

So What?

Have you ever...

- Trained for an athletic competition?
- Studied hard for a test?
- Learned to play an instrument?

If you have, you've put your time and effort into something—so that you could get the reward: placing well at the competition, getting a good grade on the test, or playing well in the music. But what if you had to give up your energy, or effort...

SAMPLE PAGE

So, before you decide whether you've considered whether the reward would be *enough*. You thought about what you'd gain compared to what you'd give. You asked, "Is it *worth* it?" If you could answer "yes," you were expecting a profit—whether you realized it or not.

How Much Is Enough?

I bet I could sell my paper and make some decent money!

Imagine you want to sell a paper you've written—how to be popular in high school. After all, you do have first-hand knowledge on the subject. And, since you're a pretty good writer, you hope the incoming ninth graders will snatch up a bunch of copies—right away.



To prepare for the sale, you've spent long hours doing what it takes to complete your project successfully—interviewing students, writing, checking your work, making corrections, and photocopying each page at Kinko's. In all, you've prepared 300 copies of your five-page paper. And, now, you're ready to start selling it.

But what do you expect to get *in return* for your efforts? And, how can you tell if what you receive is *enough*?

What Profit Is

If you're like most people, you want to get *something* for what you spend. You don't want to put a lot into a project—without some kind of reward.

In business, when a reward is measured in financial terms, it's called profit. **Profit** is *the monetary reward a business owner receives for taking the risk involved in investing in a business*. It's what a business owner gets *in return* for putting money, time, and effort (or skill) into the business.

Business owners calculate profit using a simple formula:

$$\text{Income} - \text{Expense} = \text{Profit}$$

In other words, as soon as business owners total the firm's yearly income (the money that flows into a business), they subtract everything spent for production, sales, and administration. If they purchased materials, paid for labor, or flew staff to sales meetings, they subtract the cost out of the total income received. The result is the leftover income—or profit—that business owners can use.

If, for some reason, expenses are greater than income, there's no profit. Having no profit is an undesirable situation—because there's nothing left over from what's been put in. No profit means no reward. And, unfortunately, profit is not guaranteed.

Objectives:

A Explain the importance of profit in a private enterprise system.

B Explain how factors affecting profit can be adjusted to increase profit.



In your situation, you might choose to calculate the gross profit—especially if your parent or guardian has paid the electricity bill for you.

But a clearer picture of your actual reward comes from calculating the **net profit**—*money left after the cost-of-goods expense and the operating expense are each subtracted from the total income*. Businesses are usually more interested in net profit because they want to know *how much* extra money they can keep or spend on other things. And, because net profit is a precise calculation of the reward received, it's a realistic way to determine how *well* a particular business is doing financially. The formula for net profit looks like this:

$$\text{Gross profit} - \text{Operating expense} = \text{Net profit}$$

In short, the net-profit calculation accurately tells how much is *left over*—after all is said and done.

$$\begin{aligned} &\text{Gross profit} \\ - &\text{Operating expense} \\ \hline &\text{Net profit} \end{aligned}$$



Revealing the profit motive. Not surprisingly, it's what's *left over* that drives business owners to do what they do—from the very first day of running the business. Just as you want a reward for your work, business owners want a reward for their efforts, too. And, the greater the reward, the more owners can do with it. Consider opportunities, such as:

- Building a new facility
- Expanding into a new location
- Producing an additional product
- Giving to charity
- Sponsoring research

What businesses can *do* depends on how much businesses *receive* for their efforts. If this is the case, then how much profit is *enough*? As you might expect, each business owner answers individually.

The Gray Zone

Jared, a graphic arts buff, has agreed to do a graphic design for his friends' new club. He's creating a logo to capture the essence of what the club is all about—so the club members can buy matching shirts sporting the new logo.

Jared asks the club members if \$15 an hour is an acceptable fee for an estimated five hours' worth of work. They agree to pay him \$15 an hour, expecting to

SAMPLE PAGE

pay him \$5 an hour for software and materials. Jared will receive a total of \$75 for each hour he works. If he works five hours, he'll receive \$50 in profit. Not bad!

When Jared wakes up the next morning, however, he feels too sleepy to work very fast. The project takes him seven hours instead of five. Seven hours of work at \$15 an hour is \$105—much more than his friends were expecting to pay. His total profit at \$10 per hour comes to \$70, instead of \$50.

Does Jared have the right to charge for the full seven hours? What do you think Jared should do?

Why Profit Is Important

Benefits for business owners. The possibility of making a profit certainly provides the *motivation*—the reason—for business owners to take the risks they do. But profit can also provide business owners with the *satisfaction* that comes from owning their own businesses and from serving the people in their communities.

With your project, you've probably received some satisfaction from successfully completing your paper. And, when you sell your paper, you'll get the opportunity to provide helpful information to the incoming ninth graders—producing even more inner satisfaction. So, just as the financial side of making a profit is helpful, the non-financial side is beneficial, too.

Increase sales.

- **Change what you provide.** Cara could expand her business by baking and selling peanut butter cookies or shortbread cookies, too. For each new type of cookie she offers, Cara can attract new or additional buyers.
- **Beat the competition.** If Cara's rival sells 30 cookies in a package, Cara could sell 45. If the rival sells individual cookies for \$1.50 each, Cara could sell hers for \$1.30. And, if the rival chooses to include in the chocolate-chip cookies another ingredient, such as almonds, Cara could include cashews. Whatever makes Cara's product more desirable than her rival's is likely to bring Cara some profit.

For each new type of cookie she offers, Cara may attract new customers.



Summary

To understand how to increase profit, you need to examine both the external and internal factors that influence it. While external factors include the economy, demand, and chance, internal factors include expenses and pricing. Whether external or internal, these influences are not all beyond a business owner's control. By decreasing expenses and increasing sales, an owner can increase the chances of receiving increased profit—and increased satisfaction, as well.

1. How does the economy affect a firm's profit?

2. How does demand affect a firm's profit?

3. How does chance affect a firm's profit?

4. How do expenses affect a firm's profit?

5. How does pricing affect a firm's profit?

6. What are two ways to increase profit?

Make It Pay!

Entrepreneurs in your community are closely monitoring how much profit they receive. By watching their actions, you can find out what it is they do to increase their profits. If they charge extra fees, you know they hope to increase income. If they eliminate free services, you know they hope to decrease expenses. Talk with a local entrepreneur to learn how they increase profit. In your community, how do you help this entrepreneur?

SAMPLE PAGE

MarkED

1375 King Avenue, P.O. Box 12279, Columbus, Ohio 43212-0279 Ph: (614) 486-6708 Fax: (614) 486-1819

CopyIT!® Details: www.Mark-ED.org Copyright ©2006, by Marketing Education Resource Center®