Difference between risk and return terms

Business, Management

Risk and Return Analysis

Risk and return are two financial terms which many do not clearly understand. Risk refers to the possibility of losing asset or finance – cash. There are many elements that bring about risk in business field. These include the business threats such as competitors and the dynamic market trend. Returns refer to the potential gains that are entailed to an investment. Any investment done may either take the two courses, either loss due to more weights on the side of risk or high returns that in this case are termed as profits.

There is a great relationship between risk and return. This is only understood under an investment concept of financial. The relationship between the risk and return can only be explained under the trade-off concept. The level of returns is directly proportional to the level of risk taken. In a state of investment where there are high chances of losing your money, there is relatively high risk. However, the similar state has high rewards that are in this case termed as high returns. On the other side, less risky investments though have low chances of business failure will give relatively low returns.

Taking a live example of lottery tickets, the potential risk of losing the investment is very high. A same case applies to the penny stocks which have high chances of one losing their money upon investment. However, such cases have similarly high yields and returns upon winning. An example of low risk with low returns is the case of personal savings in a bank. The chances of losing your money are very minimal. A similar case to this is buying of the government stocks. However, there are quite low risks in this. The same case

gives relatively low returns. The investments are characterized by low interest rates, where one is likely to earn very little of returns over a long period of time.

A live example of a return in the field of finance is profit. This is the most common return on investment (ROI), which is also referred to as the profitability ration. Any investor, whether individual or cooperative organizations, expects profit as a return upon investment. Profit returns are calculated as the percentage of money obtained on the money provided by the bondholders and shareholders. This form of return is obtained upon subtracting dividends by the total capital from the net income. In a case of small organizations and individual businesses, the profit form of return is obtained by deducting the original capital from the current investment value. A negative figure in either calculation is termed as loss.

An example of risk in the field of finance is Environmental risk. This is the kind of risk that can befall any operating organization. The environmental risk is caused by natural calamities that result in to in to property destruction. Natural calamities are not easily controlled and are all unpredictable. Among the natural calamities that may result to environmental risk is floods, earthquakes and tornadoes.

Taking a case of bad weather, this is a risk that may either limit the number of sales made in a day. The extremities of this bad weather will result in to destruction of property. In a case of heavy rains, the organization is at risk of collapsing buildings from the floods. The same aspect of bad weather will lead to additional expenses in the production system. A company will be

required to engage in mitigation measures. This will force the company to invest in evacuation and disaster management.

Among other natural disasters that may result in to environmental risk are earthquakes and storms. Cases of open market will lead to the products been rained on and spoiling of the products. The earthquakes and storms will destroy infrastructure and make it difficult for a company to undertake its productions. Distribution of products may be a challenge in a case of environmental risk. In a case where a company had its market segment and strongholds in a particular area that has faced an environmental disaster, the company operations are paralyzed and the organization is at a risk of losing a greater section of its costumers. The company may also end up losing its resources including human personnel in a case where the natural calamities destroy property and bring loss of lives.

Ironically, an environment risk may create a new market for particular products. The disaster management organizations will be at their climax of sales of their products and services in a case of environmental risk. The insurance will also chip in and make their sales. The construction companies are also likely to get some jobs within the regions that have faced an environmental disaster.

Stocks and bonds are two ventures that investors use when undertaking financial investment. Stocks offer the investors a chance to gain ownership stake in a company. The percentage of stocks one owns in a company gives them a chance to cooperate percentage of ownership in the company. Bonds are sort of loans rendered by the investor to the company. Stocks are more

risky and volatile compared to bonds. In a case of risk, the company experiences loss. The owners of the business, who in this case are the stockholders and shareholders, share the whole return (Campbell & National Bureau of Economic Research 1993).

In the case of loss, the debtors, who in this case are owed by the company through bonds, deserve their monthly or annual payback regardless of the form of return. The business owners have no obligation to settle their debts, which in all cases considers the debtors. The debtors are given the first priority, and then the stockholders share the remains of returns. By all cases, terms dictate that the debtors cannot lose their investment in terms of bonds.

The aspect of risk and returns are key elements that any investors need to understand before venturing in business. The relation between risk and returns are very essential concepts that need to be considered for future business ventures. Investors venturing in business have their set targets and financial goals. There is need to understand the correlation between the risk and return in order for the investor to link the two to their target goals. In case of a quick and greater return, there is need for the investor to understand where to invest. Understanding the relationship between the risk and returns helps the investors to estimate their anticipated outcomes. In conclusion, an investor will be in a position to calculate the anticipated income from the level of risk. High risky investments will tentatively give higher returns. Understanding the relationship between the two is the basis for the investors to know the appropriate business to venture in.