

A COMPREHENSIVE STUDY OF RISK AND RETURN ANALYSIS IN SMALL-CAP COMPANIES

Denson Jonal Crasta¹

¹Sahyadri College of Engineering and Management, Mangalore

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ABSTRACT

This research provides a comprehensive analysis of the risk and return dynamics associated with small-cap companies, a sector known for its high potential returns and significant volatility. Through empirical analysis of selected small-cap companies, the study examines the relationship between risk and return, portfolio strategies, and the impact of economic factors. The findings highlight the complexities of small-cap investing and offer practical insights for investors to make informed decisions, aiming to achieve a well-optimized and efficient investment portfolio.

Keywords- Small-Cap Companies, Risk and Return, Investment Portfolio, Economic Factors, Market Volatility

1. INTRODUCTION

The financial environment is always evolving, and investors constantly seek innovative ways to balance risk and return. Small-cap companies present a unique investment opportunity with their significant growth potential and inherent volatility. This study aims to provide an in-depth analysis of the risk and return characteristics of small-cap companies, with a focus on specific firms within this market segment.

1.1 Background

Small-cap companies, characterized by their smaller market capitalizations, offer high growth potential but come with increased risks such as higher price fluctuations and liquidity challenges. Understanding the risk-return trade-off is crucial for investors seeking to diversify their portfolios and achieve higher growth opportunities.

1.2 Objectives

The objectives of this study are:

- To analyze the risk and return profiles of selected small-cap companies.
- To understand the relationship between risk and return in these companies.
- To identify efficient portfolio strategies that balance risk and return.

1.3 Scope

This study is relevant for financial advisors, portfolio managers, individual investors, and financial institutions interested in small-cap investments. The insights provided can help in building effective portfolios and making informed investment decisions.

2. LITERATURE REVIEW

The literature review explores previous studies on risk and return analysis, focusing on mutual funds, equity-based investments, and small-cap stocks. Key studies include:

- **Sharma and Tripathi (2023):** Analyzed the performance and risk characteristics of Indian mutual funds, emphasizing the importance of understanding risk metrics like Sharpe Ratio and Jensen's Alpha.
- **Bhuva and Bantwa (2020):** Examined the performance of large and mid-cap mutual funds, highlighting the correlation between high risk and high returns.
- **Patjoshi and Nandini:** Investigated risk and return dynamics of equity-based mutual funds in India, emphasizing the significance of understanding market connections.

These studies provide a foundation for understanding the complexities of small-cap investing and the need for a balanced approach that considers both potential rewards and inherent risks.

3. RESEARCH DESIGN

The research design includes a detailed analysis of the selected small-cap companies, focusing on their risk and return profiles.

3.1 Data Collection

Primary data for this study is sourced from reputable financial sources such as NSE, BSE, and other market data providers. The data includes historical stock prices, returns, trading volumes, and market indices. Financial statements,

annual reports, and analyst reports are also reviewed to obtain comprehensive information on each company's financial performance.

3.2 Methodology

The study employs various financial metrics and statistical tools to analyze risk and return. These include standard deviation, beta, Sharpe Ratio, and regression analysis. The analysis aims to identify the risk-return characteristics of each company and construct an optimal portfolio using techniques like Markowitz Mean-Variance Optimization.

4. DATA ANALYSIS AND INTERPRETATION

The data analysis section provides a detailed examination of the risk and return profiles of the selected small-cap companies. Key metrics such as average return, standard deviation, beta, and Sharpe Ratio are calculated for each company.

4.1 Exide Industries Limited

- **Risk-Free Rate:** 0.6963%
- **Average Return:** 1.31%
- **Market Return:** 1.05%
- **Standard Deviation:** 0.0868
- **Beta:** 0.8280
- **Sharpe Ratio:** 0.0704
- **Jensen's Alpha:** -0.0094
- **Treynor Ratio:** 0.0074

4.2 Blue Star Limited

- **Risk-Free Rate:** 0.6963%
- **Average Return:** 1.09%
- **Market Return:** 1.05%
- **Standard Deviation:** 0.0796
- **Beta:** 0.7401
- **Sharpe Ratio:** 0.0682
- **Jensen's Alpha:** -0.0061
- **Treynor Ratio:** 0.0065

The analysis continues for the other selected companies, providing insights into their risk and return dynamics.

5. FINDINGS, SUGGESTIONS, AND CONCLUSION

The findings highlight the significant performance variance among small-cap companies and their sensitivity to economic cycles and investor sentiment. Key suggestions include:

- **Diversification:** Building a well-diversified portfolio to mitigate unsystematic risk.
- **Risk Management:** Implementing strategic risk management techniques such as stop-loss orders and periodic portfolio reviews.
- **Long-Term Strategy:** Focusing on long-term investment strategies to ride through short-term volatility and capitalize on growth potential.

The study concludes that small-cap investing can be highly rewarding but requires a balanced approach to manage the associated risks effectively.

6. REFERENCES

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