

# BUSINESS LOSS AND PROFIT\*

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Profit, in the broadest sense, is the gain derived from action; it is the increase in satisfaction (reduction in discomfort) achieved; it is the difference between the higher value attributed to the result achieved and the lower value assigned to what was sacrificed to attain it. In other words, profit equals revenue minus cost. Action invariably aims to obtain profit. When, through our activity, we fail to achieve the proposed goal, the revenue is either not greater than the cost incurred, or is less than it; in the latter case, a loss occurs, that is, a reduction in our state of satisfaction.

In this first sense, likes and dislikes are purely psychological phenomena and, as such, cannot be measured; nor is there any semantic means by which a person can describe their intensity to others. A person may say that they prefer *a* to *b*; but it is impossible for them to indicate, except in a very vague and imprecise manner, by how much the satisfaction derived from *a* exceeds that derived from *b*.

In a market economy, everything that is bought and sold for money has a corresponding monetary price. From a monetary perspective, profit appears as the surplus between the amount received and the sums invested, whilst losses amount to the excess of money spent over that received. In this way, both loss and gain can be quantified in specific monetary sums. It is possible to state, in monetary terms, how much each actor has gained or lost. However, this statement in no way refers to the psychological loss or gain of the individual concerned; it refers exclusively to a social phenomenon, namely the value attributed to the actor's contribution to the collective endeavour

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the value accorded by the other members of society. In this regard, there is no point in discussing any increase or decrease in the individual's personal satisfaction or happiness. We confine ourselves to noting the extent to which others value their contribution to social cooperation. Ultimately, the valuation is a function of the desire of each and every member of society to achieve the greatest possible psychological benefit. It is the result of the combined effect of all the subjective judgements and personal valuations of people, as reflected in the market through the behaviour of each individual. However, this valuation should not be confused with value judgements proper.

We cannot even imagine a world in which people would act without seeking some form of psychological gain, and where an action would not result in a corresponding gain or <sup>loss</sup>.<sup>1</sup> In the hypothetical construct of a steady-state economy, there are certainly no overall monetary gains or losses. Yet this does not prevent the actor from deriving personal benefit from their actions; otherwise, they would not have acted. The farmer feeds and milks his cows and sells the milk, as he values the things he can buy with the money thus obtained more highly than the costs he has had to bear in doing so. The absence of both monetary gains and losses recorded in the uniform circulation system is due to the fact that, setting aside the greater value of present goods compared to future goods, the total price of all the complementary factors required for the production in question is exactly equal to the price of the finished product.

In the ever-changing world of reality, discrepancies continually arise between the sum of the prices of the complementary factors of production and the price of the finished product. It is these discrepancies that give rise to monetary profits and losses. We shall see later how these differences affect those who sell labour or primary (natural) factors of production, and the capitalists who lend their

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<sup>1</sup> An action that neither improves nor worsens our state of satisfaction would entail an obvious subjective detriment, owing to the futility of the effort expended. It would have been better not to have acted, the individual simply enjoying life in peace.

money. For the time being, we shall confine our attention to business profits and losses. It is these that people refer to when, in everyday language, they talk about profits and losses.

The entrepreneur, like any man who acts, is always a speculator. He weighs up future circumstances, which are invariably uncertain. The success or failure of his operations depends on how accurately he has discerned such uncertain events. He is doomed if he fails to foresee what will happen tomorrow. The sole source from which the entrepreneur's profit springs is his ability to foresee, more accurately than others, future consumer demand. If everyone were able to correctly anticipate the future state of the market with regard to a particular commodity, its price would, from now on, coincide with the price of the necessary factors of production. Neither losses nor profits would be incurred by those who undertook its manufacture.

The typical role of business is to determine how the factors of production should be utilised. The entrepreneur is the person who assigns a specific purpose to each of these factors. His self-interested desire to reap profits and accumulate wealth drives him to act in this way. But he can never escape the law of the market. To achieve success, he has no choice but to satisfy the desires of consumers as perfectly as possible. Profits depend on consumers approving of his conduct.

It is important to draw a clear distinction between business profits and losses and other circumstances that may influence the entrepreneur's income.

His technical ability or scientific knowledge has no bearing on the occurrence of typical business profit or loss. The increase in the entrepreneur's income and profits due to his own technological competence, from a catallactic point of view, can be regarded as nothing more than pure remuneration for a specific service. We are, after all, dealing with a wage paid to the entrepreneur for a specific contribution of labour. Hence, it is equally irrelevant, as far as strictly business-related profits and losses are concerned, that, due to technical circumstances, production processes sometimes fail to yield the desired result. Such failures may be avoidable or inevitable. In the first

In the first instance, they arise because an imperfect technique has been applied. The resulting losses must be attributed to the entrepreneur's personal shortcomings, that is to say, to his technical ignorance or his inability to secure the necessary advisers. In the second scenario, failure is due to the fact that, at present, human knowledge does not allow us to control the circumstances on which success depends. And this may occur either because we are unaware, to a greater or lesser extent, of which factors bring about the desired effect, or because we are unable to control some of those circumstances despite being aware of them. The price of the factors of production takes account of this imperfection in our knowledge and technical skills. The price of farmland reflects in advance the fact that the harvest may sometimes be lost; consequently, the land is valued according to the expected future average yield of the plot. Similarly, the fact that the breakage of some bottles restricts the volume of champagne produced does not affect business profits and losses. This fact is merely one of the factors determining the costs of production and the prices of champagne<sup>2</sup>.

Accidents affecting the production process, equipment or finished products whilst these remain in the employer's possession constitute a further component of production costs. The technical knowledge gained from experience also informs the relevant party of the average decline in industrial output that such accidents may cause. Through appropriate accounting forecasts, these risks are converted into regular production costs. In the case of rare and highly unpredictable incidents that a typical business cannot foresee, traders join together to form a sufficiently large group to tackle the problem. They band together to address the risks of fire, flooding and other similar incidents. In such cases, insurance premiums replace the aforementioned contingency funds.

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<sup>2</sup> V. Mangoldt, *Die Lehre von Unternehmervergewinn*, p. 82, Leipzig 1855. The fact that one hundred litres of wine do not yield one hundred litres of champagne, but a smaller quantity, is of no greater significance than the fact that one hundred kilograms of sugar beet do not yield one hundred kilograms of sugar, but a lesser weight.

It should be noted that the possibility of risks and accidents in no way gives rise to uncertainty regarding the development of technological progress.<sup>3</sup> If the entrepreneur fails to take due account of such possibilities, he merely highlights his technical ignorance. The losses he consequently incurs must be attributed exclusively to such incompetence, never to his actions as an entrepreneur.

The elimination of entrepreneurs who are unable to ensure an adequate level of technological efficiency in their businesses, or whose lack of technological knowledge distorts cost calculations, takes place in the market through the same channels used to remove from the business world those who fail in typical business activities. It may happen that a particular entrepreneur performs so well in his business role that he manages to offset the losses caused by his technical errors. Conversely, there are also cases of entrepreneurs who manage to compensate for their business-related missteps with extraordinary technical expertise or a clear advantage in the differential income from the factors of production they employ. In any case, it is advisable to separate and distinguish the various functions that must be addressed in the management of a business. The entrepreneur with superior technical ability earns more than one with lesser training, just as the more skilled worker receives a higher wage than his less efficient colleague. The most perfect machine or the most fertile plot of land yields more per unit of cost; that is to say, compared to the less efficient machine or the less fertile land, the former produce a differential rent. That higher wage and that higher rent are, *ceteris paribus*, the consequence of superior material production. By contrast, specifically business-related profits and losses are not a function of the quantity of goods produced. They depend exclusively on the ability to adapt production to the most pressing needs of consumers. Their magnitude is merely a consequence of the extent to which the entrepreneur succeeds or fails in forecasting the future state—necessarily uncertain—of the market.

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<sup>3</sup> V. Knight, *Risk, Uncertainty and Profit*, pp. 211–213, Boston 1921 [Spanish trans., Aguilar, Madrid 1947].

The entrepreneur is also exposed to political risks. Government actions, revolutions and wars can harm or ruin his business. Such events, however, do not affect him alone; they affect the entire market and the population as a whole, albeit some more than others. For the entrepreneur, they are simply circumstances beyond his control. If he is astute, he will know how to anticipate them in good time. Naturally, he will not always be able to organise his actions in such a way as to avoid losses. When the perceived dangers affect only part of the geographical area in which he operates, he may withdraw to less threatened territories. However, if, for whatever reason, he cannot flee, there is nothing he can do. Even if all entrepreneurs were convinced of the imminence of a Bolshevik victory, they would not for that reason abandon their business activities. The prospect of imminent confiscation would prompt capitalists to consume their assets. Entrepreneurs would adapt their actions to the market situation caused by this consumption of capital and the threat of nationalisation of their industries and businesses. But they would not cease to act for that reason. Even if some were to leave the field, others—newcomers or established entrepreneurs expanding their sphere of activity—would occupy the vacated positions. In a market economy, there will always be entrepreneurs. Anti-capitalist measures will undoubtedly deprive consumers of the immense benefits that unhindered entrepreneurial activity would have bestowed upon them. The entrepreneur will not disappear until the market economy is completely abolished.

Uncertainty regarding the future structure of supply and demand is, ultimately, the source from which business profits and losses spring.

If all entrepreneurs were able to predict the future state of the market with complete accuracy, there would be no room for profit or loss. The prices of all factors of production would already fully reflect the future price of the corresponding finished products. When acquiring the factors of production, the entrepreneur would have to pay (after discounting the difference in value that must always exist between present and future goods) the same amount that buyers would later pay him for the

goods. The entrepreneur makes a profit when he succeeds in anticipating, more accurately than others, future market conditions. He then purchases the complementary factors of production at prices whose sum, including the discount for the time difference, is less than what he will obtain for the product.

If we are to imagine a changing economy in which there is neither loss nor gain, we must start from an unworkable assumption: that everyone possesses perfect foresight. If the primitive hunters and fishers to whom the primitive accumulation of man-made means of production is usually attributed had known in advance all the future vicissitudes of human affairs, and if both they and their descendants right up to the Day of Judgement, all possessing the same omniscience, had valued the factors of production in accordance with this knowledge, there would never have been any losses or profits. Business losses and profits arise from the discrepancy between anticipated prices and those actually paid later by the market. One can, of course, confiscate the profits reaped by one person and transfer them to another. However, in a changing world not populated by omniscient beings, neither losses nor profits can ever disappear.