**LESSON 8**

**WILL I MAKE A PROFIT?**

**Definition of Profit**

Profit is an important and often misunderstood concept in economics. Profit is the amount remaining after the costs of production are subtracted from sales revenues. States revenues are simply the proceeds from sales—the amount of products sold times price. The concept of cost, however, can have different connotations. Economists define costs as all the costs of production, including the opportunity costs of using a firm's productive resources in their best alternative use. When costs are defined in this inclusive way, profit is referred to as economic profit.

However, businesses normally use only the explicit costs of production (labor, materials, rent, interest, etc.) when computing profit. The opportunity costs of productive resources are typically not included in calculations. This more narrow definition of profit is called accounting profit. However, to make informed production decisions, businesses must take into account all the opportunity costs of their productive resources.

**Profit in a Market Economy**

Profit performs several crucial functions in a market economy. First, profit is an incentive. Without the possibility of profit, entrepreneurs would not risk investing their savings to produce goods and services for consumers. Second, profit is a signal that communicates what goods and services consumers want most. For example, if computer producers are earning high profits, this shows that there is high demand for computers relative to their supply. Producers and entrepreneurs anxious to make profits will use their productive resources to supply more computers, thus meeting the high demand. Third, profit is a reward. Profit rewards those risk-taking entrepreneurs who perceive consumer wants and who satisfy those wants most efficiently.

**Distributing Profits**

The owners of a business decide how to use any profits. Corporations, which are owned by stockholders, frequently distribute profits to the stockholders in the form of **dividends**. Sometimes the board of directors of a corporation decides not to distribute dividends. Instead, the board may decide to invest profits to expand production. In this case, profits are the source of **business savings**.

Producers (businesses) as well as consumers confront the concepts of **scarcity** and **opportunity cost** when making decisions. Business savings are limited, but the possible uses of those savings are virtually unlimited. A business that decides to use its scarce business savings to finance the production of a certain product, must forego using the savings to finance the production of another. Because of scarcity, every decision has an opportunity cost.

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**MAKING DECISIONS ABOUT PROFIT**

In this section the students close their business. First, they compute how much profit their business made. Then, they decide what to do with their profits. Finally, the students determine whether or not the business was really worth their time and effort. Should next year's class undertake the project? The students prepare a final report which makes recommendations and suggestions for next year's class.

**Teaching Objectives for Goal 1**

**OBJECTIVE1: Compute Profits**

Important Concepts

**Cost** – the expenses a business pays to produce a product

**Interest** – a fee that is charged for using borrowed money

**Profit** – the amount left over after subtracting costs from sales revenues

**Sales Revenues** – the money a business makes from selling a product

**Specific Teaching Activities**

Teach the concept of profit. Point out that any money invested by stockholders is not part of the profit, but must be returned to stockholders, along with any dividends.

Discuss how to compute profits. Use the Sales Revenues Worksheet (Form 8-1) and the Profit Worksheet (Form 8-2) to help you. You will need to complete a revised Product Cost Computation Sheet from your Resource materials in these computations. Compare your actual profit to the profit estimate. Was there a difference? Discuss why.

**Questions to Ask Students**

What is profit? *(The amount remaining after subtracting costs from revenues.)*

Why is profit important in our economy? *(Profit performs three important functions: it is an incentive to producers, it is a signal identifying the goods and services that consumers want most, and it is a reward for successfully satisfying the consumer.)*

If a business consistently makes high profits, what does this show? *(It shows that the business does a good job providing what consumers wanted, and that the business produces the product efficiently i.e., with low costs.)*

**Teaching Tip**

Donations of materials make it very difficult to compare costs. For example, a class may make the most profit only because raw materials and outside expertise were donated, not because the class was especially skillful with their business. It would be best to not allow donations of materials. To add a dose of realism, some teachers require the business pay a corporate income tax. The tax is usually paid to the school.

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**OBJECTIVE 2: Decide How to Use Profits**

Important Concepts

**Choice** – deciding among various alternatives

**Dividends** – the part of a corporation’s profit that is paid to stockholders

**Opportunity Cost** – the most valuable alternative you give up when you make a choice

**Scarcity** – when people’s wants are greater that the resources for satisfying those wants

**Specific Teaching Activities**

Use the Balance Sheet (Form 8-3) to help determine how to distribute money that the business now has on hand. This money includes any profits plus the original money used to start the business (from stockholders, bank loans, or personal savings). If your business is owned by stockholders, first decide what dividends will be distributed to stockholders. Give stockholders back their original investment plus the dividend payment. (See Teaching Tip a.) Repay any bank loans, including interest.

Completing the balance sheet requires careful decision-making. Remind students that since profits are scarce, they will have to choose among several alternative uses. Two possible alternatives are gifts to charity and setting aside savings to start next year's business. Remind students that there is an opportunity cost to their final decision.

Producers (businesses) as well as consumers confront the concepts of scarcity and opportunity cost when making decisions. Business savings are limited, but the possible uses of those savings are virtually unlimited. A business that decides to use its scarce business savings to finance the production of a certain product, must forego using the savings to finance the production of another. Because of scarcity, every decision has an opportunity cost.

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**FORM 8-1**

**SALES REVENUES WORKSHEET**

|  |  |  |  |
| --- | --- | --- | --- |
| **Item** | **Price** | **Quantity Sold** | **Sales Revenues** |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  |  |  |
|  |  | **Sales Revenues**  **from all Items** |  |

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**Form 8–2**

**Profit Worksheet**

**Total Sales Revenue (from Form 8-1) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Minus Total Costs (Use Product Cost Computation Sheet)**

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Before Tax Profit \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Tax on Profits (if any) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**After Tax Profit \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

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**FORM 8-3**

**BALANCE SHEET**

**Total Cash on Hand**

(from profits, stock sales, loans, etc.) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Distributions**

Paid to Stockholders \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Paid to Bank or Loaner (including interest) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Save for Business Improvement \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Gift to Charity \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Other Distributions, if any (rent & etc.) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Total Distributions \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

**Amount Left for Corporation**

Total Cash on Hand \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**MINUS** Total Distributions \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

For Corporation Use \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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