-11=30   25-11=14   18-11=7

41-18=23   25-18= 7

41-25=16

Total=105   Total=41   Total=20   Total=6

g = 105+41+20+6 = 172

m = n(n-1) /2 = 5(5-1)/2 = 10

Ginni's Coefficient of mean difference: $\Delta 1$ = g/m = 172/10 = 17.2

Ginni's Coefficient of Concentration:

$$G = \Delta 1 / 2 \times \overline{x}$$
$$= 17.2 / 2 \times (5+11+18+25+41) \times 1 / 5$$
$$= 0.43$$

Why Ginni's Coefficient ?

Ginni's Coefficient has a theoretical appeal since it is based on all the values of the variable and the differences of values among themselves and not on deviations from some measures of central tendency.

Thank You