

FINANCIAL RISKS

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Abstract. *Financial risk is the chance of experiencing monetary loss due to uncertainty in economic activities and financial choices. In daily life, individuals encounter financial risk when investing money, borrowing or managing businesses. On a larger scale, corporations and governments are vulnerable to market fluctuations, inflation, and worldwide economic disruptions. This article discusses the concept of financial risk, its main types, real-life examples, sources, impacts and effective management strategies.*

Keywords. *Financial risk, uncertainty, market risk, credit risk, liquidity risk, operational risk, inflation risk, political risk, loss of savings, debt burden, bankruptcy, economic slowdown, risk management, diversification, hedging*

Financial risk is part of daily life and economic activity. When an individual invests money in shares, starts a small business or takes a mortgage, there is always a chance that the outcome will not meet expectations. Similarly, companies face uncertainty when expanding operations or entering new markets. The global financial crisis of 2008 showed how unmanaged financial risks can affect not only banks but also ordinary people through job losses and reduced incomes [2;89]. Therefore, understanding financial risk is essential for both personal and professional decision-making.

Financial risk can be defined as the probability that actual financial results will differ from planned or expected outcomes. For example, a farmer may expect high profits from a good harvest, but sudden price drops or weather problems can reduce income. In business, financial risk arises when costs increase unexpectedly or revenues decline [3;42]. Financial risk does not always lead to losses, but it creates uncertainty that must be carefully managed. Types of Financial Risks:

1. Market Risk is caused by changes in market prices such as interest rates, exchange rates and stock prices. For instance, if a company imports raw materials and the local currency weakens, the cost of imports increases, reducing profits. Individual investors also experience market risk when stock prices fall due to economic or political events [1;210].

2. Credit Risk occurs when borrowers fail to repay loans on time. A common real-life example is when a bank provides housing loans and some borrowers lose their jobs, making them unable to repay installments. As a result, banks may face financial losses and reduced lending capacity [4;77].

3. Liquidity Risk arises when an individual or organization lacks enough cash to meet short-term obligations. For example, a small business may have strong sales but still struggle to pay salaries because customers delay payments. Such situations are common during economic slowdowns [2;144].

4. Operational Risk comes from internal failures such as human error, fraud, or system breakdowns. A simple example is a bank system failure that prevents customers from accessing their accounts, damaging trust and causing financial losses. Cyberattacks have become a major source of operational risk in recent years [5;63].

5. Legal and Regulatory Risk comes from changes in laws or regulations that affect financial transactions. For example, new tax laws, environmental regulations or international sanctions.

6. Inflation Risk when money loses value over time due to rising prices. For instance, savings in a bank may not keep up with inflation, reducing real purchasing power.

7. Political or Geopolitical Risk is the risk from political instability, wars, or policy changes affecting economies. For example, currency devaluation due to government decisions or conflict.

Financial risk exists because the future is uncertain. People, businesses, and governments make decisions under incomplete information, and external factors (like market trends, natural disasters, or policy changes) can create unexpected losses. Essentially, risk is the price of uncertainty in financial life. Financial risks arise from both internal and external sources. Internal sources include weak management, poor financial planning, and lack of experience. External sources include inflation, changes in government policy, natural disasters and global economic crises. For example, sudden increases in fuel prices can raise transportation costs for businesses [3;98].

The impact of financial risks can be felt at different levels. For individuals, financial risk may result in loss of savings or increased debt. For businesses, it can lead to reduced profits, layoffs or even bankruptcy. At the national level, financial risks can cause economic instability and reduced public spending on health and education [1;305].

Financial risks can have significant impacts at multiple levels. On individuals, they can lead to loss of savings from declining investments, increased debt burdens due to poor credit management, reduced purchasing power from inflation or currency fluctuations, and emotional stress caused by financial uncertainty. On businesses, financial risks may reduce profits through market fluctuations or operational failures, create cash flow problems that hinder payments to suppliers and employees, increase the likelihood of bankruptcy without proper risk management, and damage reputation, undermining investor and customer trust. On the economy, widespread financial risks can slow economic growth by reducing investment and consumption, trigger financial crises such as banking collapses or stock market crashes and increase unemployment due to business failures or cost-cutting measures. Overall, financial risks can undermine stability, wealth, and confidence across individuals, businesses, and the broader economy. The impact depends on the type and scale of risk, but in general, financial risks can lead to loss of wealth, reduced stability and economic uncertainty.

Financial risk management is the process of identifying, assessing, and mitigating potential financial risks to minimize their negative impact on individuals, businesses, or the economy. It involves analyzing different types of risks - such as market, credit, liquidity, operational and inflation risks - and implementing strategies to control them, including

diversification of investments, purchasing insurance, setting credit limits, hedging with financial instruments and maintaining adequate cash reserves. Effective financial risk management helps ensure stability, protect assets, maintain profitability and enhance decision-making, allowing organizations and individuals to operate confidently despite uncertainties in financial markets and economic conditions. For example, individuals reduce risk by saving money in different assets, while businesses diversify suppliers and markets [4;156].

Common risk management techniques include diversification, insurance, hedging, and maintaining emergency funds. Regular monitoring of financial performance helps organizations respond quickly to unexpected changes [5;121].

Financial risks cannot be completely avoided, but they can be handled efficiently. Practical experiences demonstrate that people and organizations who anticipate risks and understand their potential impact are more equipped to face uncertainties. Proper financial risk management promotes economic stability, fosters sustainable growth and ensures long-term financial security.

References

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