

EXPOSURE TO AND MANAGEMENT OF FINANCIAL RISKS OF YOUNG ENTREPRENEURS⁹⁴

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Abstract

Young people from 18 to 35 represent the basic lever of the development of every society. Their self-employment and entrepreneurship are of particular importance for poor countries and the countries in post-transitional period. The entrepreneurship of the young people is permeated by a large number of challenges. The most important challenges are the method of financing and financial risks in business. The research aim of this paper is inquiring of the exposure to financial risks with the aim of their minimization by adequate management. So as to gain the aim that is set in the paper, we are researching the exposure of young entrepreneurs to the financial risks, the sources of finance of young entrepreneurs, theoretical framework of risk management and quantitative approaches to the financial risk management.

Keywords: entrepreneurship, financial risks, management, market, young entrepreneurship

EXPOSURE TO AND MANAGEMENT OF FINANCIAL RISKS OF YOUNG ENTREPRENEURS

The data on proactive social engagement of the young people in Serbia, but also in the countries in the region, are devastating. The young people between 15 and 30 fall under the category of the most unemployed

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population. In Serbia, according to the data of the Statistical Office of the Republic of Serbia, the young people have got the highest rate of unemployment. According to the research of the position and needs of the young people in Serbia by the Ministry of Youth and Sports the hopelessness of the young people increases, so more than three-fifths of them, mainly highly-educated, believes that there are no prospects in Serbia, while only 10.1% believes that there are.⁹⁵ By the same research, the data have been obtained that the young people in Serbia see the opportunity abroad (63.5%), and as the greatest problem stands out the problem of unemployment (57.7%). The best way of solving this problem and other social problems is stimulating of the entrepreneurship. However, the entrepreneurship in Serbia, comparatively speaking, is insufficiently present among young people and often hampered by barriers from which the most important are those of financial nature. (Njegomir, 2015).

According to Richard Cantillon, the entrepreneurs are individuals that accept the risk and deploy the resources so as to maximize the financial result by using the available options. (Cantillon, 1931) Schumpeter defined the entrepreneurship in the context of development of new products or services, the development of new methods of production, identification of new segments and market, identification of different sources of offer and development of different forms of organizations (Schumpeter, 1934). Entrepreneurship essentially represents the identification of opportunities and the realization of useful ideas into practice (Acs, 2006). The tasks that require such behaviour can be fulfilled individually or in group and usually require creativity, enterprise and readiness for taking risk.

EXPOSURE OF THE YOUNG ENTREPRENEURS TO FINANCIAL RISKS

Investment in any financial instrument, and/or the form of assets is motivated by the expectation of the investor to achieve a certain yield. The yield, however, can be, but it does not have to be realized, as it can be higher or lower than the expected. The expected yield is not always certain: in other words, the investor faces with the risk that his/her investment will not give the result in accordance with his/her expectations and assumptions which have been the starting point for investment, and/or the circumstances that the investor has taken into consideration while investing.

If we call the instability of cash yields the financial risk, then the factors of that risk can be grouped in several categories: market risk, credit risk,

⁹⁵ The research on the position and needs of the young people, the Ministry of Youth and Sports of the Republic of Serbia, Belgrade, 2013.

liquidity risk, operational risk, legal regulatory risk, business risk, strategic risk and the risk of reputation.

Market risk represents the changes in market prices and ratio of exchange, which leads to reduction of value of financial assets of the portfolio. Market risk can further be decomposed in its four main forms as follows: risk of interest rate, equity price risk, risk of foreign exchange and risk of changes in commodity prices. Interest-rate risk is the risk that appears when the securities lose their value due to the increasing of market interest rate. Equity price risk is the risk that binds to the instability of the price of common shares and which can be conditioned by the activity of macroeconomic factors (systemic risk) or business of the company (individual risk). Foreign exchange risk is undesirable change of parity of foreign currencies in regard to domestic currency, which can cause significant losses in foreign trade transactions. Commodity price risk is conditioned by the ratio of supply and demand, but also by some other factors such as: the season, type of commodity, way of transport and storage, etc.

Credit risk is the risk of change of credit ability of the client (buyer), which can influence on the change of the value of financial assets of the creditor. Forms of this risk are manifested in inability to fulfill payment obligations or inability of fulfilment of the part of the obligation (as a mild form).

Liquidity risk implies deterioration or inability of the company to pay off one's obligations or inability to collect one's claims.

Operational risk is specific type of financial risk that refers to potential losses of value due to inadequate organization, poor management, wrong control, frauds, thefts and other mistakes. Operational risk implies: internal frauds (false data, stealing), external frauds (robbery), inadequate engagement of the employed (false sick leave), improper relationship with the clients, damages due to force majeure, technical problems (power cut, failure of telecommunications connections), executive problems (wrong data, incomplete documentation and the like.).

Legal and regulatory risk is the name for the risks connected to disregard or change of legal norms. Typical example is the conclusion of illegal business agreements, long litigations with the aim of non-performance of the contractual obligations or the changes of tax laws.

Business risk implies overcoming of uncertainty concerning the movement of market demand, overcoming of optimal level of market prices, the costs of production, storage and delivery of goods and other.

Under strategic risk we imply the risk of large investments where there is the risk concerning success and profitability. New dimension of risk is the

reputation risk that has become important after great accounting scandals at the end of twentieth century (Enron, Parmalat).

THE SOURCES OF FINANCIAL RESOURCES OF YOUNG ENTREPRENEURS

The researches in Serbia show that the entrepreneurs from non-bank sources of financing mostly use state aid (70%), then micro financing by non-bank entities (11.7%), help of friends and family (10%), business angels (5%) and lastly, the risk capital (3.3%). In the following presentations, we point to the most important sources of finance. Firstly, one's own sources of finance are considered and then the external that can be on the commercial basis or of the state. (Erić, 2012)

The most important sources are individual savings and the savings of family and friends. It is about the property that the owner or the owners possess before the beginning of the business. Investing of one's own savings, the personal property of the owner turns into the founding capital of the business entity. The owner's own resources and of his/her families are usually permanently connected to business of the business entity. The return of invested capital in the form of founding capital is possible only under the condition that there comes to the bankruptcy of business entity and while bankruptcy after the payout of all the creditors. However, this does not mean that the owners will not restore the invested capital in indirect way through the earnings from the business of business entity. The owner's own resources and of his/her families have got a number of advantages, but also the disadvantages. These advantages include absence of dependence on investors, minimizing the indebtedness and increasing one's own solvency and increasing the credit ability. If there are more owners, the dispersion of risk is realized except additional capital of course, with the price of losing exclusive property. The greatest disadvantages of using one's own resources are opportunity costs, and/or the costs of the lost chance that the owner with his/her own resources realizes higher yield by alternative investment in bank or other business venture, as well as the limitation of these resources for complete growth and the development of business entity.

Table 1: The sources of finance of small and medium-sized enterprises by the stages of life circle.

Type SME	The initial phase	The phase of growth	The phase of maturity
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The enterprises with small potential for growth	<ul style="list-style-type: none"> • individual savings, • equity in real estate, • savings of family and friends, • state aid, • loans of commercial banks 	<ul style="list-style-type: none"> • factoring, • leasing, • commercial loans, • bank loans 	<ul style="list-style-type: none"> • undistributed profit, • bank loans
The enterprises with moderate potential for growth and the enterprises with the potential for rapid growth	<ul style="list-style-type: none"> • individual savings, • the savings of family and friends, • business angels, • risk capitalists, • corporate investments 	<ul style="list-style-type: none"> • risk capitalists, • private offering of shares, • public offering of shares, • bank loans, • corporate investments 	<ul style="list-style-type: none"> • corporations, • bank loans, • bond funds with high yield, • pension funds, • initial public offering of shares

Source: Erić, D.D. et al: Financing of small and medium-sized enterprises in Serbia, Privredna komora Srbije, Beograd, 2012., p. 44

Except one's own savings, the savings of family and friends, the most important sources of financial resources of young entrepreneurs are of the state. Namely, there are numerous funds that finance the entrepreneurs and entrepreneurs-beginners on the basis of different criteria. The important sources are National agency for regional growth, the Ministry responsible for scientific activity and technological development, the National Employment Service, whose resources are available in case that a potential entrepreneur has previously had regular employment, financial support to the export, the Development Fund of AP of Vojvodina and the Guarantee Fund of AP of Vojvodina. The most significant resources to the entrepreneurs and entrepreneurs-beginners are granted by Development Fund of Serbia. The criteria for the estimation of investment programmes, the conditions of using the fund resources with specified minimal and maximum amounts, deadlines, interest rates and procedures for granting loans as well as other

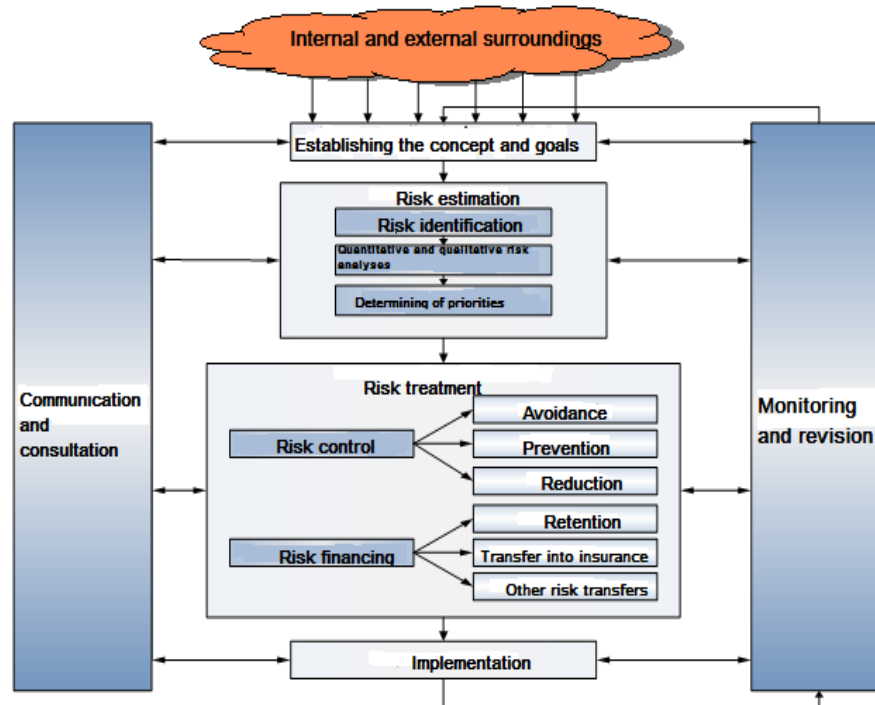
important conditions are regulated by annual Fund Programme that is the key starting point for entrepreneurs, small and medium-sized enterprises on their way to securing financial resources from the Fund.

THEORETICAL FRAMEWORK OF RISK MANAGEMENT

Risk management as a process consists of several steps: 1) establishing goals and context of risk management, 2) estimation of risk (includes identification, quantitative and qualitative estimation and prioritization), 3) treatment of risk (includes) risk control - avoidance, prevention and reduction, and b) risk financing - retention, transfer into insurance and other risk transfers) and 4) implementation. (Njegomir, 2011).

Risk management has recently been treated more as profit centre that provides the improvement of business because one starts from fundamentally different attitude according to which the risk can have positive and negative influence on business performances. Namely, variability is not necessarily bad unless the company becomes more competitive. The process of risk management has been shown by Picture 1.

Picture 1: The process of risk management



Source: Njegomir, V.: *Osiguranje (Insurance)*, *Ortomedics book*, Novi Sad, 2011., p. 39

QUANTITATIVE APPROACHES TO FINANCIAL RISK MANAGEMENT

Market portfolio is diversified portfolio at the most and it contains only the risk that cannot be eliminated by the diversification. The question arises how the risk of investment in market portfolio brings greater yield in relation to holding non-risk financial instruments. In answering to these questions, the theory has used the construction of the model of measuring the yield and risk in the context of portfolio theory. Model that measures the ratio of risk and yields of financial instruments starting from market portfolio is called Capital Asset Pricing Model - CAPM).

CAPM assumes the optimal portfolio where the investor with the aversion towards the risk combines the market portfolio with non-risk portfolio. Every investor holds (in specific proportion which suits his/her

preferences) the market portfolio. Investors that have the aversion towards the risk expects that the yield of market portfolio $E(RM)$ be higher than the yield of non-risk financial instrument (RF) for the amount - of premium which will correspond to the risk of holding of market portfolio. The difference between expected yield of market portfolio and non-risk yield is called market price of risk $E(RM) - RF$.

Tilt right that is represented by the expression (Krneta, 2006)

$$(E(RM) - RF) / \delta M$$

where δM (represents the risk of market portfolio) expresses for how many percents the investor will be awarded above non-risk yield for each 1% of taken risk.

Market price of risk enables that the expected yield of efficient portfolio J be represented by the following expression:

$$E(RJ) = RF + [(E(RM) - RF) / \delta M] \delta J = RF + \lambda \delta J$$

where

δJ - is the risk of efficient portfolio J

λ - market risk price.

Stated equation of straight line for expected yield of efficient portfolio represents CML (Capital Market Line). Expected yield of efficient portfolio consists of two components: the first, which represents the yield on non-risk investments and the second, the yield as the award for taken risk of risk investment alternative, i.e. the premium of risk. The premium of risk represents the product of market price of risk λ and the risk that corresponds to efficient portfolio δJ . From this expression it is noticed that the expected yield depends only on one component of risk that cannot be eliminated by diversification.

The theory has defined the expected yield of individual investment (securities) or every other inefficient investment portfolio. The expression for expected yield of every inefficient portfolio is called SML (Security Market Line):

$$E(RA) = RF + \lambda \delta A \rho_{AM}$$

where

RF - is the rate of non-risk yield

$E(RA)$ - expected yield of the share A

δA - total risk of the share A

ρ_{AM} - coefficient of correlation of the share A and market portfolio M

Expected yield consists of two components: non-risk yield and premium on risk. Premium on risk is the product of the market price of risk λ and the risk of the share A that further can be diversified ($\delta A \rho_{AM}$), and/or systemic risk that is in the share A. It means that the market does not secure the

premium on total risk of the share A (δA) but only on the part of systemic risk that is in the share A ($\delta A \rho_{AM}$).

Values δA , δM , ρ_{AM} represent the variability of yield of the share A (risk), variability of market portfolio M (market risk) and mutual correlation between the share A and the market. So as to facilitate the calculation of expected yield of the share A, beta coefficient of the share A has been introduced, which mathematically represents its covariance in relation to market portfolio, divided with covariance of market portfolio. Beta coefficient is defined by the expression:

$$\beta A = (\delta A * \rho_{AM}) / \delta M$$

In other words, beta coefficient of the share A is equal to the quotient of systemic risk of the share A and the risk of market portfolio that consists of only systemic risk, i.e. systemic market risk. It is the measurement of systemic risk and expresses the risk of financial instrument in relation to the market risk. If beta coefficient for some share is less than 1, then that share is less risky than the market as a whole. If, for example, for some share beta is equal to 0.9 and if the risk of the market is increased for 1%, the risk of that share will increase for 0.9%. If for this coefficient for some share is equal to one, that share is risky as the market is risky as a whole. If beta is greater than one, observed share is more risky than the market portfolio.

ASSUMPTIONS AND DATA FOR THE RESEARCH OF THE MARKET MOVEMENTS

The research of the stability of the beta coefficient depending on the market trend direction includes the period of exactly five years from 09.01.2006 – 31.12.2010. For the said period, there is available series of data for 1258 trading days which represents reliable statistical basis. All data on the index values and stock prices, daily returns, as well as other data related to trading, are downloaded from the website of the Belgrade Stock Exchange www.belex.rs. In the said five-year period, the capital market in Serbia has had three clearly differentiated different trends, in accordance with the movement of all developing markets in the region. The periods are determined on the basis of the extreme values of the index Belexline and are stated in the table 1.

The movement of the index Belexline and Belex15 in the period of 2006 - 2011 is shown in picture 2, and the basic data on the realized turnover, number of stock transactions and the movement of the index value of the Belgrade Stock Exchange are presented by years in the table 2.

Table 2. The period of analysis with the characteristics of the trend of growth, decline and consolidation

	PERIOD	NUMBER OF DAYS	TREND
I Period	9.01.2006 - 3.05.2007	327	GROWTH
II Period	4.05.2007 - 1.04.2009	87	DECLINE
III Period	2.04.2009 - 31.12.2010	44	CONSOLIDATION



Picture 2. The movement of the index BELEXline and Belex15 in the period of 2006 - 2010.

The first sub-period, and/or in the second half of 2006 and in the first quarter of 2007, is characteristic not only for the Belgrade Stock Exchange, but for all markets in the region, as marked increasing. Both indices have at the same time achieved their historical maximum value on 03.05.2007. As the first sub-period is characterized by extremely strong increasing trend, so the second sub-period (from 30.05.2007 to 01.04.2009) has had strong downward trend. The market fall lasted until April 2009, after which the recovery followed in the third period and the period of consolidation where

the indices moved in relatively narrow range. It is noticeable that after achievement of maximum values of the Belgrade Stock Exchange there followed the period with constant decrease of turnover and transactions. The index Belex15 realized its minimum value of 354 points on 11.03.2009, after which on 1.04.2009 the index Belexline realized its historical minimum value of 842 points. In 2010 and despite the further decrease in stock transaction, a larger number of transactions is expressed, as a result of inclusion of Naftna industrija Srbije (NIS) into the capital market. NIS is the first company whose shares about 4.8 million citizens received free. They are started to be traded on the market from August 2010, however, neither such company did stimulate more significant interest of investors in trading on the Belgrade Stock Exchange.

The index values and stock price at the beginning and at the end of each of three analysed trends within five-year period and the returns at some periods are presented in the table 3. The value of the market capitalization is stated at the same time on 21.01.2011 at average effective rate EUR/RSD of 104,9470 din/euro. The shares split has been made in this period in the company Tigar, Privredna banka and Sojaprotein at 1:10, 1:20, and 1:5 and that in October 2000, and/or in June 2007 and in January 2008, respectively.

The stock liquidity for five-year period and for each individual trend is shown in the table 4. The liquidity is expressed as a percentage of number of days where the trading has taken place in relation to total number of trading days in the considered period for every stock individually. It should be pointed out that the analysis did not include the stocks that were traded by the method of prevailing price starting from 09.01.2006. It is the case with the stocks of Univerzal banka, Privredna banka, Komercijalna banka, and Metals banka. The analysis is carried out for them starting from the day when they passed to the method of consistent trading, and that was 17.01.2006, 27.06.2006, 17.08.2006, and 29.12.2006. Shorter period of consideration is taken only for those stocks. Indicators and method of analysis is the same for all stocks.

	2006	2007	2008	2009	2010
Turnover mil EUROS	1.051	1.852	816	387	177
Number of Transactions	115.992	285.566	110.787	68.503	716.30
Belex 15	1.675,20	2.318,37	565,18	663,77	651,78
% turnover Belex 15	58,01	38,39	-75,62	17,44	-2
BELEXline	2.658,16	3.830,84	1.198,34	1.311,84	1.282,66
%turnover BELEXline	36,01	44,12	-68,72	9,47	-2,22

Table 3. The basic data on stock trading on the Belgrade Stock Market

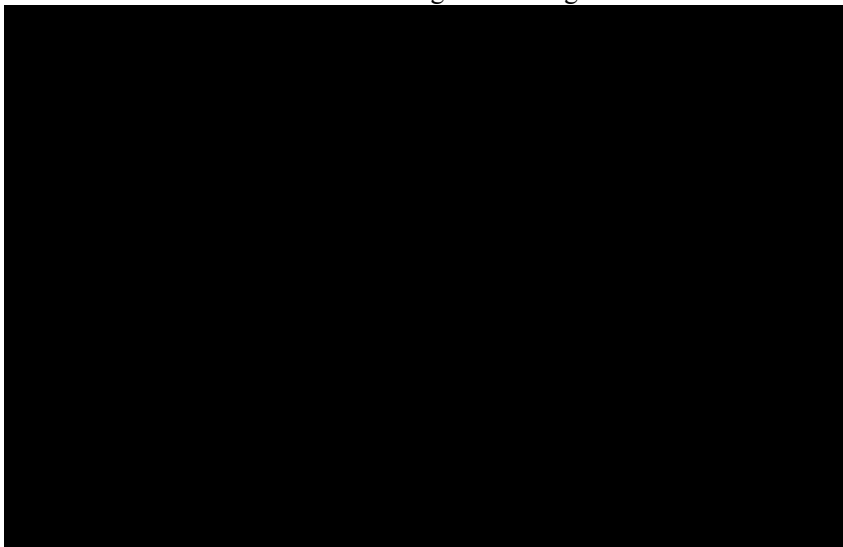
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Table 4. The index values, prices of selected stocks and their returns by periods

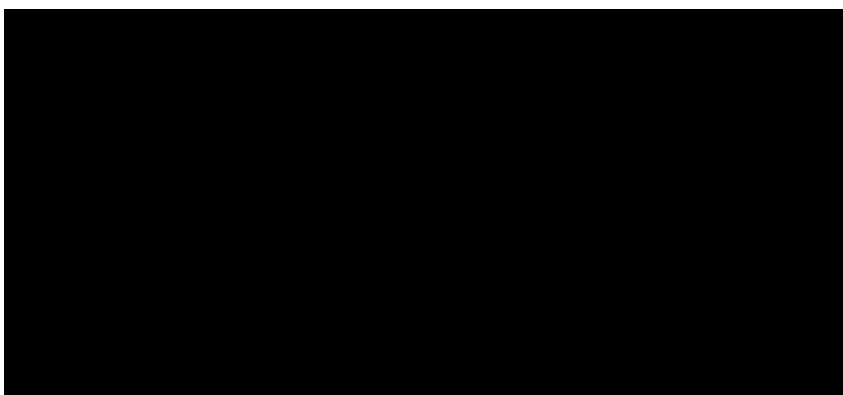
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Table 5. The liquidity of trading

The data on the turnover value, number of transactions and cumulative trade volume are shown in the table 6, which shows the indicators of liquidity. The liquidity in the analysis is important because it indicates the stability of the beta coefficient.

The number of transactions and the turnover value indicate that the most liquid stocks in the third period have been AIKB ENHL AGBN and SJPT.

The turnover value per transaction indicates the dominant participation of institutional investors (if the turnover values have been high) or of small investors (if the turnover values have been low). By comparison of indicators ENHL and ALFA, it is noticed that a large number of transactions with low turnovers is characteristic for ENHL, and small number of transactions with high turnover for ALFA.

On the basis of the indicators of liquidity, there follows the conclusion that the stocks AIKB, ENHL, AGBN and SJPT are the most liquid stocks of 14 companies that enter into the composition of the index. Also the stocks TIGR and IMLK have better liquidity than other stocks from the index basket Belex15.

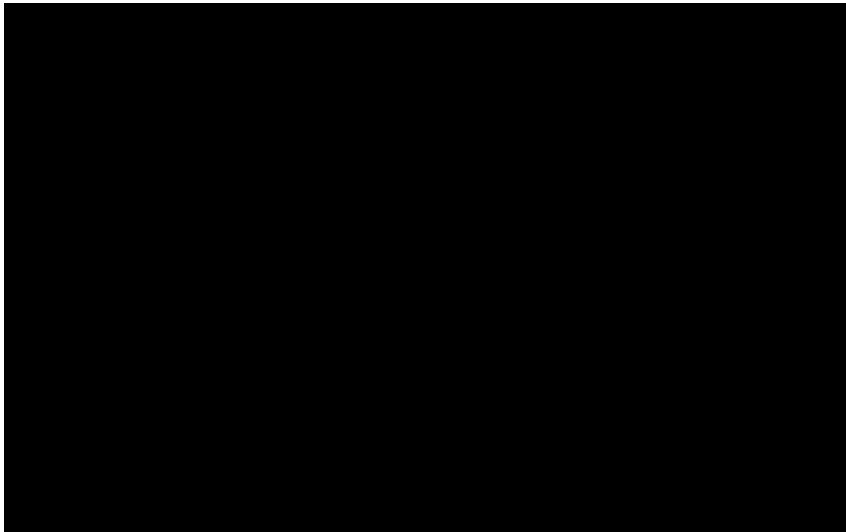


Table 6. The indicators of liquidity of trading in III period

THE ANALYSIS OF THE EMPIRICAL RESEARCH RESULTS

The research results are determined on the basis of daily returns of the index and daily returns of the individual stocks. The value of the beta coefficient and the value of the constant member of regression for entire five-year period but as well as for each of three considered trends have been determined (by regressive analysis, and on the basis of the expression (3)) for each stock individually and the index Belex15 in relation to the market portfolio, which is presented by the general index of the Belgrade Stock Market Belexline. Also, the correlation coefficient, the coefficient of determination and the return rate have been determined. (table 6)

It is noticed in a five-year period that stocks AIKB, ENHL, AGBN, KMBN, IMLK, MTLC and UNBN have the beta coefficient higher than 1, while other companies have the value lower than 1. It means that the stocks with beta higher than 1 have been more risky in relation to the whole market and that their intensity of price change has been higher than of the market. Similarly, it is noticed that the correlation coefficients for the entire period for the stocks of four companies AIKB, ENHL, AGBN, KMBN have the values over 60 %, while for even six companies the correlation coefficient is lower than 30%.

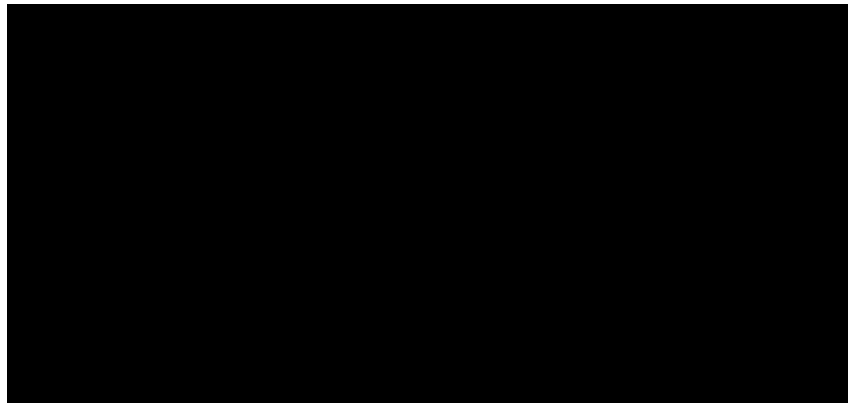


Table 7. The beta coefficient, the correlation coefficient and the coefficient of determination for selected stocks and Belex15

By consideration of some periods, it may be generally concluded that the correlation of the return, stocks of individual companies, in relation to the market return has been significantly lower in relation to the remaining two sub-periods. This can be explained by the fact that the disadvantages and undevelopment of the market were manifested exactly in the first sub-period. This statement practically makes difficult consistent conducting of research, because the examination of the stability of the beta coefficient depends on the market trend direction and the first period that is the representative of the increasing trend of the market. Apart from this, the results provide that the characteristic is noticed and to make the conclusion related to the beta coefficient for some stocks on the capital market in Serbia.

For these reasons, the consideration is focused on the second and the third sub-period. In the period of the market fall, significantly larger number of stocks had the beta coefficient higher than 1, (even 8 stocks), while in the period of consolidation only five stocks had the beta higher than 1. It is interesting to notice that the stocks SJPT IMLK and MTLC in the second

sub-period had beta coefficient higher than one, and in the third sub-period had lower than one. Also it can generally be ascertained that the correlation coefficient of the stock return is significantly increased in the second and in third sub-period than in the first.

It is noticed that only ALFA has had negative beta coefficient value (truly, the small value -0,064) in the second sub-period, which means that it is negatively correlated with the market and that it has the opposite direction of return movements in relation to the return of the market portfolio. (that the return has the opposite movement direction of the general market movement). In the third sub-period, ALFA has low beta value of 0,359 with low correlation coefficient of 0,185.

In the second and in the third sub-period it is clearly noticed that the stocks with higher correlation coefficient with the market have also higher beta coefficient.

The coefficient of determination represents the portion of share variability that can be attributed to its linear connection to the market variability. In other words, the percentage value of determination shows how much the price change on the whole market (the market index values) participates in percentage price change of the stock. Thus for AIKB in the second sub-period the coefficient of determination is 0,539, which means that there has been a 54% price change AIKB, as a result of the whole market variation. In the third sub-period the determination is practically the same and is 55%. Although the third sub-period is characterized by lower liquidity and lower turnovers (when we exclude the stock trading of NIS) four stocks are noticed AIKB, ENHL, AGBN, KMBN where the coefficient of determination is expressed in percentage over 30% in both periods, while for the first three stocks it is over 45%. For stated three stocks, the value of the beta coefficient is practically the highest and significantly higher than one (for both periods it ranges from 1,37 to 1,93). It is noticed that the beta coefficient at AIKB ENHL is lower in the third sub-period than in the second, while at AGBN it has increased in the third sub-period.

The stocks KMBN and SJPT in both sub-period have the coefficient of determination ranging from 27% to 42%. For stocks of all other companies that are considered (such are even 9) the coefficient of determination is very low which immediately indicates inapplicability of the beta concept for those stocks.

The analysis of the beta coefficient is also done for the index Belex15. In this context, the index Belex15 can be considered as the investment fund with portfolio of stocks that constitute the index basket. For all three sub-periods, the high value of the correlation coefficient with the index BELEXline is noticed. The correlation coefficient from the value of 0,654 in the first sub-

period increased significantly in the second and in the third sub-period to very low values of 0,973 and/or 0,966. Analogously, the high value is of the coefficient of determination in the second and in the third sub-period, 95% i 93%. It confirms that the index Belex15 is the representative and well-structured as an indicator of the movement of the most liquid stocks of the Belgrade Stock Market. The beta coefficient in the first sub-period is 1,106 while in the second and in the third sub-period it is significantly higher 1,511 and 1,282. It is known that the beta coefficient of the portfolio is, as a rule, significantly more stable than the beta coefficient of the individual companies. In our example it is not so expressed as it would be expected. We can consider this as the confirmation of the capital market undevelopment in Serbia. The beta coefficient reduction in the third sub-period and its approaching to one confirms the empirical observation that over time the beta coefficient tends to 1.

The beta dependence of the time series length is not analysed in the paper, but the beta stability of the direction of the market trend is tested. It has proved that only for several stocks the coefficient of determination is over 40% in two periods and that there are differences of the beta coefficient for the same company in some periods.

This research shows that the price change at individual stocks causes instability of the beta coefficient, which need not be caused by the general market movement. In the second and in the third sub-period, significant fluctuation of stock price is not associated with the general market movement, than with the day of dividend for stocks of the companies that work successfully, or with the repurchase of own stock, or with the expectations about takeovers of the companies and other. The stated events lead to price fluctuation apart from the general market movement.

CONCLUSION

Young entrepreneurs have got difficult access, and/or unfavourable conditions while borrowing the resources and that is why in the initial stage they rely on their own resources at most part. At later stage of development of entrepreneurship, other forms of financing occur in the form of: factoring, leasing, bank credit, public offering of shares, but the increasing of capital from profit and other. Ensuring sufficient financial resources for business and enlargement of material base is one of the factors for success and further existence on the market.

Investment in any other form of assets basically has got expecting of yield. As the yields are connected to the risks and in that way that great yields bring great risks as well, then it is important to know and analyse

financial risks. The most important are featured as: market risk, credit risk, liquidity risk, operational risk, legal regulatory risk, business risk, strategic risk and reputation risk. Risk estimation includes the identification, quantitative and qualitative analysis and determining of risk priority. The next steps are control and risk financing.

At the foundation of the management of financial risks is the formation of portfolio with the aim to combine financial instruments that enable the most favourable yield in relation to the risk. By the diversification, the portfolio risk can be reduced so that the lower coefficient of correlation between the securities reduces the risk. By the diversification, the risk that stems from uncertainty that surrounds some enterprises is reduced. The risk that can be reduced by diversification is called specific non-systemic risk. There is also the risk that by diversification cannot be avoided and that is called systemic or market risk. Portfolios that contain all instruments that are available on given market have got market risk in theoretical sense. Market risk stems from the fact that there is uncertainty connected to general economic movements that affect all economic entities.

The market risk is important for the owner of the portfolio because a specific risk is reduced almost entirely through diversification. Portfolio risk is reduced if the number of instruments in portfolio increases. If the number of financial instruments in the portfolio is such that it includes all financial instruments on the market, then the portfolio risk becomes the risk of total market. It means that by the enlargement of portfolio, and/or by addition of new elements, standard deviation of portfolio tends to be equal to standard deviation of market portfolio. Formation of optimal portfolio starts from the calculation of expected yield of certain securities, then from determining of expected yield of portfolio and determining of risk of individual security and the portfolio. Beta coefficient is the measure of systematic risk and it expresses the risk of financial instrument with regard to market risk. Quantitative approach to one's basis helps in making decisions according to preferences of the investors.

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