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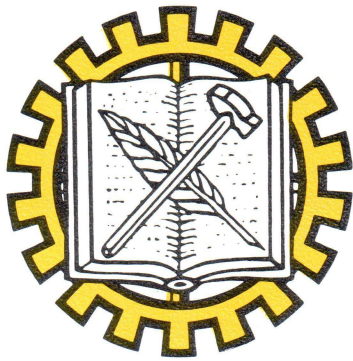
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The

entrepreneur

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Profits and Entrepreneurship

by Dr. John C. Moorhouse

In its fifteenth year, the ENTREPRENEUR is a quarterly journal and newsletter of the Belden Center. It contains executive monographs, position papers, faculty articles, and current tracts which address contemporary economic issues from a moral perspective.

The ENTREPRENEUR is mailed around the country to 7500 interested individuals, opinion leaders, businesses, chambers of commerce, professional associations, and School of Business alumni. It has received numerous awards from the Freedom's Foundation in the categories of Published Works, Non-profit Publications, Economic Education, and Public Affairs-Advertising. The ENTREPRENEUR serves to implement the following objectives of the Belden Center:

1. To **promote** an accurate and objective understanding of the American Incentive System in its many aspects and its various components.
2. To **act** as an information exchange among those involved with private enterprise education.
3. To **create** a high degree of economic literacy among teachers, business people, and higher education faculties.
4. To **work** with other publics such as employees and the media to assist in their learning of our private enterprise system.
5. To **provide** a focus — a rallying point — for opinion leaders who are committed to economic, political, and intellectual freedom; thereby harnessing the great potential which flows through our constituency.

I. EDWIN LAND — ENTREPRENEUR

In 1932, Edwin Land hardly presented the image of the young man most likely to succeed. This son of a Connecticut scrap dealer, in quick succession, dropped out of college and moved to New York City where he rented a loft in a rundown building on 55th Street. Impatient with formal studies, Land left school in order to pursue his passionate interest in optics. Living on borrowed funds and working alone in a makeshift laboratory, he struggled for three years developing what he called "polaroid screens" — soon to become non-glare sunglasses.

With samples of his device in hand, Land approached American Optical Company, where the significance of his invention was recognized immediately. Soon American Optical was marketing the new sunglasses. This much superior product proved to be a commercial success. To meet the growing demand, American Optical expanded production, hired more workers, and cut prices of its polaroid sunglasses. Meanwhile, profits from the venture allowed Land to establish the Polaroid Corporation in 1937. Its capital value was one million dollars.

The heart of the enterprise was a modern research laboratory in Cambridge, Massachusetts. There, Land turned his attention to developing additional new products including camera filters, 3-D motion picture lenses and 3-D viewing glasses. By the late 1930s, imaginative businessmen were flocking to the laboratory in order to negotiate contracts by which they could produce and market Land's innovations. Contracts were signed with Kodak, Bell and Howell, and several motion picture companies. Of course, not all of the products proved commercially successful. For example, initial consumer

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acceptance of 3-D movies quickly waned and by the mid 1950s no major studio in the United States was producing 3-D motion pictures. But for the most part, American consumers gave Land their dollar votes as they purchased the products which his inventiveness made possible.

Land's greatest financial success story was his introduction of the Polaroid Instant Camera in 1949. Its development took ten years. Solving the problems of camera design, the chemistry of the film pack, and of lens operation, represented significant technological achievements. Land personally devoted many more years to redesigning and to perfecting the instant camera. The rest is history. Today, instant photography is a major competitive factor in the world market for cameras. The asset value of the Polaroid Corporation now stands at over 1.5 billion dollars. Although it has had ups and downs in recent years, it is the 180th largest corporation in the United States and provides employment for thousands.

Was Land's financial success assured by his scientific genius? Not according to Land. "I am an artist. My *most significant talent* lies (not in optics or chemistry) but in the ability to *foresee the demand for new consumer products* and to believe that the product can be made...My goal has always been to create new products that are well made and useful and to make them attractive values to the public and at attractive *profits* to the Company.¹ (emphasis added)

Economists would call Edwin Land an "entrepreneur." Entrepreneur has its root meaning in the French verb "entreprendre," which means "to undertake." An entrepreneur is a person who *undertakes business production projects because he alertly sees what he thinks are future demands by consumers*. Mr. Land foresaw that Americans would be willing to purchase a camera which offered instantaneous development of a snapped photograph. He estimated that he could organize the production of such a product so that the *costs of producing the camera* (parts, labor, machines) would be less than the price per unit which consumers would be willing to pay for the new product, thus yielding him a profit.

As a result of his entrepreneurial decision, consumers obtained a new picture-taking product at prices they could afford. In addition, literally thousands of individuals obtained more attractive jobs, at higher wages, working for Polaroid. The profits generated in the process provided both the incentive to undertake the entrepreneurial venture in the first place and the means to finance *later* product development, production, and distribution. The key to grasping the important role of profits arise not from genius in isolation but from the

special ability to identify and serve the interests of consumers.

Not all entrepreneurial profit-seeking involves the introduction of novel inventions as in Land's case. However, in all cases, an entrepreneur only earns profits if he correctly *anticipates* the future demands of consumers for the product he is intent upon providing.

Who can be an entrepreneur? The answer is simple — anyone. One does not have to be a businessman; most businessmen focus their attention on week-to-week management and production decisions. Nor does an entrepreneur need a lot of money (capital). Capital is just another productive input like labor or raw materials; capital can be hired (borrowed from those who save money from their incomes). No, entrepreneurs are not managers or capitalists. They are economic seers *who act* on the information they have about the future. Each person has information that is *not widely known yet*. If that special information is of economic significance and one is willing to act upon it, one may become an entrepreneur just as Edwin Land did.

II. HOW ARE PROFITS PRODUCED?

Let's explore in more detail the process which leads to profits. First, entrepreneurial profits can be earned in a variety of ways. Edwin Land earned profits by producing completely *new consumer goods*. Other entrepreneurs have developed *new techniques* for producing old products. The handheld calculator, for example, performs much the same functions as the old bulky adding machine. But the newer instrument is designed around sophisticated microelectronic circuitry while the older is entirely mechanical. The electronic calculator generated profits for its developers, not so much because it was a completely new product, but because its production was based on the use of very low-priced inputs.

Profits can emerge without the introduction of any new technology simply because of a *change* in consumer demand which is correctly anticipated and met by an alert entrepreneur. For example, the baker will earn a profit when he decides to bake and market more units of whole wheat bread because he correctly projects that consumers will demand more natural foods than they have heretofore. Such profits are just as much profits as those obtained by Edwin Land from his camera.

New methods of exploring for crude oil, producing energy from hitherto unknown sources, relaying communications, transporting goods, and informing consumers about goods and services are all examples of entrepreneurial activities undertaken because of the

promise of profit. Profits can arise at any of the stages of production from the acquisition of the original inputs, through intermediate processing, to the marketing of finished goods and services.

Second, when thinking about profit, it is important to remember that when the entrepreneur first sets out to offer a new product, there are, as yet, no profits in hand, *only* future profit *possibilities*. Anticipated profits do provide a real incentive for entrepreneurs to remain alert to opportunities and to act upon them, but such profits are *never guaranteed!*

Two things must be anticipated correctly by the entrepreneur for *potential profit* of his "dreams" to become realized or *actual profit* in his wallet:

- (1) The entrepreneur must have correctly predicted consumer demand for his final product which is strong enough to yield him a certain price, and
- (2) The entrepreneur must have correctly predicted the costs of the various inputs or components which he combined to make the final product.

If the price he foresaw is willingly paid by enough purchasers for this package of inputs that he has brought together, and if his costs when combined together are lower than the price received, then and only then will profit appear.

All too often, the general public condemns profits *after* they emerge. Profits are viewed as "unearned" or arising from something that "anybody could have done." What is often forgotten by the "man on the street" is that entrepreneurs commit themselves *today* for an uncertain reward tomorrow. By contrast, most economic actors make commitments today for sure, contractual payments in the future.

Third, suppose an entrepreneur successfully markets a new product which generates positive profits. Those profits will tend to foster imitation; they attract other entrepreneurs, that is, other businessmen, who, observing the original success, will begin to offer similar products. The consumer ends up with alternative sources of the good at lower prices. The original market innovator finds his profits eroded and the imitators find that the new market price of the good just covers the costs of production.

Consumers of the product and employees in the newly expanded industry are the real long-run beneficiaries of the competitive profit system. Notice that it is the existence of entrepreneurial profits that sparks the competitive market process. In the typical case, entrepreneurs can expect to earn profits only for a little while until the competitive process lowers prices and spreads the permanent benefits of entrepreneurial action throughout the economy.

III. WHAT ABOUT LOSS?

The future is always uncertain. One can never have perfect foresight. One can never have the information necessary to perfectly predict future consumer preferences, input prices, competitors' actions, government policies, weather conditions or international political relations. Indeed, it is conceptually impossible to obtain such definite information because *it does not and cannot exist*. As a result, entrepreneurs must exercise their best judgment as to future conditions. If their judgments are wrong, business mistakes will be made and losses generated!

The system just described is better referred to as *the profit and loss system* rather than "the profit system." The market process rewards sound decisions and penalizes mistakes. The long-run result is to drive from the ranks of entrepreneurs those who systematically make mistakes and waste scarce resources. This is socially responsible and economically correct. Since entrepreneurial action is the mechanism bringing about economic change, the discipline of the profit and loss system is itself highly desirable.

An entrepreneur is also a loss bearer as well as a profit maker. Suppose that he contracts for a load of timber; the lumber is paid for at the market price. The fact that as a result of his entrepreneurial decision the lumber is transformed into furniture that consumers do not want to buy, in no way affects the contractual payment for the lumber. Any losses are the furniture manufacturer's.

On the other hand, since the lumberman played no role in deciding how the lumber would be used, he shares in neither the profits *nor the losses* that result from the furniture entrepreneur's decision. The loss on the exchange is borne entirely by the entrepreneur. The responsibilities shouldered by the entrepreneur here are real. Profits or losses are unique rewards to entrepreneurship; they have nothing in common with payments for other productive inputs — wages to labor, prices per unit of raw material, or interest payments on capital equipment.

IV. PROFIT AND PUBLIC OPINION

Today, unfortunately, the existence of profits is often portrayed as harmful. Of the key driving forces in a market economy, profit is the most widely criticized and least understood. In classrooms, from public platforms, and in Labor Day speeches, "making profits" is routinely condemned. The theme is always the same — profits are earned by cutting corners, selling shoddy goods, charging consumers high prices, and paying labor too little. Profits are said to go to the wealthy, making the rich richer and the poor poorer. Not to be left behind, the news media report quarterly profits in such a way as to suggest something is wrong with the profit motive.

Indeed, profit has such a bad name that businessmen are beginning to apologize for seeking profits. The Committee for Economic Development, whose Board of Directors reads like the Who's Who of American Business, published a report stating that, "There are likely to be many areas of social improvement in which the prospects for profit do not meet prevailing corporate criteria. Corporations will need to re-examine traditional

concepts and measures of profit in this newer context."

In the last two decades, opinion leaders in the United States have largely succeeded in swinging the public's attitude against the profit system. Public opinion polls suggest both a growing hostility to the profit system and widespread ignorance about business profits and their role in the economic system.

The ENTREPRENEUR is a quarterly journal and newsletter addressing contemporary economic issues from a moral perspective. One may not agree with every word printed in the ENTREPRENEUR series, nor should one feel he needs to do so. It is hoped that the reader will think about the points laid out in the publication, and then decide for himself.



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