

RISK MITIGATING STRATEGIES OF RETAIL INVESTORS IN THE STOCK MARKET

Abstract

For the successful navigation of the stock market's complexity, especially for ordinary investors, smart risk management measures are required. The stock market offers both attractive opportunities and inherent risks. The purpose of this study is to investigate and evaluate the risk management techniques used by individual stock market investors. This study aims to provide insight on the efficacy and influence of these strategies on overall portfolio performance by analyzing the various methods used by retail investors.

An in-depth examination of the academic literature, business reports, and empirical data has been done for this study. Well-structured surveys and interviews are used to collect primary data in order to get information directly from retail investors. To capture the variety of risk, the research includes a wide range of retail investors, including beginners, seasoned investors, and traders.

Diverse risk management tactics have been reviewed, including diversification, stop-loss orders, asset allocation, hedging measures, and market timing. The study also examines retail investors decisions and their risk-taking capacity, as these are also important parameters to be considered before investing in a stock market.

The findings of this work will clarify the prevalence and effectiveness of various risk management techniques used by retail investors in the stock market. The study will also identify frequent errors and difficulties faced by retail investors while managing risks.

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In the end, this study aims to add to the body of knowledge on stock market risk management techniques while also acting as a tool for retail investors to use when making decisions that are in line with their risk appetite and financial objectives. Investors can create effective risk management plans to minimize potential losses and maximize their investment returns in the dynamic and constantly shifting stock market environment by recognizing the advantages and disadvantages of various approaches.

Keywords: Risk Management, Retail Investors, Stock Market, Investment Strategies, Behavioral Biases.

I. INTRODUCTION

- 1. Understanding Risk Management:** The process of identifying, analyzing, and accepting or mitigating uncertainty in investment decisions is known as risk management in the realm of finance. It is the process of identifying the risks associated with investments and the best strategy to manage those risks. Therefore, assessing risks and acting to either eliminate or decrease them by implementing control measures is the process of risk management (Shukla & Kukreja, 2014). Risk management may also be referred to as a process that combines the identification of risks, their appraisal, the development of management strategies, and their mitigation through the use of managerial resources (Kungwani, 2014).

However, risk cannot be separated from the returns which an investor may get. Every investment carries some risk, therefore every time a person invests money, he or she is exposed to a certain level of risk based on the risk profile of the security. The investor's expectations for returns influence the security they choose. The investor will be exposed to greater risk when the expectation of return is larger. Therefore, we need an effective risk management framework which could be aligned with the retail investors' investment strategy. This will give an assurance to the investors that their investments are safe and being monitored and controlled efficiently. This study seeks to evaluate strategies for risk management used by retail investors in various kinds of financial market investment methods.

- 2. Understanding Risk and its Classification:** Before we could formulate the risk management strategies we need to know about risk and its classification.

In finance, risk is the degree of uncertainty and/or possible financial loss present in a decision to make an investment. It also includes the likelihood that the results from an investment will differ from the predicted returns or gains, in addition to the risk of losing some or all the investment amounts. A higher level of volatility increases the likelihood that the actual return will differ from the predicted return since it increases the uncertainty of outcomes.

Majority of investments have some risk, although its range can vary from low to extreme. Government-issued Treasury Bills (T-Bills) are considered as risk-free investments as the return on these instruments are certain. This risk can be classified broadly as systematic and unsystematic risks. Let us understand them in depth:

- 3. Systematic Risk:** Systematic Risk refers to the risk posed by the market as a whole. It captures the total effect of financial, geopolitical, and economic issues. As a result, it happens as a result of shifting macroeconomic conditions such as inflation, interest rates, political instability, legislative changes, tax reforms, and economic recession, among others. Instead of just affecting one company, it affects the entire economy.

Systematic risk is typically unanticipated and challenging to totally prevent. It is also called as "market risk" because it has an impact on the entire market. Systematic risk is "un-diversifiable" in the same way that investors cannot avoid such risk. This indicates that holding a variety of securities won't allow investors to completely reduce systemic risk.

- 4. Unsystematic Risks:** The risk associated to various assets or securities within a portfolio are referred to as unsystematic risk, also known as specific risk, diversifiable risk, or idiosyncratic risk. Such risk works at micro level and associates with a company or industry only. It has seldom to do with macro-economic environment. An investor is expected to diversify his portfolio to mitigate such kind of risk.

Therefore, what options an investor has and what is the risk and return trade-off, these questions need to be answered before an investor invests specially in stock market. Table 1 allows helps us in understanding risk and return level of various investment options available in the market. From the table 1 we can infer that retail investor behavioral biases plays a vital role in deciding about the investments which is to be done in equity shares, derivatives, and mutual funds. An investor motive to invest depends on the *-Investment Holding Capacity, Profit Motives, Risk appetite, Market sentiments, Market knowledge, Current financial status and goals and Macro-economic factors*. Retail investors' holding capacity on the Indian stock market can vary significantly and is influenced by several variables, including their personal financial status, risk tolerance, investment objectives, and market conditions. Indian retail investors come from a variety of origins, have variable levels of discretionary money, and have different levels of financial experience.

The Securities and Exchange Board of India (SEBI), which oversees the Indian securities market, has taken several actions to safeguard ordinary investors and encourage their involvement in the stock market. These actions include streamlined account opening procedures, improved transparency, investor education initiatives, and legislation to stop fraudulent activities.

Risk and Return Profile of Investment Avenues			
Instrument	Risk	Expected Return	Tenure
Treasury Bills	No	Very Low	Long term
Government Bonds	Very Low	Low	Long term
Bank and Post Office Deposits, such as Fix deposits, Recurring deposits, other options	Low	Moderate	Long term
Government schemes – Sukanya Yojana, Personal Provident Funds, other government run pension schemes	Very low	Moderate	Very Long term
Corporate Bonds	Moderate	Moderate	Very Long term
Shares	Very High	High	Depend on profit motive
Derivatives	Very High	Very High	Depend on profit motive
Mutual Funds	High	High	Depend on fund type and lock in period

Source: Self compiled

II. RETAIL INVESTORS

Any investor who is not an institutional investor is referred to as a retail or non-institutional investor. Retail investors are those who use their own funds to buy or sell securities through brokers on their own accounts. Retail investors so handle their own money management. Retail investors have little to no impact on the direction of the stock market due to their minimal purchasing power.

In their study, Bayar et al. (2020) examined how demographic factors and financial literacy levels affected people's willingness to take financial risks. In one more study conducted by Prithiviraj & Gokul (2016), factors affecting retail investment decisions were analyzed. In this study risk tolerance level of the retail investor were analyzed. Whereas, in one more study of Kannadhasan (2015) risk tolerance and risk-taking behavior of the retail investors was studied. Surender (2015), in his study found that a variety of sources can be used by the retail investor to find information on the many aspects needed for trading equity investments. Retail investors lack the knowledge and skills to use complex analytical tools to make investing decisions. They use relatively straightforward and quicker methods to decide whether to invest in equities securities. These retail investors may be affected by many factors before they take investment decision but they always have some risk management techniques in their hand which could be leverage for them.

III. RISK MANAGEMENT TECHNIQUES

Risk management is crucial while making financial investments. The following strategies of risk management could be used by retail investors:

1. Portfolio Diversification: By investing in several asset classes and industries, diversification can assist investors prevent a sudden decline in portfolio value. If a stock, asset, or sector gets struck hard, another person may manage the portfolio. For instance, gold's value might have increased if the stock market saw a decline. As a result, if an investor parks some of their money in a gold ETF, their loss from the stock market's decline is offset by an increase in the fund's Net Asset Value (NAV).

Investors can diversify their portfolios using a variety of asset types, including shares, mutual funds, bonds, derivatives, commodities, bank and post office deposits, and commodities.

2. Lowering Portfolio Volatility: Volatility is the amount by which an asset's price deviates from the mean price, either upward or downward. The more an asset's price changes, the more volatile it is and riskier the security. Mutual funds that focus on the stock market and equity typically have a high volatility. An investor must lower the portfolio's volatility in order to control risk. Allocating a portion of the total to cash and cash equivalents will accomplish this. This will not only enable investors to profit from a market collapse by averaging their investments, but it will also protect them from losing money if they must sell their assets during a market slump. Depending on the investor, different amounts of cash should be kept on hand.

3. Consistency in Investment: Investors might benefit from the rupee-cost averaging method by making a recurring investment. When the market is down, this will enable

them to purchase more units of a security like shares or mutual funds. Investors can also average risk in this way. A consistent investing approach can assist investors in creating a solid corpus in accordance with their investment goals because markets often increase over an extended period of time.

- 4. Risk Analysis:** The goal of risk analysis is to locate and access the variables that might have an impact on investment returns. It enables a risk analysis and aids in determining whether to proceed with an investment decision. The investor can conduct a risk analysis utilizing data provided by the stockbroker, herding effects, or their own knowledge or study.
- 5. Stock Evaluation Technique:** Technical analysis and fundamental analysis are two methods for assessing securities. By attempting to calculate a security's intrinsic worth, fundamental analysis examines securities. It is built on the EIC framework, which considers the economy, industry, and company. It makes an effort to analyze the nation's overall economic situation, industrial conditions, and the core competencies and leadership of specific organizations. On the other hand, technical analysis is used to examine statistical patterns in the volume and price of the stock. Based on an analysis of previous price and volume data, it makes predictions about future price movement.
- 6. Risk Tolerance Capacity:** The maximum amount of loss an investor is willing to tolerate when making an investment is referred to as risk tolerance. Investors have different capacities for accepting risk. While some investors are willing to take on significant risk, others are not. Investors can be categorized as aggressive, moderate, or conservative depending on their capacity for risk. Investors that are aggressive are willing to take on a high level of risk, whereas moderate investors are less risk-averse than aggressive and conservative investors are the least risk-averse.

IV. CONCLUSION

The examination of retail investors' risk management tactics in the stock market concludes by emphasizing the critical need of careful consideration and readiness of the retail investor. Retail investors, who have little resources and experience, are subject to a variety of risks, from market volatility and economic uncertainty to risks related to a particular stock.

The results show that a well-rounded strategy is necessary for successful risk management among retail investors. The impact of any single unfavorable event can be minimized by spreading risk across a variety of assets and industry sectors through diversification. To further reduce emotional biases and rash decision-making, clear investment goals, risk tolerance limits, and adherence to disciplined portfolio management are essential.

Although there are many risk management techniques and financial instruments, the analysis emphasizes the value of education and expertise in enhancing investors' capacity to identify and manage risks successfully. Making wise investment decisions can be improved by actively learning new things and keeping up with industry trends and advancements.

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