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By Timothy G. Nash and William L. E. Freeland

PROFITS



IN DEFENSE OF PROFITS

Here is an old story with an important message. It is titled "I'm for People, Not for Profit."

Once upon a time there was a Little Red Hen who scratched about and uncovered some grains of wheat. She called her barnyard neighbors and said, "If we work together and plant this wheat we will have some fine bread to eat. Who will help me plant the wheat?"

"Not I," said the Cow. "Not I," said the Duck. "Not I," said the Goose. "Then I will," said the Little Red Hen and she did.

After the wheat starting growing, the ground turned dry and there was no rain in sight. "Who will help me water the wheat?" asked the Little Red Hen.

"Not I," said the Cow. "Not I," said the Duck. "Not I," said the Pig. "Equal rights," said the Goose. "Then I will," said the Little Red Hen and she did.

The wheat grew tall and ripened into golden grain. "Who will help me reap the wheat?" asked the Little Red Hen.

"Not I," said the Cow. "Not I," said the Duck. "Out of my classification," said the Pig. "It's not in my contract," said the Goose. "Then I will," said the Little Red Hen and she did.

When it came time to grind the flour, "Not I," said the Cow. "I'd lose my unemployment compensation," said the Duck.

When it came time to bake the bread, "That's overtime for me," said the Cow. "I'm a dropout and never learned how," said the Duck. "I'd lose my welfare benefits," said the Pig. "If I'm the only one helping, that's discrimination," said the Goose.

"Then I will," said the Little Red Hen and she did. In fact, she baked five loaves of fine bread and held them up for her neighbors to see.

"I want some," said the Cow. "I want some," said the Duck. "I want some," said the Pig. "I demand my share!" said the Goose.

"No," replied the Little Red Hen. "I can rest awhile and eat the loaves myself."

"Excess profits!" cried the Cow. "Capitalistic leech!" exclaimed the Duck. "Company fnk!" grunted the Pig. "I will call Michael Moore!" screamed the Goose and they hurriedly painted picket signs

Foreword

In just over 50 years, Northwood University has become a highly regarded institution for the education of men and women seeking careers in enterprise across the United States and around the world. Our success is anchored in the fact that Northwood has, since its inception, been dedicated to teaching the values and principles of a free and moral society driven by economics, ethics, entrepreneurship, and cutting-edge strategic management decision-making.

and marched around the Little Red Hen, singing, "We shall overcome."

And they did. For when the Farmer came to investigate the commotion, he told the Little Red Hen, "You must not be greedy. Look at the oppressed Cow. Look at the disadvantaged Duck. Look at the underprivileged Pig. Look at the less-fortunate Goose. You are guilty of making second-class citizens of them."

"But — but — I earned the bread," said the Little Red Hen.

"Exactly," said the wise Farmer. "That is the wonderful free enterprise system; anybody in the barnyard can earn as much as he or she wants. You should be happy to have this freedom; in other barnyards you would have to give all five loaves to the Farmer. Here you only have to give four loaves to your suffering neighbors."

The Little Red Hen obliged and walked away in silence...

It has been some time since the Farmer's lecture. The barnyard is now dilapidated, the animals are always hungry, and the Little Red Hen, well, she left some time ago.

The hostility toward the Little Red Hen's success was based on greed and ignorance. Today, those who defend the profit motive face the same obstacles. Too many people are envious of a profitable business and/or just don't understand profit.

We Should be Thankful for Profit

We are awakened in the morning by an alarm clock that was made for a profit. Practically everything we come into contact with from that waking moment was produced by people seeking profit.

The breakfast we eat, the clothes we wear, and the house in which we live are all made possible by profit. The car we drive, our jobs, our paychecks—they too are based on the profit motive.

The meals we eat outside the home are available only because someone can prepare them at a profit. The trip to the amusement park, or that late-night snack; once again, profit. Even government is made possible, in large part, through taxes on the profits of private companies.

In the free world, most of our wants and needs, from vacations in the Bahamas to blankets for babies, are made possible by profit.

Profit makes the world go 'round!

Profit in a free economy is the reward for satisfying the consumer

through a product or service. It is awarded to the producer by the customer through their patronage.

Profits are a barometer of efficiency in a free market economy. More efficient, customer-focused companies will earn larger profits. Profitable companies will grow; they will continue to find new ways to offer the public what it wants at the lowest possible price.

The individuals who earn profits must never forget that competition—actual and potential—continually threatens to take away those profits. The profit-seeker must keep mistakes to a minimum or the consumer will take his business elsewhere. This is the idea of "consumer sovereignty."

We consumers decide whether Exxon, Toyota, or any other firm will be successful from year to year. If producers do not satisfy us, their profits will turn into losses. We are hard to please and will not settle for second best.

It is quite clear that in a truly free market, the consumer is royalty, the producer a servant, and only if the servant serves competently, will the consumer bestow profits.

The Alleged Evils of Profit

It is common today to read in the newspapers that corporations are unfeeling entities with no concern about their employees; their only goal is profit. Professor Ludwig Von Mises, in his essay "The Elite Under Capitalism," refuted this charge: "If one deplores the businessman's unfeeling preoccupation with profit-seeking, one has to realize two things. First, that this attitude is prescribed to the entrepreneur by the consumers who are not prepared to accept any excuse for poor service. Secondly, that it is precisely this neglect of the 'human angle' that prevents arbitrariness and partiality from affecting the employer-employee nexus." (1)

Put more simply, business people are focused on profit because their customers expect it of them. They are required to provide a good product, at a low price, and with good service. They in turn must be impersonal with their employees because they are required to make the hard decisions required to keep prices low and quality high. Though the employer-employee relationship is important to productivity, the business owner or executive ultimately must answer to consumers, not employees.

Another argument commonly presented by those who do not understand profit is that "business must be limited to a fair profit." These people often will organize consumer groups to lobby in Washington to convince the bureaucracy to enact laws allowing only a "fair" profit for "fair" compensation of executives and stockholders. New regulations, levies against windfall profits, rebates, and a progressive tax scale are byproducts of this mentality. Meanwhile, just what is a "fair" profit is never clearly explained.

Many in Washington believe U.S. corporations are under-taxed even when the facts suggest otherwise. The U.S. economy levies the second highest corporate income tax rate in the industrialized world, at 39.27 percent, slightly lower only than underperforming Japan. By comparison, former communist countries such as China, Russia, and India tax business at a substantially lower rate. (2) The above, coupled with talk of additional profit reducing taxes on Medicare, carbon emissions, consumption of goods and services, and business operations, increases the risk/reward ratio for doing business in the U.S., driving more and more businesses offshore.

The incessant claims that retailer Wal-Mart puts "profits ahead of people" is a good example to examine. The argument is that Wal-Mart "strong-arms" producers and exploits their employees, particularly citizens of the developing world, in order to maximize profitability. Indeed it's true that Wal-Mart has generated tremendous profits—through most of the early 2000s, five members of the founding Walton family were among America's 10 richest citizens despite controlling less than 40 percent of the company. But is it true they achieved this wealth by choosing profits over the welfare of individuals?

The answer is "no." Wal-Mart has achieved success as a business because of its very low prices. By providing essential items at lower prices, Wal-Mart has empowered consumers to improve their quality of life. Customers benefit from Wal-Mart's relentless focus on low prices; that's why they choose to shop there and it's obviously a major factor in the company's success.

Similarly, the producers that are allegedly "strong-armed" and the individuals who are said to be "exploited" by Wal-Mart benefit greatly from their affiliation with the company. These organizations and people have clearly demonstrated that working with Wal-Mart is their most profitable option. If this were not true—if they had other options that would provide greater overall returns—why in the world

would they not be exploring those options? The fact that employees and producers agree of their own free will to work with Wal-Mart is strong evidence that this relationship presents the highest valued use of their products and services.

The truth is that customers are left with more money in their pockets after shopping at Wal-Mart, producers become more profitable after contracting with Wal-Mart, and workers in the developing world are left with higher total compensation by working for Wal-Mart suppliers. This is clear because these individuals and organizations choose to work with Wal-Mart. If they were not receiving sufficient value or had better opportunities, they would be free to go elsewhere.

Wal-Mart does not make these people better off because they are fond of them, though indeed it's possible they are. Wal-Mart's motivation is profits and the outcome of their motivation is bettering the lives of their employees, their customers, their suppliers, and workers who are employed by their suppliers.

It's also quite important to consider who the recipients of profit are and recognize their importance. The late Dr. Dale Haywood, Northwood University economics professor and committed defender of free enterprise, eloquently argued this point in the November 2002 issue of *The Freeman*: "When we get to the bottom line of the income statement, 'profit,' yet another group of people comes to my mind: stockholders. They own the corporations. They don't show up for work, yet they perform a vital role. They, along with the creditors, finance the plant and equipment that the workers use. Those tools multiply what the workers can accomplish with brains and brawn alone. Some of these stockholders might be currently working. Others might not be. But most of them became stockholders by working at some time in their lives. It's likely that many of them had to work harder than current workers, because they had less-advanced tools at their disposal. They made sacrifices. They didn't spend everything they earned. They chose to buy stock with some of their savings. Profits compensate them for their vital role." (3)

These shareholders, who risk their savings in hopes of receiving a return provided by a company's profit, aren't caricatures of greedy Wall Street fat cats or executives holding stock options. Plain and simple, they are you and me. They are millions of Americans, young and old, rich and poor, saving for retirement in hopes that they won't have to work until the end of their life. These people toil away, saving per-

haps a few thousand dollars a year in an IRA or betting on their public or private pension plan. What will give them the return they desire, the return they need, in order to retire? Profits. What types of companies will not only make profits but continue to be both successful and solvent, therefore protecting their investors' initial capital? Companies that are driven by the profit motive.

It is time we realize that the only fair system is the market system. All that any person is entitled to in the marketplace—businessman or wage earner—is what others will offer in a voluntary exchange. If both parties to an exchange did not expect to benefit, the exchange simply would not happen.

Profit-Seeking Businesspeople

Adam Smith put the actions of profit-seeking businesspeople into proper perspective in his classic work, *The Wealth of Nations*: "By directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain...he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention...by pursuing his own interests, he frequently promotes that of the society more efficiently than when he really intends to promote it."⁽⁴⁾

John D. Rockefeller was a successful businessman at a point in his life when most men today are in college. Rockefeller was considered a greedy "robber baron" who took risks only because there was a potential for profit; the result being Standard Oil Corporation. Even if it were true that Rockefeller was motivated by greed, so what! For every thousand dollars Rockefeller spent on himself, he spent millions more creating jobs and providing consumers the best product at the lowest possible cost.

Henry Ford, driven by the desire for profit, built a great American "empire." But when Ford became complacent and adopted the theory that the consumer should have a car of any color, "as long as it was black," he attracted the competition of other profit-seekers. Alfred P. Sloan, then head of General Motors, felt he could increase sagging profits and put GM back on its feet by offering the consumer a quality car in a choice of colors on easy credit terms. The public loved the idea and within a few years General Motors was the country's largest manufacturer of automobiles.

More recently, General Motors has fallen victim to a similar fate. A common explanation of GM's decline is that the company failed to respond to the changing demands of consumers who desire smaller and more fuel efficient cars. GM's slowness to adapt to changes in their customers' preferences created an opportunity for competitors to "take business" from GM. Had GM, or Ford in the previous example, reacted more quickly to provide consumers with the cars they truly wanted, they likely would have held on to a good portion of the business that went to their competitors. So it is that profit is not only a reward for services rendered to the consumer, but also an incentive to compete.

It is important to note that profits unjustly earned are not part of this defense. The profit motive is valuable, not because profit itself is good, but because the framework of society leads individuals motivated by a desire to earn profit to actually improve the condition of their fellow man without any deliberate intention to help those with whom they trade. This social framework, commonly provided by government, includes a fair and just court system that protects property, enforces contracts, and offers special privileges to none, as well as institutions such as a police force that provide for peaceful interaction.

The profit motive leads to bad outcomes when it is not the product of voluntary cooperation among individuals who are equals in the eyes of the law, and/or it is the result of markets that have been distorted by politicians and government bureaucrats who favor a particular business or industry. Subsidies, bailouts and special regulatory privileges provide businesses with unjustly earned profit and the unleashing of a type of self-interest that benefits a few at the expense of many, as opposed to mutual benefit. This is no different than the case of a business cheating its customers or sabotaging its competitors to earn profit.

It also must be noted that this essay does not suggest that all business owners who are motivated by profit will also do the "right thing" or act to benefit society as a whole. Without question, people are at times greedy and allow their greed to motivate them in ways that are bad for society—free markets are indeed imperfect. The question is, do we compare greedy and imperfect business people motivated by profit with politicians and government bureaucrats who are benevolent and motivated only by the greater good of society? Or, perhaps, do those same greedy and imperfect people work in government itself? Government intervention is the alternative to voluntary interactions

among people in free markets. Whatever imperfections profit-seeking business people might have, those shortcomings must be considered alongside an imperfect government whose agents are also motivated by personal profit and whose incentives often don't align with the greater good of society or any type of mutual beneficial gain. Facing this comparison, business people motivated by profits and forced to compete in the marketplace are most often the better answer to the questions of how to structure society and solve its ills. Also, the billions of dollars given annually in the U.S. through volunteerism and the charitable giving made possible by profits speak highly to the civic stewardship innate in many profit seeking businesspeople and their employees.

A Lesson to be Learned

William E. Simon explains the role of our profit-seeking entrepreneurs in this excerpt from *A Time For Truth*: "Productivity and the growth of productivity must be the first economic consideration at all times; not the last. That is the source of technological innovation, jobs, and wealth. This means that profits needed by investment must be considered a great social blessing, not a social evil."⁽⁵⁾

We can learn an important lesson from the pre-British Industrial Revolution. In 1749, death from disease and malnutrition claimed more than 50 percent of children younger than the age of five in England. (6) Today, because of the science and the production made possible by industrialization and profit, England and the U.S. have infant mortality rates that are a fraction of a percent. (7) Furthermore, studies by economists Robert Lawson and James Gwartney clearly show that as a nation becomes more "economically free"—in which the profit motive is a major component—the average age of its people becomes higher and the mortality rate of its infants lower. (8) The United States rose to greatness on the strength of the profit-motive. We have goods and services and a standard of living that people could not have conceived of two hundred years ago—all because of the lure of profit.

Likewise, there is no way to know what potential inventions or innovation will be developed and subsequently brought to market in the coming years that will enable us to live longer, more healthy, comfortable, and enjoyable lives. What we do know is that the scientists who develop the breakthrough goods and the entrepreneurs who bring them

to market will largely be motivated by the opportunity for profit. They will change the world for the better, not solely driven by their love for their fellow man, but instead by their own self-interest, of which pure monetary self-interest, or profit, is often a major component.

We stand at a crossroads; we will decide whether America will continue to be the land of opportunity and growth or a stagnant, decaying, once-great nation.

The crucial insight of the parable of the Little Red Hen is that the Hen should keep what she earned because it was through her efforts alone that the loaves were produced. No one else has a moral claim to this profit. Further, not only is profit just and moral, as history demonstrates, it is essential to the growth and economic health of a nation. We are convinced that if we strive to be like the Little Red Hen instead the Cows, Ducks, Pigs, and Geese of the story, America will once again be great.

Personally, we cast our votes for profit, because we're for people.

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