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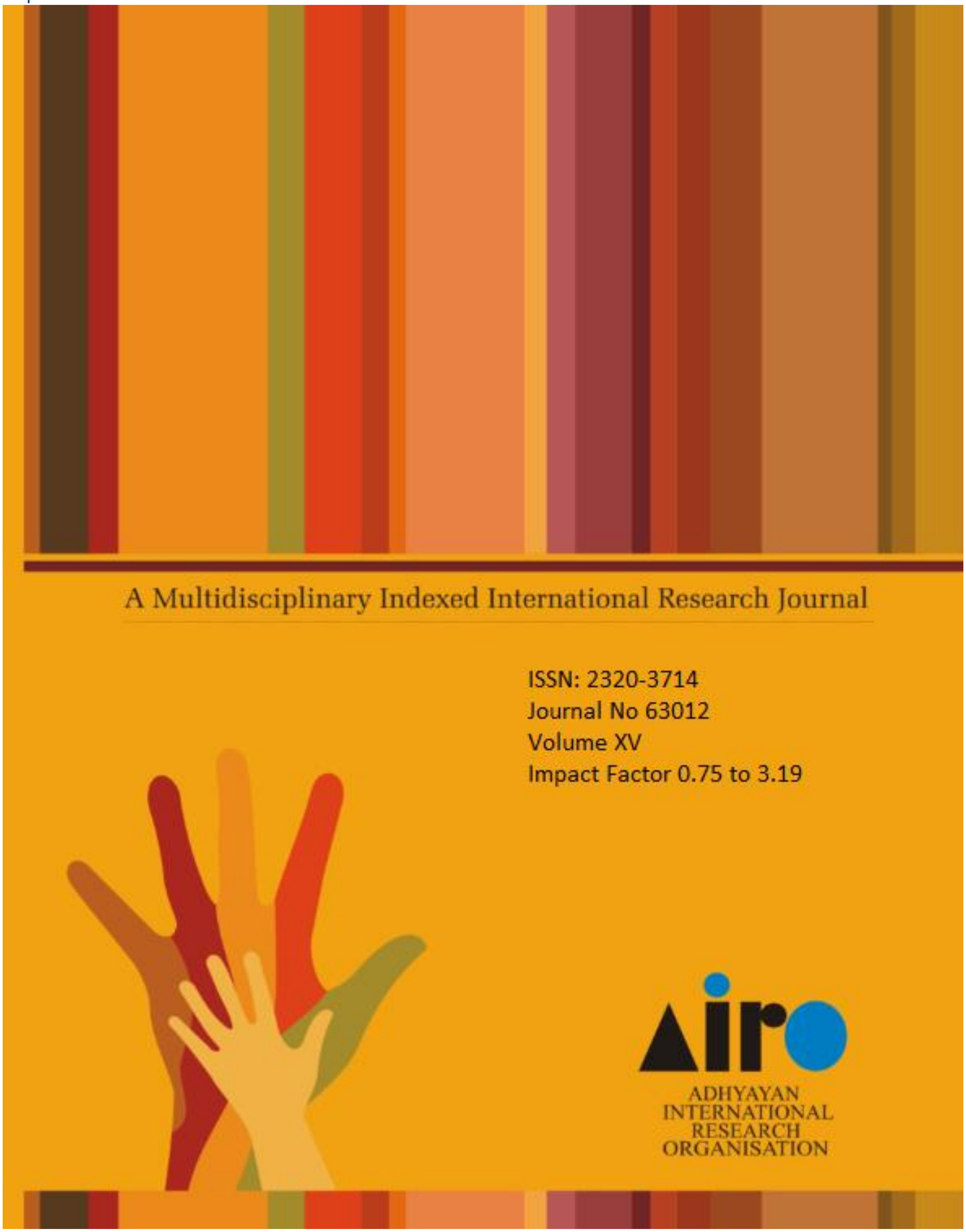

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NEED OF FINANCIAL ACCOUNTING IN COMPANIES

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ABSTRACT

Financial risks are those risks which emerge as a result of direct or indirect price fluctuation in the value of a company. Financial risk management is evolved as a result of interest rates, discontinuity in commodity price and volatility in foreign exchange rate. There are many risk factors which plays a major part in the success or failure of a business. Some of these associated risk factors are exposure of interest rates, change in exchange rates and lack of proper management etc. The financial price risk is transferred to other parties by enhancing the derivative tools so as to facilitate financial risk management. The current article highlights the implications of financial derivatives as risk management.

KEYWORDS: *Risk, Management, Financial, Derivatives*

INTRODUCTION

There are two approaches to implement financial risk management. First method is to implement a diversification planning in the businesses conducted by the organization and second method is the engagement of organizations in financial transactions. In the first approach, organizations are moved to financial markets which deal with the volatility of their earnings. Hence, many alternatives methods have been emerged for the financial markets to reduce volatility by investing directly. With the introduction of derivative markets, now it has become easier financial risks which are outside managerial control. Before the concept of derivative markets, there were some exchange traded derivatives; but they were not so much efficient that could control the risk factors. Derivative markets play a major role in managing the financial risk.

In practical, it seems consistent to use financial derivatives as risk management practices. It is observed that an organization can reduce the cash-flow volatility by hedging the associated financial risks such as commodity risk, interest rate and currency etc. Further, the value of expected future cash flow can be increased by reducing the expected financial costs.

Sufficient internal funds for future investment can be improved by minimizing the cash flow volatility. A risk management program can be operated with the help of flexible set-up cost. In some cases, it is found that a lot of organizations are not hedged at all after exposing to the financial risks. The major benefit of hedging programs is observed in organizations with large size.

In this competitive market, the environment of businesses and firms is found to be risky due to complexity, volatility and unpredictability. For the success of a business, the strategies related to risk factors of cost and resources have become significant with the analysis and measurement of risk management.

It is also observed that these financial derivatives play an important role in reducing the risk factors. In case of banks, financial derivatives are used as a tool of risk management to hedge on transactions of balance sheets by controlling the interest rates, exchange rates and commodity prices. These benefits of financial derivatives motivate an organization or firm to employ the financial derivatives as risk management so as to increase the efficiency of the firm/organization.

These financial derivatives are capable of determining the risk so that effective steps can be taken against the risk so that no external factor can influence the growth of the organization. Further, risk management can be used to influence the volatility of stock market.

REVIEW OF RELATED LITERATURE

Schindler et al. (2010) described that decision making is a complex process involving choosing a particular alternative among a number of possible courses of action after careful evaluation of each option.

Shleifer et al. (2010) specified that most crucial challenges to investors is to make investment decision having a difference in their profile like socio and economic factors, demographic factors, educational levels, age, gender etc.

Lintner, G. et al. (2012) pointed out that behavioral finance helps investors as well as market participants to understand biases and other psychological constraint they display in market. And critical issue is that market participant cannot behave rationally always, as they deviate from rationality and expected utility assumption while making investment decisions.

Barber et al. (2013) described that behavioral Finance equips Finance professionals with a magnified lens which allows them to scrutiny, understand and overcome many proven psychological traps that exist involving behavioral biases i.e. emotional biases and cognitive biases.

Shefrin et al. (2010) mentioned that behavioral trap exists across the board because of psychological influences of Heuristics & Biases. A financial market is a market in which people trade financial securities, commodities, and other fungible items of value at low transaction costs and at prices that reflect supply and demand.

Frankfurter et al. (2010) described that securities include stocks and bonds, and commodities include precious metals or agricultural goods. In Economics, typically, the term market means the aggregate of possible buyers and sellers of a certain good or service and the transactions between them.

Shefrin H et al. (2011) specified that the advocators of behavioral finance firmly believe that psychological factors influence investor's investment decisions. They defend that in today's economic scenario and investment decisions demand a better understanding of investor psychology or rather individual investor's behavioral biases.

NEED OF FINANCIAL ACOUNTING

The information regarding the risk factors associated with investment and transaction processes can be determined with the help of asset returns. Determination of the dynamics of volatility is important as the stock markets generally show high range of price volatility; resulting in unpredictable results.

Stock market has opened many ways for the common men to gain the profit by investing some amount. It is not necessary that an investor will get the profit every time. In some cases, he/she may have to suffer from some loss of money due to flexible nature of this stock market.

In stock market, the shares tend to increase or decrease with the changing circumstances. Sometimes, an investor needs some luck factor so as to earn profit from the stock market as the shares of any company can move from lower to higher within few hours.

It is observed that a person who invests money in the stock market for the longer duration; gets profit in most of the cases. Sometimes, an experienced person fails to predict the nature of share market due to its very flexible nature.

Also, some kinds of risk factors are associated with the stock market. With the help of financial derivatives, these risks are tried to cover so as to enhance the liquidity. These derivatives also tend to influence the stock market.

It is observed that the efficiency of stock markets can be increased by reducing the seasonality according to the mean returns. Also, in practical, it is noticed that the impact of future & opinion trading is negligible on the stock market volatility. There seems to be no relation between variables of trading activities and stock market volatility.

In case of Nifty index, no change in the volatility of stock market is observed but in some cases, the structure of volatility tends to change to some extent. It is also observed that the volatility tends to reduce with the introduction of future trading.

DISCUSSION

Before investing in market, an individual studies all the options available and compares the market value of stocks and finally, makes the decision of buying interested stock. It is noticed that the decision of buying stock after a deep decision process goes right and gains the profit.

In some cases, the investor could not get the expected profit and may suffer a loss due to flexibility in the nature of market. Investor studies what went wrong and why the decision does not go in favor. It is also suggested by the experts that one should invest in market for long duration to get the effective profit as the flexible in the market is so much that short term investments may cause some loss. No one also can't deny the luck factor of the investor in order to make profit from stock market.

Behavioral finance also studies the cognitive factors such as emotional and mental status of the individual in the process of decision making for investing. In most of the cases, it is observed that a confident person takes better decision as compared to confused one.

The educational qualification also plays an important role in the process of decision making. It is noticed that less qualified person shows inconsistency in good decisions whereas average or higher educators take their decisions wisely and a sense of consistency is found in their decisions. These little things are very crucial for individual's ability of decision making.

The branch of behavioral finance tends to understand the psychology of the investor and tries to understand the irrationality of the investors. Investors take the relevant information from the market experts and use their mind to take effective decisions.

Sometimes, investors are not able to realize the associated risk factors and pay the price for it. The use of business principles is also done by behavioral finance so as to understand the decision making process of investor. These days, the role of brain functioning of investor in financial decision is investigated.

It is also observed that the past experience of an individual in investing also influences the financial decisions. If a person invests in a particular stock and gets expected profit then psychologically, it increases the chances that the same investor will invest in the same stock next time and also suggest others in investing in that stock.

Behavioral finance studies the psychological, sociological and financial factors which can really influence the decision-making process of an individual.

CONCLUSION

To a greater extent Mental Accounting and Anchoring can help investor yield a satisfiable outcome. It is advisable for individual investors to take professional advice from Financial Planners and implement financial planning for their financial goals.

The psychological biases are not necessarily meant to make investors irrational but to know how investor processes the information and how they act on such information. An investor to be successful should understand his own investment psychology and it starts with recognizing and avoiding psychological biases from their own experiences and by setting of realistic and achievable objectives through a diversifiable portfolio and also consider all the mechanisms of financial market.

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