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Answer to the question 1

The risk-return states that the potential return rises with an increase in risk. Using this principle, individuals associate low levels of uncertainty with low potential returns, and high levels of uncertainty or risk with high potential returns. According to the risk-return tradeoff, invested money can render higher profits only if the investor will accept a higher possibility of losses.

Business risk is a broad category. It applies to any event or circumstance that has the potential to prevent you from achieving your business goals or objectives. Business risk can be internal (such as your strategy) or external (such as the global economy).

Different types of risk should be managed and treated differently. You should understand exactly what type of risk you are facing before you consider how to deal with it.

Types of business risks

The main four types of risk are:

Strategic risk - eg a competitor coming on to the market.

Compliance and regulatory risk - eg introduction of new rules or legislation

Financial risk - eg interest rate rise on your business loan or a non-paying customer

Operational risk - eg the breakdown or theft of key equipment

These categories of risks are not rigid and some parts of your business may fall into more than one category. The risks attached to data protection, for example, could be considered when reviewing both your operations and your business' compliance.

Other sources of business risk

Other factors can present certain threats to your business, including:

- environmental risks, such as natural disasters
- political and economic instability in any foreign markets you export goods to
- health and safety risks - see health and safety risk assessment
- commercial risks, including the failure of key suppliers or customers

- workforce risks, eg maintaining sufficient staff numbers and cover, employee safety and up-to-date skills

<u>Answer to the Question No 2</u>

Diversification is the act of spreading investment dollars across a range of assets to reduce investment risk. A well-diversified portfolio provides balance so that your investment performance does not rely too heavily on one asset.

Diversification is a common investment strategy through which investors spread their portfolio across different types of securities and asset classes to reduce the risk of market volatility. It's part of what's called asset allocation, meaning how much of a portfolio is invested in various asset classes. Three of the most common asset classes include stocks, bonds and cash (or cash equivalents). To achieve diversification, investors will blend dissimilar assets together so that their portfolio does not have too much exposure to one individual asset class or market sector.

Investors have many investment options, each with its own advantages and disadvantages. Some of the most common ways to diversify your portfolio include diversification by asset class, within asset classes and beyond asset class.

<u>Diversification example</u>

Say you invested all of your money only in Apple stock (AAPL). Apple is a technology company, so this would mean that your asset allocation would be 100% equity (or stock) all in the technology sector of the market. This is a risky approach because if Apple stock prices were to slump due to unforeseen circumstances, your whole investment portfolio would suffer the consequences. You might diversify within the technology sector by investing in other tech companies, but if the whole technology sector is negatively impacted, your portfolio would still take a big hit.

To appropriately diversify a portfolio, you'll need to include stocks from many different sectors. Even still, you may also want to include bonds or other fixed income securities to protect against a dip in the stock market as a whole.

Diversification is the simplest way to boost your investment returns while reducing risk. By choosing not to put all of your eggs in one basket, you protect your portfolio from market volatility. Diversification may look a little different for each investor. Factors such as time horizon and risk tolerance should be assessed on a case-by-case basis to determine how to best construct each portfolio to fit the individual needs of each investor. Luckily, there are plenty of tools available that help make it easy to diversify your investment accounts.

Here are five steps for helping you with diversification:

1. Spread the Wealth

Equities can be wonderful, but don't put all of your money in one stock or one sector. Consider creating your own virtual mutual fund by investing in a handful of companies you know, trust, and even use in your day-to-day life.

But stocks aren't just the only thing to consider. You can also invest in commodities, exchange-traded funds (ETFs), and real estate investment trusts (REITs). And don't just stick to your own home base. Think beyond it and go global. This way, you'll spread your risk around, which can lead to bigger rewards.

2. Consider Index or Bond Funds

You may want to consider adding index funds or fixed-income funds to the mix. Investing in securities that track various indexes makes a wonderful long-term diversification investment for your portfolio. By adding some fixed-income solutions, you are further hedging your portfolio against market volatility and uncertainty. These funds try to match the performance of broad indexes, so rather than investing in a specific sector, they try to reflect the bond market's value.

These funds often come with low fees, which is another bonus. It means more money in your pocket. The management and operating costs are minimal because of what it takes to run these funds.

3. Keep Building Your Portfolio

Add to your investments on a regular basis. If you have $10,000 to invest, use dollar-cost averaging. This approach is used to help smooth out the peaks and valleys created by market volatility. The idea behind this strategy is to cut down your investment risk by investing the same amount of money over a period of time.

With dollar-cost averaging, you invest money on a regular basis into a specified portfolio of securities. Using this strategy, you'll buy more shares when prices are low, and fewer when prices are high.

4. Know When to Get Out

Buying and holding and dollar-cost averaging are sound strategies. But just because you have your investments on autopilot doesn't mean you should ignore the forces at work.

Stay current with your investments and stay abreast of any changes in overall market conditions. You'll want to know what is happening to the companies you invest in. By doing so, you'll also be able to tell when it's time to cut your losses, sell, and move on to your next investment.

5. Keep a Watchful Eye on Commissions

If you are not the trading type, understand what you are getting for the fees you are paying. Some firms charge a monthly fee, while others charge transactional fees. These can definitely add up and chip away at your bottom line.

It’s a matter of what you are paying and what you are getting for it. The cheapest choice is not always the best. Keep yourself updated on whether there are any changes to your fees.

Answer to the Question No 3

Financial instruments are assets that can be traded, or they can also be seen as packages of capital that may be traded. Most types of financial instruments provide efficient flow and transfer of capital all throughout the world's investors. These assets can be cash, a contractual right to deliver or receive cash or another type of financial instrument, or evidence of one's ownership of an entity.

Types of Financial Instruments

Financial instruments may be divided into two types: cash instruments and derivative instruments.

Cash Instruments

The values of cash instruments are directly influenced and determined by the markets. These can be securities that are easily transferable.

Cash instruments may also be deposits and loans agreed upon by borrowers and lenders.

Derivative Instruments

The value and characteristics of derivative instruments are based on the vehicle's underlying components, such as assets, interest rates, or indices.

An equity options contract, for example, is a derivative because it derives its value from the underlying stock. The option gives the right, but not the obligation, to buy or sell the stock at a specified price and by a certain date. As the price of the stock rises and falls, so too does the value of the option although not necessarily by the same percentage.

There can be over-the-counter (OTC) derivatives or exchange-traded derivatives. OTC is a market or process whereby securities–that are not listed on formal exchanges–are priced and traded.

Types of Asset Classes of Financial Instruments

Financial instruments may also be divided according to an asset class, which depends on whether they are debt-based or equity-based.

Debt-Based Financial Instruments

Short-term debt-based financial instruments last for one year or less. Securities of this kind come in the form of T-bills and commercial paper. Cash of this kind can be deposits and certificates of deposit (CDs).

Exchange-traded derivatives under short-term, debt-based financial instruments can be short-term interest rate futures. OTC derivatives are forward rate agreements.

Long-term debt-based financial instruments last for more than a year. Under securities, these are bonds. Cash equivalents are loans. Exchange-traded derivatives are bond futures and options on bond futures. OTC derivatives are interest rate swaps, interest rate caps and floors, interest rate options, and exotic derivatives.

Equity-Based Financial Instruments

Securities under equity-based financial instruments are stocks. Exchange-traded derivatives in this category include stock options and equity futures. The OTC derivatives are stock options and exotic derivatives.

Selecting Short term and long term assets:

Long term assets are resources that are utilized for long lengths, for example over a year in the business to produce income. Short-term assets are utilized for not exactly a year and create income/pay inside a one-year time span.

Long-term assets are those held on a company's balance sheet for many years. Long-term assets can include tangible assets, which are physical and also intangible assets that cannot be touched such as a company's trademark or patent.

Some examples of long-term assets include:

- Fixed assets like property, plant, and equipment, which can include land, machinery, buildings, fixtures, and vehicles
- Long-term investments such as stocks and bonds or real estate, or investments made in other companies.
- Trademarks, client lists, patents
- The goodwill acquired in a merger or acquisition, which is considered an intangible long-term asset

A short term asset is an asset that is to be sold, converted to cash, or liquidated to pay for liabilities within one year. In the rare cases where the operating cycle of a business is longer than one year (such as in the lumber industry), the applicable period is the operating cycle of the business, rather than one year. An operating cycle is the time period from when materials are acquired for production or resale to the point when cash is received from customers in payment for those materials or the products from which they are derived.

Examples of Short Term Assets

All of the following are typically considered to be short term assets:

- Cash
- Marketable securities
- Trade accounts receivable
- Employee accounts receivable
- Prepaid expenses (such as prepaid rent or prepaid insurance)
- Inventory of all types (raw materials, work-in-process, and finished goods)

Answer to the Question No 4

Financial controls are a key element of organizational success and survival. There are three basic financial reports that all managers need to understand and interpret to manage their businesses successfully: (1) the balance sheet, (2) the income/profit and loss (P&L) statement, and (3) the cash flow statement. These three reports are often referred to collectively as "the financials." Banks often require a projection of these statements to obtain financing.

- As a new manager, I will provide the basis for sound management and allow other managers to establish guidelines and policies that enable the business to succeed and grow. Budgeting, for instance, generally refers to a simple listing of all planned expenses and revenues. On the basis of this listing, and a starting balance sheet, I can project a future one. The overall budget I will create is a monthly or quarterly projection of what the balance sheet and income statement will look like but again based on my list of planned expenses and revenues.
- I have a good grasp of accounting fundamentals. Financial statements provide management with information to monitor financial resources and activities. The income statement shows the results

of the organization's operations, such as revenues, expenses, and profit or loss. The balance sheet shows what the organization is worth (assets) at a single point in time, and the extent to which those assets were financed through debt (liabilities) or owner's investment (equity).

- Financial ratio analysis examines the relationship between specific figures on the financial statements and helps explain the significance of those figures: By analyzing financial reports, as a new manager I will be able to determine how well the business is doing and what may need to be done to improve its financial viability.
- As a proactive manager I will have financial data available based on actual results and compares them to the budget. This process points out weaknesses in the business before they reach crisis proportion and will allow me to make the necessary changes and adjustments before major problems develop.
- Most organizations, uses computer software programs to do record keeping and develop financials. These programs provide a chart of accounts that can be individualized to the business and the templates for each account ledger, the general ledgers, and the financial reports. These programs are menu driven and user-friendly, but knowing how to input the data correctly is not enough. As a manager I must also know where to input each piece of data and how to analyze the reports compiled from the data. Widely accepted accounting guidelines dictate that if I have not learned a manual record-keeping system, I will need to do this before attempting to use a computerized system.