

CHAPTER XV

THE NATURE OF PROFITS

WE have seen that rent goes to the landlord as the price of land use, while interest is received by the capitalist as the return for the use of capital. The two shares of the product which remain to be considered include an element which is absent from both rent and interest. The use for which profits and wages are paid comprises not merely the utilization of a productive factor, but the sustained exertion of the factor's owner. Like the landowner and the capitalist, the business man and the laborer put the productive factors which they control at the disposal of the industrial process; but they do so only when and so long as they exercise human activity. The shares that they receive are payments for the continuous output of human energy. No such significance attaches to rent or interest.

The Functions and Rewards of the Business Man

Who is the business man, and what is the nature of his share of the product of industry? Let us suppose that the salaried manager of a hat factory decides to set up a business of the same kind for himself. He wishes to become an entrepreneur, an undertaker, a director of industry, in more familiar language, a business man. Let us assume that he is without money, but that he commands extraordinary financial credit. He is able to borrow half a million dollars with which to organize, equip, and operate the new enterprise. Having selected a favorable site, he rents it on a long term lease, and erects thereon the necessary buildings. He installs all the necessary machinery and

other equipment, hires capable labor, and determines the kinds and quantities of hats for which he thinks that he can find a market. At the end of a year, he realizes that, after paying for labor of all sorts, returning interest to the capitalist and rent to the landowner, defraying the cost of repairs, and setting aside a fund to cover depreciation, he has left for himself the sum of ten thousand dollars. This is the return for his labor of organization and direction, and for the risk that he underwent. It constitutes the share called profits, sometimes specified as net profits.

This case is artificial, since it assumes that the business man is neither capitalist nor landowner in addition to his function as director of industry. It has, however, the advantage of distinguishing quite sharply the action of the business man as such. For the latter merely organizes, directs, and takes the risks of the industrial process, finds a market for the product, and receives in return neither rent nor interest but only profits. In point of fact, however, no one ever functions solely as business man. Always the business man owns some of the capital, and very often some of the land involved in his enterprise, and is the receiver not only of profits but of interest and rent. Thus, the farmer is a business man, but he is also a capitalist, and frequently a landowner. The grocer, the clothier, the manufacturer, and even the lawyer and the doctor own a part at least of the capital with which they operate, and sometimes they own the land. Nevertheless their rewards as business men can always be distinguished by finding out what remains after making due allowance for rent and interest.

It is a fact that many business men, especially those directing the smaller establishments, use the term profits to include rent and interest on their own property. In other words, they describe their entire income from the business as profits. In the present discussion, and throughout this book generally, profits are to be understood as comprising merely that part of the business man's

returns which he takes as the reward of his labor, and as insurance against the risks affecting his enterprise. Deduct from the business man's total income a sum which will cover interest on his capital at the prevailing rate and rent on his land, and you have left his income as business man, his profits.

The Amount of Profits

In a preceding chapter we have seen that where the conditions of capital are the same, there exists a fairly uniform rate of interest. No such uniformity obtains in the field of profits. Businesses subject to the same risks and requiring the same kind of management yield very different amounts of return to their directors. In a sense the business man may be regarded as the residual claimant of industry. This does not mean that he takes no profits until all the other agents of production have been fully remunerated, but that his share remains indeterminate until the end of the productive period, say, six months or a year, while the shares of the other agents are determined beforehand. At the end of the productive period, the business man may find that his profits are large, moderate, or small, while the landowner, the capitalist, and the laborer ordinarily obtain the precise amounts of rent, interest, and wages that they had expected to obtain. That there exists no definite upper limit to profits is proved by the history of modern millionaires. That there exists no rigid lower limit is proved by the large proportion of enterprises that meet with failure.

Nevertheless it would be wrong to infer that the volume of profits is governed by no law whatever, or that they show no tendency toward uniformity in any part of the industrial field. There is a calculated or preconceived minimum. No man will embark in business for himself unless he has reason to expect that it will yield him, in addition to protection against risks, an income as large as he could obtain by hiring his services to some one else. In

other words, contemplated profits must be at least equal to the income of the salaried business manager. No tendency toward uniformity of profits exists among very large enterprises nor among industries which are constantly adopting new methods and new inventions. In businesses of small and moderate size, and in those whose methods have become standardized, such as a retail grocery store, or a factory that turns out staple kinds of shoes, profits tend to be about the same in the great majority of establishments. In such industries the profits of the business man do not often exceed the salary that he could command as general manager in the same kind of business.

Profits in the Joint-Stock Company

Up to this point we have been considering the independent business man, the undertaker who manages his enterprise either alone or as a member of a partnership. In all such concerns it is easy to identify the business man. Who or where is the business man in a joint-stock company? Where are the profits, and who gets them?

Strictly speaking, there is no undertaker or business man in a corporation. His functions of ownership, responsibility, and direction are exercised by the whole body of stockholders through the board of directors and other officers. It is true that in very many, probably in most corporations, one or a very few of the largest stockholders dominate the policies of the concern, and exercise almost as much power and authority as though they were the sole owners. Neither these, however, nor any other officer in a corporation receives profits in the same sense as the independent owner of a business. For their active services the officers of the corporation are given salaries; for the risks that they undergo as owners of the stock they are compensated in the same way as all the other stockholders, that is, through a sufficiently high rate of dividend. For example, in railroads the bonds usually pay from four to five per cent, the stock from five to six per cent. The

bonds represent borrowed money, and are secured by a mortgage on the physical property. The stock represents the money invested by the owners, and is subject to all the risks of ownership; hence its holders require the protection which is afforded by the extra one per cent which they obtain over that paid to the bondholders.

While a corporation has no profits in the sense of a reward for directive activity or a protection against risk, it frequently possesses profits in the sense of a surplus which remains after costs and expenses of every kind have been defrayed. These profits are ordinarily distributed pro rata among the stockholders, either outright in the form of an extra dividend, or indirectly through enlargement of the property and business of the company. They are surplus gains or profits having the same intermittent and speculative character as the extra gains which the individual business man sometimes obtains in addition to those profits which are necessary to remunerate him for his labor and protect him against risks. They are not profits in the ordinary economic sense of the term.