Meaning of Risk

Risk refers to the **possibility of loss or uncertainty in the expected return** from an investment or business decision. It arises because the future is uncertain and outcomes may differ from what is anticipated. In financial terms, risk means the **variability of actual returns from expected returns**. The higher the uncertainty, the greater is the risk. Risk is an unavoidable part of investment and business activities, as future events such as economic changes, market fluctuations, or firm-specific problems cannot be predicted with complete accuracy.

Difference between Systematic Risk and Unsystematic Risk

Risk can broadly be classified into **systematic risk** and **unsystematic risk** based on its nature and source.

Systematic Risk

Systematic risk is the type of risk that affects the **entire market or a large segment of the economy**. It arises due to factors that are **external and uncontrollable** by individual firms or investors. Since this risk influences all securities in the market, it **cannot be eliminated through diversification**.

Systematic risk occurs due to changes in macro-economic variables such as:

- Inflation
- Interest rate fluctuations
- Economic recession or depression
- Political instability
- Natural disasters
- Changes in government policies

Because systematic risk affects the whole market, even well-managed companies cannot escape its impact. For example, during an economic recession, most industries and businesses experience a decline in profits regardless of their internal efficiency.

Unsystematic Risk

Unsystematic risk is the type of risk that affects a **particular company or a specific industry**. It arises due to **internal factors** related to the firm or industry and is therefore **controllable to some extent**. Unlike systematic risk, unsystematic risk **can be reduced or eliminated through proper diversification** of investments.

Unsystematic risk arises due to factors such as:

- Poor management decisions
- Labor strikes

- Financial problems of a firm
- Failure of a new product
- Sudden loss of market share
- Industry-specific regulations

For example, if a company faces a labor strike, only that company or industry is affected, not the entire market. By investing in different companies and industries, an investor can minimize the impact of such risks.

Risk is the **possibility of loss or uncertainty** about the actual return or outcome of an investment. In simple words, it means the chance that the result may be different from what is expected—often worse.

Difference between Systematic Risk and Unsystematic Risk

Basis	Systematic Risk	Unsystematic Risk
Meaning	Risk that affects the **entire market or economy**	Risk that affects a **specific company or industry**
Nature	**Uncontrollable** by an individual investor	**Controllable** to some extent
Cause	Economic, political, social, or natural factors	Company-specific factors like strikes, poor management, or product failure
Impact	Affects **all securities** in the market	Affects **only particular securities**
Diversification	**Cannot be reduced** by diversification	**Can be reduced** by diversification
Examples	Inflation risk, interest rate risk, recession, war	Business risk, financial risk, management failure

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In short:

- **Systematic risk** = Market-wide risk (cannot be avoided)
- **Unsystematic risk** = Company-specific risk (can be reduced)

Conclusion

In conclusion, **systematic risk** is market-wide, unavoidable, and cannot be diversified away, whereas **unsystematic risk** is firm-specific and can be minimized through diversification. Understanding both types of risk helps investors and managers make better financial and investment decisions.