

WHAT DO YOU UNDERSTAND BY EXTERNAL RISK? EXPLAIN

INTRODUCTION

Risk is the possibility of loss or uncertainty regarding the outcome of a decision or activity. In business and finance, risks are generally classified into **internal risks** and **external risks**. External risk is one of the most important types of risk because it arises from factors outside the control of an organization.

MEANING OF EXTERNAL RISK

External risk refers to the risk that arises due to external factors or forces that are beyond the control of a business organization. These risks originate from the external environment and cannot be controlled or prevented completely by management.

In simple words, external risk is the uncertainty caused by outside factors such as economic changes, political instability, natural disasters, legal changes, or market competition.

FEATURES OF EXTERNAL RISK

1. It arises from outside the organization.
 2. It is uncontrollable in nature.
 3. It affects all firms operating in a similar environment.
 4. It creates uncertainty in business operations.
 5. It may have both short-term and long-term impact.
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TYPES OF EXTERNAL RISK

External risks can be classified into various categories:

1. Economic Risk

Economic risk arises due to changes in the overall economy of a country or the world. It includes:

- Inflation
- Recession
- Interest rate changes
- Exchange rate fluctuations
- Unemployment

For example, during the global financial crisis of 2008, many businesses across the world suffered losses due to economic slowdown.

2. Political Risk

Political risk arises due to changes in government policies, political instability, wars, or international conflicts. Examples include:

- Change in taxation policy
- Trade restrictions
- Nationalization
- Political unrest

Businesses operating in different countries are highly exposed to political risk.

3. Legal and Regulatory Risk

Legal risk occurs due to changes in laws and regulations. Governments may introduce new rules regarding:

- Environmental protection
- Labor laws
- Taxation
- Consumer protection

Compliance with new laws may increase operating costs.

4. Natural Risk (Environmental Risk)

Natural risks arise due to natural disasters such as:

- Earthquakes
- Floods
- Cyclones
- Droughts
- Pandemics

For instance, the global outbreak of COVID-19 severely affected businesses worldwide by disrupting supply chains and reducing demand.

5. Technological Risk

Technological risk occurs when rapid technological changes make existing products or services obsolete. Companies that fail to adapt to new technology may lose market share.

For example, traditional camera companies were heavily affected when digital technology and smartphones replaced film cameras.

6. Market Risk

Market risk refers to the risk arising from changes in market conditions such as:

- Demand fluctuations
- Changes in consumer preferences
- Intense competition
- Price changes

Market risk directly affects sales and profitability.

7. Social and Cultural Risk

Changes in social trends, lifestyles, and cultural values may influence consumer behavior. Businesses must adapt to changing social expectations to remain competitive.

IMPACT OF EXTERNAL RISK ON BUSINESS

External risks can have several consequences:

1. Reduction in sales and profits
2. Increase in operating costs
3. Business uncertainty
4. Disruption of supply chain
5. Financial instability
6. Loss of market reputation

Sometimes external risks may lead to business closure if not properly managed.

METHODS TO MANAGE EXTERNAL RISK

Although external risks cannot be controlled completely, businesses can reduce their impact through:

1. Risk diversification
2. Insurance coverage
3. Strategic planning
4. Market research
5. Maintaining emergency funds
6. Flexible business models
7. Compliance with regulations

Proper risk management helps in minimizing losses.

DIFFERENCE BETWEEN INTERNAL AND EXTERNAL RISK

Basis	Internal Risk	External Risk
Source	Arises within the organization	Arises outside the organization

Basis	Internal Risk	External Risk
Control	Can be controlled by management	Cannot be controlled fully
Examples	Employee fraud, machine breakdown	Inflation, political instability

External risk refers to the uncertainty arising from factors outside the control of a business organization. These risks include economic, political, legal, natural, technological, and market risks. Although external risks cannot be completely eliminated, proper planning, diversification, and risk management strategies can reduce their adverse effects. Understanding external risk is essential for business survival and long-term success in a dynamic environment