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Don P. Diffine Ph.D.
Harding University, ddiffine@harding.edu

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A Newsletter of The Center for Private Enterprise Education

Harding College Department of Business and Economics

The entrepreneur*

New Economics Team Promotes 'Creative Capitalism'

Business and economics students and faculty are our greatest hope for providing credible free enterprise education to other school disciplines and the community. It is for this reason the business community chooses to ally itself more and more with colleges of business in preserving and improving the free enterprise and incentive system.

Begun three years ago, the "Students in Free Enterprise" competition challenges young people anticipating business careers to devise and implement programs that will help preserve the competitive American business system, thereby preserving for their generation and those that follow the opportunities for a better life which it provides. National Leadership Methods of Austin, Texas directs and administers the programs for several corporate sponsors involving schools in fourteen states.

This year's winner in the Southwestern Life Insurance competition, Harding College, built its entry around its Center for Private Enterprise Education. Organized by students, the center also is staffed by young people who are "pioneers in mass communication of economics." Using the center — which is actually a library of private enterprise literature and audio-visual materials — as the core, Harding students radiated their efforts in a number of directions.

However, the 1977-78 school year means a fresh start, for the past is prologue. This year's Economics team is composed of members Doug Sanders, student chairman, of Antioch, Tenn., Marsha Bender of Alamogordo, N.M., Daniel Holt of Effingham, Ill., Susie Qualls of Searcy, Arkansas, and Ted Thompson of Norfolk, Va. These young people would welcome your ideas as they accept the challenge through intercollegiate competition (October, 1977 through April, 1978) to design and implement free enterprise programs suited to our local and Mid South constituency.

Unfortunately, the fact that free enterprise is simply freedom applied to the marketplace has rarely been taught. The Center for Private Enterprise Education takes the approach that economic individualism, private property and the market economy are not just neutral concepts. They are, in fact, worthwhile and attainable goals. Let's support the system that supports us.

D. P. Diffine, Ph.D., Director
Associate Professor of Economics

Seven Misconcepts Behind The Mounting Attack On Big Business

by Charles Hull Wolfe, President
American Economic Foundation

It is commonly said that the American people display a growing hostility "toward business and businessmen."

Actually, people today think well of *small* businesses and the men who run them; their wrath is targeted at "big business" and "big businessmen."

The University of Michigan Survey Research Center asked the public how "honest and moral," in their opinion, were those who run various institutions. Small businessmen ranked high — above state and local government officials, national news media leaders, even above U.S. Senators. "Big businessmen" rated low. Only officials of the federal government and of labor unions ranked lower.

Small Business Is Trusted

The same researchers asked the public to evaluate the job being done by various institutions. Small business got a top mark — right behind the churches, ahead of the schools and the Supreme Court. Large corporations rated near the bottom.

"Are large corporations essential for the nation's growth?" For years, when Opinion Research Corporation asked that question, almost everyone said they were. In 1965, 88 per cent agreed.

Understandably, more people now urge chopping up large corporations. In 1967, 36 per cent said that "For the good of the country, many large companies ought to be broken up." In the latest survey, 53 per cent felt that way.

Just as jolting is a Louis Harris finding that two-thirds of the public believes the country is in "deep and serious trouble" and that the group most responsible is "big business."

Is Big Business Guilty?

Are big companies mainly to blame for our difficulties? Would it serve the public to break them up? Are they doing their job poorly? Are men who manage large corporations far less moral than those who run small enterprises?

Objective evidence says No. Then why does the public hold such views? Because Americans distrust all big

*The acting, organizing enterpriser in the world of commerce.

institutions — big government and big labor as well as big business. When the economy is marred by inflation and unemployment, people feel insecure, and resent any institution that seems to be rich, impersonal and impervious to trouble. Again, large companies are under attack by consumerists, environmentalists and socialists.

Also, people feel antagonistic because they entertain economic misconcepts, such as the following:

1. **"Big business makes too much profit."** Some Americans think *all* business is too profitable. Others direct this charge at *large* companies, like chain food stores which have averaged less than 1 per cent net profit.

Not long ago, Opinion Research Corporation compared the public's opinion of the size of profits with facts supplied by First National City Bank. People supposed U.S. manufacturers averaged 33 cents after-tax profit per sales dollar, when the fact was 5.2 cents. They guessed the oil industry's profit to be a whopping big 61 cents when it was actually 7.2 cents. They imagined the auto industry's profit to be a juicy 39 cents, when it was 1.9 cents.

2. **"Big corporations pay their workers too little, but their executives and stockholders get too much."** According to Opinion Research Corporation, the public believes that employee compensation as a share of corporate income is only 25 per cent, but U.S. Department of Commerce figures show that employees received 89.6 per cent of divisible income in the U.S. operations of all U.S. companies in 1975, and net profit accounted for only 10.4 per cent.

Do "excessively high executive salaries" account for the "lion's share" of big corporations' payroll? A few years ago, a study showed that of the General Motors' earning available for salaries, wages, dividends and reinvestment, GM dealt out only 0.42 per cent to directors, officers and other top executives, while 83.88 per cent went to other salaries and wages, 11.8 per cent to dividends, and 3.9 per cent reinvestment.

The two-way split at Singer Company revealed that 0.37 per cent went to directors and officers, and 99.63 per cent to all other employees.

3. **"Big corporations exercise enormous concentrated power."** Professor Neil Jacoby says, "There can be little doubt that the relative political strength of business has fallen dramatically in the past centry." And how can the notion of unlimited corporate economic power be reconciled with rising consumerism? With the growing power of unions to get huge wage increases? With strangling governmental regulations? With sustained high corporate taxes? With the diminishing share of corporate profits in the national income?

4. **"Big corporations are becoming increasingly dominant in our economy."** For many years there has been one "business enterprise" for every 40 persons in this country. The percentage of self-employed persons — individual entrepreneurs — has remained almost constant. About as large a proportion of working Americans work for themselves as in 1945.

Just a few years back, a study showed that less than one-quarter of one per cent of the corporate population had assets of $100 million or more. While the largest firms have made moderate gains in the share of corporate assets held compared to medium and small companies, there has been an enormous increase in the number of small companies.

5. **"Big business owns the preponderance of U.S. wealth."** Less than one-third of the tangible wealth is owned by corporate business, and this share has not changed much for generations. The great bulk of wealth is owned by governments and private individuals; and the share taken by government continues to mushroom.

Individual ownership of corporate stock exploded after World War II. In 1970, some 31 million — one out of every four adults — owned stock. The number would be higher today were it not that corporate profits are relatively small — and unpredictable.

6. **"U.S. multi-nationals are exploiting underdeveloped nations."** Case studies by the National Planning Association show that investment by multinational U.S. corporations has a highly positive effect on less developed countries.

In each case, the corporation had an innovative, catalytic role: it started new local industries, gave the country new management and technical skills as well as additional capital — and in many cases built new schools, housing, health and transportation facilities.

7. **"If giant companies were broken up, the country would be better off."** The size of a business is controlled largely by the kind of goods and services it produces. Firms that make steel, extract and refine oil, produce automobiles or airplanes *must* be big; they can produce efficiently only on a large scale. If such companies were broken up, our total productive capacity would be weakened and, most likely, the prices of their products would increase.

If more Americans grasp facts such as these, and share them with others, it will not only help neutralize unfair attacks on on large corporations, it will help preserve the entire free enterprise system.

"There Are No Profits — Only Costs" Says Economist Peter Drucker

by Charles Hull Wolfe, President American Economic Foundation

Recently a prominent economic analyst and business consultant, Peter F. Drucker, startled a great many people by declaring that not only the public but most businessmen "don't seem to know the first thing about profit and profitability."

"The essential fact about profit," Professor Drucker observed, "is that there is no such thing. There are only costs." In this surprising statement, Dr. Drucker confirmed the long-held view of the founders of The American Economic Foundation who seldom used the word "profit" (except in parenthesis) and who insisted that what was commonly called profit was in fact "the cost of using capital" — as essential a cost of business as wages or outside purchases.

Drucker's provocative observation draws attention to this important subject after a year in which profits were subjected to fierce attack. Since many economists consider the attack misguided, are concerned about the present low level of profit, and see higher profits as necessary to cope with inflation and recession, this is an opportune time to review some vital but little understood facts.

1. Profit — payment for the use of capital — is as necessary under socialism and communism as under private capitalism. Every economic system that lifts people above abject poverty must generate large amounts of capital to provide the industrial tools that multiply human productivity. But communism takes capital from the people by force, via taxes or government bonds which the people are not asked but *told* to buy.

Interest on these bonds becomes payment for the use of tools. The difference between a Soviet plant's income and outgo is returned to the Kremlin as a "turnover tax" (a term the Russians prefer to "profit"). Under their system of "profit planning," Soviet bureaucrats seek to impose needed profitability in advance by government mandate rather than let it be decided freely by the marketplace.

2. The private profit system acquires capital voluntarily — without force — through the savings of free men and women. Profits motivate people to undertake useful economic activity and reward tisk-takers for saving capital and putting it to work in productive enterprise. Profits in a free society also provide "a mechianism for social control": they guide business and its customers in deciding how labor and resrouces should be employed to satisfy the people's wishes.

3.. The private system is the least expensive way of acquiring capital. History shows that competitive enterprise generates more capital and at lower cost — a much lower rate of profit. L. E. Hubbard says in SOVIET FINANCE AND MONEY, "In the Soviet system all large-scale industry is state monopoly, therefore the State is in a position to exploit the consuming masses, or in other words, make monopoly profits."

4. Total profit is small compared to total wages. Karl Marx insisted that private capitalism divides society into two hostile camps, owners and workers, and results in "crying inequalities in the distribution of wealth." The falsehood has been widely accepted. Studies show the American people believe that workers get only about 25 per cent of the income divided between employee compensation and profit. The fact is, U.S. workers get about 90 per cent of the total divisible income in wages plus benefits, whereas the owners get only about 10 per cent in net profit. About half of that 10 per cent is reinvested to strengthen the business, make jobs more secure and workers more productive, which in turn increases real wages.

5. Profits are widely distributed. Under American capitalism, about half of all families are direct owners of business, and thus direct recipients of profits, and just about every American is an indirect owner. There are some 30 million owners of stock in corporations listed on the Exchanges, million more stockowners in unlisted corporations, more than 10 million more unincorporated businesses, more than 2 million profit-seeking private farms. In many corporations, 25 per cent to 75 per cent of employees are stockholders. All the millions who have savings accounts, insurance policies or who participate in private pension funds are indirect investors, and thus beneficiaries of profits.

6. Profit per dollar of sales is one-seventh what the public believes. Even college graduates, those earning over $15,000 a year, and business managers, greatly overestimate size of profits. Asked, "How much profit does the average manufacturer make per dollar of sales after taxes?" the public answered 28 cents. Youth and the poor said 33 cents. Even stockholders guessed 22 cents. The fact? The average manufacturer earns 3 to 4 cents profit per dollar. Interestingly, the public believes 10 cents would be "fair"!

7. Adjusted for inflation, profits are shrinking drastically. In the time between the period when a product is researched, developed and manufactured — and the time when it is finally sold — the purchasing power of the dollar keeps on shrinking. Thus the dollars a company receives when it sells a product are worth less than the dollars it had to spend in creating that product.

Traditional accounting methods do not reflect this vital fact. Only when costs and revenue are measured in the same dollars (i.e. dollars with the same buying power) do we see what is happening to real profits. When such a calculation is made (adjusting for "under-depreciation" and illusive "inventory profits"), we find that after-tax profits for all U.S. non-financial corporations have been falling steadily over the past decade, from $36 billion in 1965 to an estimated $20 billion in 1974. In constant dollars the adjusted earnings in 1974 were only slightly more than half of those in 1965.

8. Profit is not a "surplus" but a basic cost that must be paid. If business income and outgo could be accurately predicted, there would be no "profit." Just as fixed sums are agreed on in advance to cover cost of wages and outside supplies, so there would be fixed sums to cover cost of capital.

But since income and expenses of an enterprise cannot be exactly forecast, some participants must accept an uncontrolled amount of compensation for their contribution. The only ones willing to do so are the investors who provide the capital that makes the business possible and pays for the tools of production. Payment for this contribution is an inescapable cost. The only variables are exactly how much this cost will be and exactly when it will be paid.

9. Profits are needed to create jobs, raise real wages, provide job security. Just as wages are the payment for those who do the job, profits are the payment for those who create the job. Only as profits increase can there be an increase in quantity and quality of power tools per worker, and thus in individual productivity and real wages. In companies where there are solid profits, there is excellent job security; where there are poor profits, there is little job security; and where there are losses, often employees have to be let go.

10. Only as businessmen maintain keen concern with profits will they have the funds to cope with social challenges. The Yankelovich survey of college-age youth found that the most widely-felt criticism of American society today is that "business is too concenred with profits and not with public responsibility." Yet the corporation's only source of funds for social problem-solving is profit. And if companies fail to earn a profit, they can neither cope with their most basic social function (employing people and providing products) nor pay taxes in support of government and its social programs.

11. Variation in profits is normal in a market economy. Companies are attacked for making "high" profits, yet these are often a sign of efficient management and success in pleasing customers. Industries with high capital investment (in oil exploration it comes to $170,000 per worker) must earn a higher percentage of profit per dollar of sales than industries (such as retail food) where capital investment per employee is modest. Profits do not add to prices of products, but finance production improvements which bring prices down. Generally, companies that earn higher profits pay higher wages, and as a greater percentage of all companies earn profits, employment goes up.

From this review, what do we see as the overal profit picture? Profit — payment for the use of capital — is absolutely necessary under *any* economic system. Compared to socialism or communism, the private system generates *more* capital at *lower* cost and does it *voluntarily* — not by compulsion.

Profit is not a "surplus" but an actual cost of business. The amount of profit is much smaller than most people think, is more widely distributed, and does more for everybody: it is needed to make jobs secure and increase our standard of living.

The Greatest Weakness In Economic Thinking

In our emotional search for instant answers to our socio-economic problems, the most common error is to forget a basic law of economic — "Nothing in our material world can come from nowhere or go nowhere, nor can it be free; everything in our economic life has a source, a destination and a cost that must be paid."

In practical application, this "where from, where to," principle boils down to double-entry bookkeeping, the fundamental tool of money management and economic thought. Any proposal that cannot be reduced to a balanced double-entry calculation has not been properly thought through.

This applies to personal projects, business projects and public projects. The Federal Government has one tremendous advantage; when it runs out of money, it can print some more. But nobody else can.

This editorial was prompted by the enormous pressure on business to meet its "social responsibilities." These demands ignore the fact that the money that any business can spend or give is limited to the amount if receives from customers.

We would rate the responsibilities of business as follows:

1) To protect and pay a fair return on the savings invested in the business;
2) To pay fair wages to employees;
3) To act as a tax collector;
4) To product good products as acceptable prices;
5) To, within it resources, make the community a better place to live and work.

Obviously, the area of debate must center around item five because, while business wants to do as many "good things" as it can to improve its public image, the inexorable discipline of double-entry bookeeping makes it necessary that the buying public pay the bill. Ironically, this means that the people would really be doing these good things for themselves and business would be getting the credit.

The reader may be thinking that the Federal Government could solve the problem by allowing business to deduct the expense from taxes. This, however, is a fallacy because the government needs the money and the equivalent taxes would have to be collected from the buying public in some other way.

As a way around this, it might be supposed that the government could create "new" money instead of new taxes. But this, too, is a fallacy because the "new" money takes on value only by taking it away from all other money. So it becomes the most burdensome of all taxes — a capital levy.

No matter how we twist and turn, we still face the fact that the cost of all "social programs" undertaken by business comes out of the customer's pocket one way or another.

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The Center for Private Enterprise Education
Department of Business and Economics
Harding College, Searcy, Arkansas

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