Risk and Return

Most of us take some risk every day. Our personalities determine how much of a risk-taker we are. However, we know that 'risk' can lead to either good (positive) or bad (negative) results, so we weigh up what might happen – what the consequences may be - and then make a judgement. Everyone's different, so you should make informed decisions based on what's best for you.

Financial decisions can be risky, so we need to thoroughly research beforehand, and then plan carefully. Here are some of the financial risks that adults sometimes take:

Lending and borrowing money

- If you borrow money, there's a risk that you won't be able to pay it back. If you lend money, you risk it not being returned to you. This can lead to major arguments, particularly if the money has been borrowed from friends or family members.
- When you sign a contract to borrow money from a financial organisation, you will have to pay back additional money in the form of interest, as well as the amount you borrowed.
- Some companies charge higher rates of interest than others and it's important to shop around, read the terms and conditions and plan your repayments carefully. You may also be charged a higher rate of interest if the lender thinks there is a risk of you not paying back the money (e.g. if you are self-employed, don't have a permanent address or are nearing retirement). Such organisations have specialists who calculate the risk.

Types of interest rates

- Whether you are borrowing or saving money, it's important to consider the interest rates.
- Interest rates differ from place to place and can also move up or down; something that looks good now may not be if rates alter, so choosing a mortgage/loan can involve risk.
- Rates can be 'fixed', which means you are offered the same rate for a certain period of time. They can also be 'variable' or 'tracker' rates, which rise and fall according to the base rate set by the Bank of England. So, for example, if you take out a mortgage with a fixed rate for two years and rates rise, you will pay less than you would have done with a variable rate. However, if rates fall, you still have to pay the higher rate that you agreed to.
- With any account or loan, it's important to read the terms and conditions and make sure they are suitable for you. For example, some accounts offer high interest rates but you may have to leave your money in the account for a year or more and lose all the interest if you take it out early.

Investment and the Stock Market

- A major form of financial risk-taking is investing on the stock market, where shares in businesses and organisations are bought and sold.
- Investors buy the shares in the hope that the company will make lots of profit, pay a 'dividend' or cash income, and its shares will increase in value.
- Investing money in a business can be risky, as the company may do poorly with investors losing some or all of their money. It is important to research a business thoroughly before putting money into it in order for you to calculate your Return on Investment (ROI). This calculation is done by dividing the return benefit by the cost of the investment.

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Risk and Return cont'd

Gambling

- Gambling is really paying out money in the hope of making a lot more money.
- Forms of gambling range from buying a lottery ticket or scratchcard, playing fruit machines, betting on horseracing or the football pools, to playing in a casino.
- Gambling can be addictive and people can lose a great deal of money or even their house and possessions.

Insurance

- Deciding whether or not to take out insurance is another form of risk taking. If you decide not to take it out, you could end up being hit with a very expensive bill and having to pay out a lot all at once to replace something.
- But you may end up paying out just as much in insurance payments…and you may never need to claim the insurance. (See Fact Sheet FC2 - Insurance for more information about insurance.)