Factors influencing the adoption of high risk financial products

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Abstract

Financial products act as an investment avenue and provide the required financial security to the investors based on the risk-return profile of the financial products. We looked at the effects of risks and risk factors on the adoption of financial products. A range of definitions were given on financial products, risks, risk factors, and financial risks, types of financial risks, factors influencing taking behaviour in financial products, types of risks, and factors contributing to high risk investments. The observation suggests that there is a large potential for efficiency gains in high risk investments compared to the investors who have enough knowledge on risks. And a small portion of investors is realized not have awareness about different types of risks and how risks can be managed, this results in risk diversification by risk takers and more return rewords are achieved leading to the economic development of the developing countries.

Key words: financial products, Risks, financial risks, types of risks, risk factors.

Introduction

Financial products perform as an investment Path and provide the necessary financial security to the investors based on the risk-return outline of the financial products. In the earlier period, traditional financial products were offered by government initiatives by Public Sector Banks (PSBs) (deposit account, credit account), Life Insurance Corporation, postal branches, and Saving Certificate. However, in current years with the increase of liberalization of financial services industry, a variety of financial products have been introduced through the contribution of private and foreign entities adding up to the public sector enterprises. These include products like debit and credit cards by banks, open-end and closed-end mutual fund schemes,, life and non-life insurance schemes. It further included shares and debt securities presented by different entities, investments which are mainly facilitated by the brokerage houses. This has led to increasing of competition through introduction of new and attractive products, regulatory initiatives and expansion in the investor support along with increased marketing performance in the financial sector.

Definition

Financial products are the products offered by banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, and some government sponsored enterprises.
Generally they involve every type of product where a consumer is putting his money and getting some product which involves the complexities of risk, return, volatility etc (**Shelagh and Heffernan, 2002).**

Types of high risk Financial Products

Mutual Funds: Are pools of money invested by an investment company in a number of securities like stocks, bonds, or government securities? Because most mutual funds invest in a large number of securities, they offer investors the benefit of diversification, which can help reduce market risk**. (Raghunandan, 2015**).

Stocks: Are financial instruments that signify an ownership position-referred to as equity-in a corporation**. (Serdar and Mats, 2014).**

Bonds: Are debt instruments, also considered loans, that an investor makes to a corporation, government, federal agency, or other organization in which the bond holder typically receives the amount of the face value of the bond on a future date, and regular interest payments (**Edwin et al, 2001).**

Systematic Investment Plans: is an increasingly rare type of financial product sold almost exclusively to members of the military. They allow you to accumulate shares of a mutual fund indirectly by making small regular monthly payments, but with high first-year costs **(Raghava and Sreenivasulu, 2015).**

Shares: These represent ownership of a company. While shares are initially issued by corporations to finance their business needs, they are subsequently bought and sold by individuals in the share market. They are associated with high risk and high returns. Returns on shares can be in the form of dividend payouts by the company or profits on the sale of shares in the stock market. Shares, stocks, equities and securities are words that are generally used interchangeably**. (Pushpa Bhatt, (2012).**

Options: Options are rights to buy and sell shares. An option holder does not actually purchase shares. Instead, he purchases the rights on the shares**. (Agnew, et al, 2003).**

Structured products:

Structured products are synthetic investment instruments specially created to meet specific needs that cannot be met from the standardized financial instruments available in the markets. Structured products can be used: as an alternative to a direct investment; as part of the asset allocation process to reduce risk exposure of a portfolio; or to utilize the current market trend. (Wallmeier **and Diethelm, 2009).**

And there are two main types of structured products.

Structured deposits:

Structured deposits are savings accounts, offered from time to time by some banks, building societies and National Savings & Investments, where the rate of interest you get depends on how the stock market index or other measure performs.

Structured investments:

Structured investments are commonly offered by insurance companies and banks. Your money typically buys two underlying investments, one to protect your capital and another to provide the bonus. The return you get depends on how the stock market index or other measure performs.

Venture Capital Trusts:

A venture capital trust is designed as a way for individual investors to gain access to venture capital investments via the capital markets. Its mandate is to seek out potential venture capital investments in small unlisted firms to generate higher than average risk-adjusted returns for its investors. Typically, they are bound by regulations to the percentage of funds that must be allocated to qualifying investments, or holdings, along with timelines for capital injection loans and investments outside of those held in said qualifying holdings. However, the majority of VCTs aim to invest a large majority of their funds with the goal of achieving higher risk-adjusted returns than other investments available in the market. (**Haritha et al, 2012).**

Spread betting:

Spread betting is a type of speculation that involves taking a **bet** on the price movement of a security. A spread betting company quotes two prices, the bid and offer price (also called the **spread**), and investors **bet** whether the price of the underlying stock will be lower than the bid or higher than the offer**. (Gander, 1998).** Spread betting is riskier than other types of investment.

Land banking

Land banking is an investment where you **buy a plot of land that hasn't been granted planning permission** – in the hope that, planning will be granted and the plot will significantly increase in value. (**Beresford et al, 2003).**

What is a Risk?

Risk can be referred as the chances of having an unexpected or negative outcome. Any action or activity that leads to loss of any type can be termed as risk. There are different types of risks that a firm might face and needs to overcome. Widely, risks can be classified into three types: Business Risk, Non-Business Risk and Financial Risk. (**Glyn Holton, 2004)**.

Types of Risks: Business Risk: These types of risks are taken by business enterprises themselves in order to maximize shareholder value and profits**.(Archie et al,2010).** As for example: Companies undertake high cost risks in marketing to launch new product in order to gain higher sales.

Non- Business Risk: These types of risks are not under the control of firms. Risks that arise out of political and economic imbalances can be termed as non-business risk**. (Nadia et al, 2015).**

Financial Risk: **According to Sunday et al, (2014)**.Financial Risk as the term suggests is the risk that involves financial loss to firms. Financial risk generally arises due to instability and losses in the financial market caused by movements in stock prices, currencies, interest rates and more.

Types of Financial Risks:

According to Narayan et al, (2013). Financial risk is one of the high-priority risk types for every business. Financial risk is caused due to market movements and market movements can include host of factors. Based on this, financial risk can be classified into various types such as Market Risk, Credit Risk, Liquidity Risk, Operational Risk and Legal Risk

Market Risk:

This type of risk arises due to movement in prices of financial instrument. Market risk can be classified as **Directional Risk** and **Non - Directional Risk**. Directional risk is caused due to movement in stock price, interest rates and more. Non- Directional risk on the other hand can be volatility risks. (**Mikael Bask, 2010).**

Credit Risk:

This type of risk arises when one fails to fulfil their obligations towards their counter parties. Credit risk can be classified into Sovereign Risk **and** Settlement Risk. Sovereign risk usually arises due to difficult foreign exchange policies. Settlement risk on the other hand arises when one party makes the payment while the other party fails to fulfil the obligations. **(Edward, 1998).**

Liquidity Risk:

This type of risk arises out of inability to execute transactions. Liquidity risk can be classified into Asset Liquidity Risk and Funding Liquidity Risk**.** Asset Liquidity risk arises either due to insufficient buyers or insufficient sellers against sell orders and buy orders respectively. (**Muhammad et al, 2011).**

Operational Risk:

This type of risk arises out of operational failures such as mismanagement or technical failures. Operational risk can be classified into **Fraud Risk** and **Model Risk**. Fraud risk arises due to lack of controls and Model risk arises due to incorrect model application. (**Izabela and Jonek, 2012).**

Legal Risk:

This type of financial risk arises out of legal constraints such as lawsuits. Whenever a company needs to face financial loses out of legal proceedings, it is legal risk.(**Angelo, 2007).**

Risk factor in financial products

Risk factor is a measurable characteristic or element, a change in which can affect the value of an asset, such as exchange rate, interest rate, and market price. All financial products carry a certain degree of risk. Even "low risk" investment strategies involve an element of uncertainty. The types of risk that might apply will depend on various matters, including how any relevant product instrument or service agreement is created or drafted. Different instruments involve different levels of exposure to risk. Risk factors may occur simultaneously and may compound each other resulting in an unpredictable effect on the value of any investment. The value of investments and the income from them can fall as well as rise and you might lose the original amount invested. Fluctuations in such value and income can result from factors such as market movements and variations in exchange rates. Past performance is not a reliable indicator of future. (**Maryam et al, 2013).**

High risk financial products

High risk financial products are the financial products in which investor can get high return associated with high loss. high risk financial products can carry high degree of risk when the investor takes high risk in his/her investments - meaning, there is a strong chance that he/she can lose a substantial amount (or all) of the investments..The potential benefit of high risk financial products is that, the investor can make diversification of investments in different financial products so that there is a chance that he can make a very high return on the investment as well. Investing comes with risks. Sometimes those risks are minimal, as is the case with treasury bonds, but other times, such as with stocks, options and commodities, the risk can be substantial. The more risk the investor is willing to take, the more potential for high returns. But great investors know that managing risk is more important than making a profit, and proper risk management is what leads to profitable investing. An Aggressive investor values maximizing returns and is willing to accept substantial risk. This investor believes maximizing long-term returns is more important than protecting principal. Some examples of the high risk financial products include Stocks, Money market investments, Mutual funds and Systematic Investment Plans. **(Raghava and Sreenivasulu, 2015).**

Medium risk financial products

Medium risk financial products are financial products where, a Moderate investor values reducing risks and enhancing returns equally. This investor is willing to accept modest risks to

seek higher long-term returns. A Moderate investor may endure a short-term loss of principal and lower degree of liquidity in exchange for long-term appreciation and Financial instruments with moderate risk have prices which are subjected to larger market fluctuations examples of medium risk financial products are like **stocks** and its types which are seen bellow, **Blue chip stocks**: a history of paying dividends in good times and bad.

Growth stocks: good potential for price appreciation because sales and earnings are growing faster than average.

Warrants: A warrant is an option to buy a security at a specified price for a specified period of time. tocks is very often defensive issues.

Rights: A right is an option to buy a new stock issue at a specified price for a specified period of time (on issuer terms). An investor who owns a stock when it goes ex-right automatically becomes a right holder (**Core, (1997**).

Low risk financial products.

Low risk financial products are nothing but financial products in which the investor has a low risk in the investments he can make. This means that the investor takes very low risk, so his investment which is considered to be relatively safe is not gaining any return reword. On the other hand, the downside of low risk investments is that he will also likely receive a very small return. Compared to the work done by the investor **Littlechild, (1970**). A few examples of low risk financial products include products like Insurance, Banking services and related investment products, credit cards, bonds, Treasury Bills**,** annuities and certificate of deposits**.(Shahid et al,2015).**.

Factors influencing risk taking behaviour in financial products

Financial Literacy: refers to the set of skills and knowledge that allows an individual to make informed and effective decisions through their understanding of finances. (**Hsu-Tong Deng, et al, 2013).**

.**Information a symmetry**: deals with the study of decisions in transactions where one party has more or better information than the other**. (Sowunmi et al, 2012).**

Accounting Information is that, it covers information used to prepare financial statements which report the results and financial position of a business to the decision makers (**Nneka et al, 2012).**

-**Perceived risk**: is considered to be a critical determinant in the consumer's willingness to adopt new products. (**Hirunyawipada and Paswan, 2006).**

The term "risk taking" refers to engaging in activities that have the potential to result in undesirable qualities but which also have a slim chance of resulting in positive outcomes (**Algambacorta & Marqués, 2010).**

Factors contributing to high risk investments

A high-risk investment is one where there is either a large percentage chance of loss of capital or underperformance, or a relatively small chance of a devastating loss on your investment time frame.

Risk capital

Risk capital is money available to invest or trade that will not affect your lifestyle if lost.**According to Shleifer and Vishny, (1992).** Risk Capital should be defined as liquid capital,

or capital that can easily be converted into cash. Available risk capital and your current net worth should be important considerations when determining investment risk tolerance. Net worth is simply your assets minus your liabilities. Therefore, an investor with a high net worth can assume more risk. The smaller the percentage of your overall net worth the investment or trade makes up, the more aggressive the risk tolerance can be.

Investment experience

When it comes to determining your risk tolerance, your level of investing experience must also be considered. Are you new to investing? Have you been investing for some time? It is prudent to begin new ventures with some degree of caution, and investing is no different. Aim to get some experience under your belt before committing too much capital. Always remember the old cliché and strive for preservation of capital, (**Grable1, 2014).**

Investment objectives

The investment objectives must also be considered when calculating how much risk can be assumed. If people are saving for their retirement, how much risk do they really want to take with those funds**? (Hull and White, 1998).**

The actual investments that are to be considered.

Different investments carry different levels of risk. All investments involve a degree of risk and returns can never be guaranteed so it is important to choose investments that suit your circumstances. (**Mehrdad, 2011).**

Options:

Options offer high rewards for investors trying to time the market. An investor who purchases options may purchase a stock or commodity equity at a specified price within a future date range. If the price of a security turns out to be not as desirable during the future dates as the investor originally predicted, he does not have to purchase or sell the option security. This form of investment is especially risky because it places time requirements on the purchase or sale of securities. Professional investors often discourage the practice of timing the market, and this is why options can be dangerous or rewarding. (**Hessam et al, 2011).**

Initial Public Offerings

According to **Brau et al, (2006).**They Argued Tha**t** Some initial public offerings, such as Box's in early 2015, attract a lot of attention that can skew valuations and the judgments professionals offer on short-term returns. Other IPOs are less high-profile and can offer investors a chance to purchase shares while a company is severely undervalued, leading to high short- and long-term returns once a correction in the valuation of the company occurs. IPOs are risky because, despite the efforts make by the company to disclose information to the public to obtain the green light on the IPO by the SEC, there is still a high degree of uncertainty as to whether a company's management will perform the necessary duties to propel the company forward.

Venture Capital

Memba et al, (2012). Suggested that the future of start-ups seeking investment from venture capitalists is particularly unstable and uncertain. Many start-ups fail, but a few gems are able to offer high-demand products and services that the public wants and needs. Even if a start-up’s product is desirable, poor management, poor marketing efforts and even a bad location can deter the success of a new company. Part of the risk of venture capital is the low transparency in management's perceived ability to carry out the necessary functions to support the business. Many start-ups are fuelled from great ideas by people who are not business-minded. Venture

capital investors need to do additional research to securely assess the viability of a brand new company.

Foreign Emerging Markets

A country experiencing an industrial revolution or a new political regime that encourages development can be an ideal investment opportunity, as it has been for China over the past ten years. Spurts in economic growth in countries are rare events that, though risky, can provide investors a slew of brand new companies to invest in to bolster personal portfolios. The greatest risk of emerging markets is that the period of extreme growth may last for a shorter amount of time than investors estimate, leading to discouraging performance. The political environment in countries experiencing economic booms can change suddenly and modify the free market or capitalist economy that previously supported quick growth. (**Kehl, 2007).**

REITs

According toAekkachai and Jiroj, (2012). Real estate investment trusts (REITs) offer investors high dividends in exchange for tax breaks from the government. The trusts invest in pools of commercial or residential real estate. Due to the underlying interest in real estate ventures, REITs are prone to swings based on developments in an overall economy, levels of interest rates and the current state of the real estate market, which is known to flourish or experience depression. The highly fluctuating nature of the real estate market causes REITs to be risky investments. Although the potential dividends from REITs can be high, there is also pronounced risk on the initial principal investment. REITs that offer the highest dividends of 10 to 15% are also at times the riskiest.

High Yield Bonds

Whether issued by a foreign government or high-debt company**,** high-yield bond**s** can offer investors outrageous returns in exchange for the potential loss of principal. These instruments can be particularly attractive when compared to the current bonds offered by a government in a low interest rate environment, (**Campbell and Glen, 2003).**Investors should be aware that a high-yield bond offering 15 to 20% may be junk, and the initial consideration that multiple instances of reinvestment will double a principal should be tested against the potential for a total loss of investment dollars. However, not all high-yield bonds fail, and this is why these bonds can potentially be lucrative.

Currency Trading

According to Neely and Weller (2011). Currency trading and investing may be best left to the professionals, as quick-paced changes in exchange rates offer a high-risk environment to sentimental traders and investors. Those investors who can handle the added pressures of currency trading should seek out the patterns of specific currencies before investing to curtail added risks. Currency markets are linked to one another, and it is a common practice to short one currency while going long on another to protect investments from additional losses. Trading on the forex market does not have the same margin requirements as the traditional stock market, which can be additionally risky for investors looking to further enhance gains.

Conclusion

From the observations made in different dimensions of risk factors that influencing the adoption of high risk financial products, a good number of investors are willing to take high risk in financial products ,because the more risk taken by investors the more return rewards are received. This means that if more investors get associated with high risk taking, more returns would be increased and more financial products would be invested in by different investors. This

will lead to increased economy of the country. Hence taking high risks by the investors within and outside the country will give a picture of investors to have a clear way of how they can manage risks in different dimensions of their investments. Resulting in development of financial and economic development in undeveloped and developing countries.

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