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# RISK TYPE AND CONTROL METHODS

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**Abstract**
*The purpose of this paper is to highlight which are the main types of risk that may arise when making an investment, and not only, as well as their detailed area. We must also identify the risk, so that we can choose the best methods to combat or mitigate them. From this point of view, once the risks have been identified, it is necessary to use methods to mitigate them, to combat them, in order to finally eliminate them.*

**Keywords:** *risk, methods of control, mitigation, types of risk*

**JEL Classification:** M21, M41

## I. INTRODUCTION

A definition of risk can be reproduced as well, according to the theories and literature: "the risk of losing a certain amount is the opposite of expectation and the true measure of the risk is the product between the risked amount and the probability of losing it"( see www.slideshare.net/adinaromanescu/riscul-in-afaceri). This theory also continued in some of the treatments of Condorcet (1791) and Tetens (1788), works of economic character. There was always a confusion or better said a similarity between the term risk and uncertainty, whereby they were considered as unable to predict the evolution of events that were to take place.

Most of the principles of the scientific system, have shown, in most cases, there are very big differences between the two concepts, especially in the paper "Risk, Uncertainty and Profit" by Knight (1921) which supports the two distinctions. From the point of view of this author, he considers that the situations of uncertainty are constituted whenever the person concerned is in front of an event that has an unrepeatable character, the probability that these results are known are average, but that is not known are probability distributions, while the risk frame or component is performed at repetitive events performed under the same conditions, this is also the cause for which, if followed repeatedly, the frequencies of the results that can be obtained can be reproduced.

## II. RISK CATEGORIES

Every investment involves some level of risk. Understanding the type of risk, or the combination of types of risk, is essential in reducing those risks (Parker, 2012). We identify two major categories of risks, which in turn branch into many other classifications. Thus, we identify internal risks and external risks.

### Internal risks

The internal risks of a commercial organization are based on factors within it or within the project in which it was implemented, thus being easier to control.

*Risk in business or in business.* It is often a category of risk that is characterized by the fact that it arises due to the technological progress within the entity, if it manifests itself at a rapid rate, and at some point it can have significant consequences that may be more difficult than before. controlled, especially if they have reached a high level of manifestation. Not only this element characterizes the risk of the enterprise, but also the evolution of the demand, the changes that have been made regarding the tastes of the consumers, the way in which the prices have evolved, as well as the policy of the respective entity according to the way in which it has made its advertising on market (see https://capital.com/ro/risc-de-piata-definitie).

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If we want to relate to all the factors mentioned above, we must take into account the fact that they are in close connection with each other, which leads from the presence of a factor to the generation of the latter and have as an effect the presentation of the business risk or the quality that will be attributed to the forecasts that are made in relation to future profits.

Within an entity in which the investment is made, it should be noted that this category of risk is the one that defines the activity undertaken by the economic agent, which can have two edges: either it brings dynamic activity and it attracts more attention, or it can lead the entity to state of dissolution, followed by that of liquidation, after which bankruptcy if the company can not recover.

*Financial risk.* This category of risk arises when the entity has reached a high level of loans taken from banks. It is a risk with a rather heavy load, in the sense that, when the entity has degenerated and is in an unfavorable situation, then all the profits obtained by it are volatilized and give up the place of losses. It is the moment when the entity, even though it has financial results, will not even be able to pay the interest related to the loans taken from the banks (see https://capital.com/ro/risc-de-piata-definitie).

But there may be a more favorable situation, in the sense that the company does not have bank debt, the operating profits are at the same level as the net benefits, and in this case, the financial risk is low. What can lead to the opposite situation are the bank loans that have a high weight and thus diminish the expected net profits, which leads to an increase of this risk to the shareholders to receive their due dividends. All the situations that may arise as a result of triggering this risk must be considered, especially when the investment made is a fundamental factor, and the consequences are likely to ruin all the effort made up to that point.

*Bankruptcy risk.* It is the risk with the biggest burden, being the most feared by all investors and beyond. It appears when the entity is in a rather difficult situation, which is preparing to disappear from the economic market, to be declared bankrupt. As I mentioned before, not only are the economic agents exposed to this situation, but also the investors who put their money into this economic activity, the employees who have put in the work necessary to develop the business, the creditors who lose their debts or they can partially recover them or throughout the period, as well as the shareholders of the company, which everyone should be afraid of.

The insolvency or insolvency crisis, returns that state of the enterprise that is unable to fulfill its obligations to employees, shareholders, state and many of the categories, which leads to a premeditation of the proper functioning of the economic mechanism. It is important that when this situation is notified, the entity insures all the necessary damages in order to be able to overcome this situation.

*Insolvency risk.* This category of risk makes its presence felt within an economic entity when the company is unable to fulfill its commitments initially assumed. When the company is in this juncture, the next step is to enter the liquidity state, which involves selling all the assets held and paying the debts or there is another way, namely contracting an additional bank loan or merging with a stronger company that takes over. all its assets and liabilities, a way to help it get out of deadlock (Anghelache, Marinescu & Mirea, 2017).

If we want to refer to the last variant, that is, the merger, then the company in question loses its independence, which can sometimes be final. Such an event within the economic entity shows a fragility and sensitivity of the management of the company, which in the future will realize its handicap.

*The risk of losing autonomy*- appears and makes its presence felt before that crisis of insolvency is triggered, that is, by the fact that the economic entity considers that it is no longer able, by its own means to maintain its position on the market, to lend itself in appearance. commercial. From these considerations, it is evident that the means of self-financing of the entity become insufficient in relation to the development needs (Petrisor, 2017). The manager is responsible to find a way to keep the entity close to the stable level, in the sense that it has the possibility to catalog the company in the category of small or medium, and on the other hand it can increase the capital to be able to ally with another company strong.

*The risk of reducing the profitability or the risk of dilution*. The nature of this risk is more financial in nature, which shows that, although the capital of the entity has been increased, the resulting net profits will not have the same proportion as the increase, hence this dilution phenomenon appears. If we refer to the investments made, this risk is planned for them, but it needs to be calculated and determined by the company when establishing the financial strategy of the company (see https://www.linguee.com/english-romanian/translation/dilution+risk.html). Even if it is not considered to be a serious risk, it must be determined at all times and must be known at the company level, in order to avoid adverse or negative events.

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**External risks**

This category of risks is based on a number of factors in the area or environment in which the economic entity performs its activity, compared to the internal ones, in which the control is carried out outside it.

*Market risk.* This category of risk has an effect on an investment, in the sense that they may decrease from one period to another depending on the economic evolution, respectively due to events that may affect the entire market. If we were to relate to the evolution of a market, the first cause of their influence would be inflation, which generates negative situations (see https://capital.com/ro/risc-de-piata-definitie). In this category, we can identify other risks as follows:

- capital risk;
- interest rate risk;
- currency risk.

*a) Capital risk*. It represents that category in which the market price of shares varies from one period to the next, which leads to a change in demand and supply. Moreover, the capital risk manifests itself as a risk of loss, due to the fact that there have been decreases in the market price of the shares, respectively the shares of capital (see http://www.efin.ro/analiza_financiara_1967/riscul_de_capital.html).

*b) Interest rate risk*. The interest rate shows periodic changes that can have a significant impact on the bonds. When this category of bonds is held until the end of the proposed term or at maturity, the investor has the chance to recover its nominal value, to which is added the interest related to it. In the opposite situation, when we sell the bond before maturity, its value can be changed, meaning that it can receive a value greater or less than the nominal value previously held (Codirlasu,1900). Thus, an increase in these interest rates due to the bonds, may attract more investors, for which the newly formed bond will have a higher value of the rates, than the previous ones or the old ones. It is important to know that when we have an older bond, we may need to make a reduction in order to sell it.

*c) Currency risk*. It is appreciated that this risk most often depends on the currency exchange rate of the reference currency. Such a category of risk occurs when foreign investments are made, ie "Foreign Investment", which is manifested by the fact that money can be lost from international commercial contracts between the period in which the contract was signed and the due period (see https://www.tradeville.eu/tradepedia/risc-valutar). For example, if we consider the US dollar, it becomes less valid than the Canadian dollar, a ratio where if we have investments made in the United States of America, then they will be less valid for Canadian dollars.

*Liquidity risk*. This risk can be viewed from several angles, in the sense that if we are to relate to the investment made, then there is the possibility that the investor, you will not receive the money at the time you want. If we want that investment to be sold, we may not be able to make it at the most fair price, so that there is a situation where to accept the investment we accept a low price or it is likely that sometimes it will not be sold.

*Risk of concentration*. We are in the case of an investor who focuses only on one area of activity in which to put his money. When this area grows or diversifies, we spread the risk on different types of investments, industries or geographical locations. If we remained focused only on an investment, then the risk would be much higher, in which case we could also record losses (see https://lege5.ro/Gratuit/gm4tenbtga/riscul-de-concentrare-regulament-3-2014).

*Credit risk.* From the point of view of the complexity of this risk, it is triggered within the framework of granting loans or attracting loans. We end up in this situation of credit risk when the borrower or the borrower of a sum of money does not have available to repay them, and the lender or bank will not recover his credit and the interest due to him (see https://www.financialmarket.ro/terms/riscul-de-credit-credit-risk). If we ask ourselves when is this risk, then, when the debtor wants to use the cash flows to be set up at some point in the future, needed to cover the current debts. The debtor undertakes to pay a certain interest for the amount received, to repay the creditor, who assumes this credit risk. In the event that the lender, the one as bank or credit institution does not collect the credit and the related interest at maturity, then the banks, in order to avoid this credit risk, use different techniques to assess the quality of those who apply for loans, are collateral, as well as a smaller number of debtors and other items that provide reliable information to banks.

*The risk of reinvestment*. When a new investment decision is made, that risk of reinvestment may occur, which presents us with the loss recorded as a result of the respective investment, in the context of an economic activity or the income at a lower interest rate.

*The risk of the horizon*, which implies that our investment area will be reduced due to an unforeseen event, such as the loss of the job, which can lead us to sell long-term investments. However, we must sell them at the right time, in order not to lose money.

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*The longevity risk*, that is, to exceed our savings. Being one of the major risks, in the sense that it reflects how much this danger can manifest around an investment, realizing a hypothesis from the beginning. We must not only relate to the duration, but also to how, over time, this risk may affect our activity. Thus, an important element would be the immediate and prompt identification of all situations incompatible with the business.

*The risk of foreign investments*. If we consider making an investment in a country other than the one of reference, then we can analyze it as a foreign type investment. Certainly, to this investment we attach a different kind of risk, which warns us that there is a probability that those invested money will lose (see https://www.getsmarteraboutmoney.ca/invest/investing-basics/understanding-risk/types-of-investment-risk).

## III. MEASURES TO PREVENT, MITIGATE, COMBAT OR ELIMINATE INVESTMENT RISKS

Each stage of the investment process involves the consideration of certain categories of risk, which we must allocate and determine certain methods that will first of all combat them, and then eliminate them.

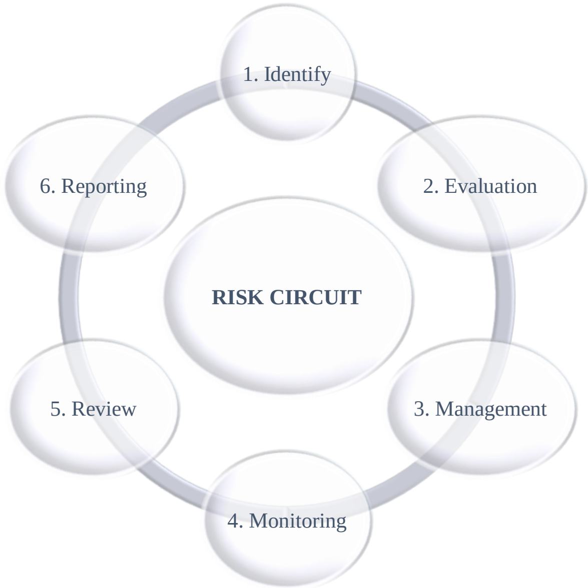


**Figure 1. Steps to quantify risk**
Source: Own elaboration

If we want to reduce the risks of the process, then we can use the following techniques:

• Programming, when the respective risks are associated with the execution period, then with the help of scientific programming on the activities we have carried out, through network graphs, we can reach the point where the risks can be reduced within acceptable limits;

• Training, mainly on personnel, because, we can say that most risks can occur within the job security. All these have a negative effect on the activity we carry out, but especially on the results obtained in its productivity. We refer to this sector, due to the fact that it is the sector most exposed to accidents, which is why a training activity leads to the reduction of the effects that it achieves.

• Redesigning, another method by which we can reduce the risks and which involves a reorganization regarding the work team and the personnel within it, as well as the tools, equipment used (Cornescu, 2004).

The activities we carry out, whether we make an investment or other such activities that involve the use of cash in different forms, make us aware that they are risk-bearing, which is why we have to take certain margins of protection, so it should not be too late when the risks are already triggered and they have taken over our activity. Within the investment projects, there are certain stages of their progress, to which we can attach measures or methods on prevention, respectively risk reduction. In this case, we can focus on the following:

• During the preparation phase of the investment project, different risks may arise for which we can use the following techniques or tools:

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a) Economical-mathematical calculation tools, in which we forecast the need for resources and how to allocate them, through a sensitivity analysis, simulation and forecasting techniques or even methods to measure our stock level;

b) Instruments that are formalized to identify the risks, in which we structure a list by which we envisage certain possible risks, a tree that shows us the errors, which elaborates a risk profile, and as we carry out the activity we identify the potentials. risks that may arise and the budget through which we have managed to cover them once they are clearly defined (see https://www.diploma.ro/licente/metode-si-tehnici-de-diminuare-a-riscului-investitional-1893“);

• Another step that we must perform is the one in which we execute the respective project that we have designed and in which we use such protection methods:

a) An eloquent method would be to pass the risks that we identify to an insurance company, which, after being triggered, will offer us a redemption and help us to fulfill our mission;

b) To mitigate the risks arising by going through the steps in their order of appropriateness, that is, to schedule our activities and to train the staff employed on the requirements they must fulfill (Șușu, 2006);

c) Let us not forget that everything we do is based on supporting documents, so we must be very careful about the contracts concluded with different companies and if it is possible to negotiate them, we will improve them.

• The last stage we carry out in an investment project is the one in which we give meaning to it, that is, we execute it, put it in motion and in which, as precautionary methods, we use:

a) To inform the competent personnel of all the necessary information on how to use the equipment or technologies that have resulted from the project drawn up;

b) To make contracts with the best suppliers on the market, which we analyze before concluding a contract, based on the information we have researched (Prunea, 2003);

c) One of the most ethical aspects of carrying out an investment project is the fulfillment and observance of the legislation.

## IV. CONCLUSIONS

When we use methods that measure our investment risks, these are the ones that inform the entrepreneur about the possible consequences and losses that may arise as a result of their trigger, the company being able to make the best decisions that will not affect the situation. and that can be influenced by how it can deal with the risk, respectively the attitude it adopts. After the possible risks have been identified within the entity, the entity is the one that has to make decisions regarding how to solve them, the role that is left to the manager of this entity who keeps the risks resulting at a certain level of control, regardless of the category. to them, ie medium or low. It can also use a method by which it transfers all the risks held to another company, that is, by outsourcing them, this it can also be categorized as a risk management strategy.

After identifying the main methods and strategies that can be used as risk control methods, then the entity's management must decide on the decision making, from which we recognize: the transfer of the earthquake risk to an insurance company, which is based on in a contract concluded between the two parties, the risk of incapacity to pay is kept under control and eloquent strategies are sought for this situation, and not least, the analysis in an internal manner of the competitive risk.

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