Risk Theory of Profit:

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8 July 2020

This theory is associated with American economist Hawley. According to him profit is the reward for risk-taking in business. Risk-taking is supposed to be the most important function of an entrepreneur. Every production that is undertaken in anticipation of demand involves risk. According to Drucker there are four kinds of risk. They are replacement, obsolescence, risk proper and uncertainty.

The first two are calculated and therefore they are insured. But the other two are unknown and unforeseen risks. It is for bearing such risk profit is paid to entrepreneur. No entrepreneur will be willing to undertake risks if he gets only the normal return.

Therefore the reward for risk-taking must be higher than the actual value of the risk. If the entrepreneur does not receive the reward, he will not be prepared to undertake the risk. Thus higher the risk greater is the possibility of profit.

According to Hawley the entrepreneur can avoid certain risks for a fixed payment to the insurance company. But he cannot get rid of all risks by means of insurance. If he does so he is not an entrepreneur and would earn only wages of management and not profit.

Criticism:

1. Risk-taking is not the only entrepreneurial function which leads to emergence of profits. Profits are also due to the organizational and coordinating ability

of the entrepreneur. It is also reward for innovation.

2. According to Carver profit is paid to an entrepreneur not for beaming the risk but for minimizing and avoiding risk.

3. This theory assumes that profit is proportional to risk undertaken by entrepreneurs. But this is not true in practical life because even entrepreneurs who do not take any risk are paid profit.

4. Knight says that it is not every risk that gives profit. It is unforeseen and non-insured risks that account for profit. According to Knight risks are of two types viz., foreseeable risk and unforeseeable risk. The risk of fire in a factory is a foreseeable risk and can be covered through insurance. The premium paid for the fire insurance can be included in the cost of production. The entrepreneur can foresee such a risk and insures it. An insurable risk in reality is no

risk and profit cannot arise due to insurable risk.

5. There is little empirical evidence to prove that entrepreneurs earn more in risky enterprises. In a way all enterprises are risky, for an element of uncertainty is present in them and every entrepreneur aims at making large profits.