CHAPTER-11

PROFIT AND THEORY

Que.1 ***Risk and uncertainty bearing theory of profit.***

Introduction:

Several theories have been formulated to explain how do profits arise but unfortunately none of these theories provide a comprehensive explanation of the profit .Risk and uncertainty bearing theory of profit is one of the most important theory y which we discuss below:

Risk bearing theory:

The risk bearing theory was developed by the American economist prof. Hawley in his book Enterprise and productive process published in 1907.

According to this theory profit is a reward for risk bearing. prof .Hawley justifies his views in the following manner.

Some risk are inherent in every business .this is because all business are more or less speculative .thus profit is not reward for differential ability .The essential function of the entrepreneur is the risk taking because he cannot delegate this function of anybody else .he alone has to bear the risk and profit is the reward for this risk taking.

As we know every business in modern time involves some risk. Only entrepreneur bears risk. Except entrepreneur all parties which are connected in business activity. They are working with pre-fix contract. Therefore they don’t have any business risk in this way only entrepreneur bearing the risk without any expectations nobody is willing to bear the risk.

The degree of risk varies in different business .according to prof.Hawley there is a positive relationship between risk and profit - higher the risk greater is the possibility of profit and smaller the risk, lower is the possibility of profit in this way profit is a reward for risk taking.

CRITICISMS:

The risk bearing theory has been criticized on the following grounds.

1) Profit is reward not for risk bearing but it is the reward for avoiding the risk.

2) There is never a straight relation between the extent of risk and the amount of profit

3) There are some risks which can be known as 'INSURABLE' and hence shitted over to the insurance company- the entrepreneur therefore dose not bear that risk.

4) The theory overlooks other factors like monopoly, innovation, unexpected, situation etc. Which can create profit.

***UNCERTAINTY BEARING THEORY*:**

A refinement was however made by prof. knight in Hawley’s risk bearing theory of profit.

According to prof. knight pure profit are linked with uncertainty and risk bearing. He classifies risk in to (1) INSURABLE RISKS AND (2) NON- INSURABLE RISKS. Of the many risks involved in the business .some risks are predictable because they are certain and hence are insurable. for example fire ,theft, accident etc.. Are risks in business but these can be insured.True entrepreneurship lies in bearing non insurable risks. There are some risks in business which are uncertain and non-calculable. Such risks being unpredictable, no insurance company would be willing to cover them. We can include in non-insurable risks-such as fluctuations in demand, depression phase of trade cycle. Technological changes, changes in degree of competition, changes in govt. policies etc.

According to prof. knight –all these risks are uninsurable and uncertain. Every business involves less or more uncertainty. It is the main function of the entrepreneur to bear all such uncertainties of business. Thus, profit is an exclusive reward for the entrepreneur, for making business decision under unpredictable and uncertain economic condition.

In short Knight theory implies that uninsurable risks are uncertainty of business and Profit is the reward for uncertainty bearing.

***Criticisms*:**

The uncertainty bearing theory has been criticized on the following grounds.

1) Uncertainty of business is not only the determinants of profit. There are many factors influencing the earning of profit.
2) In fact it is managerial skill rather than uncertainty which leads to higher profit.
3) The theory dose not focus on the phenomenon of monopoly profit.
4) Uncertainty bearing is not only the function of an entrepreneur.
5) In modern time the owner (shareholders) and the entrepreneur (professional manager) are different. The concept of profit and entrepreneur at function in such case is not properly exposed by the theory.