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PROFIT

Profit is the reward to an entrepreneur for the functions he renders in productive activity. Out of the income earned by the farm, land owner is paid rent, labourer is paid wage and capitalist is paid interest. Whatever is left over goes to the entrepreneur as profit. Hence, profit is also called a residual income.

Uncertainty-Bearing Theory of Profit

This theory was propounded by F.H. Knight. Knight divided risks into
(i) Foreseeable risk-a risk that can be foreseen by the entrepreneur and
(ii) Unforeseeable risk-a risk, which cannot be foreseen by the entrepreneur.
Knight calls this unforeseeable risk as uncertainty. According to Knight, profit does not arise on account of foreseeable risk, since such risks can be insured. Hence, risk taking is not the function of the entrepreneur, but of the insurance companies. Profit, according to Professor Knight, is due to non-insurable risk (or, unforeseeable risk). A loss due to fire accident in a factory is an insurable risk.
A few cases of non-insurable risks are: (i) Loss due to labour strike, (ii) loss due to heavy competition from rival companies, (iii) Loss due to changes in tastes and preferences of the consumer which in turn would result in low demand for the product. It is the primary function of the entrepreneur to anticipate and provide alternative arrangements to tackle non-insurable risks or uncertainties. Thus,

profit is paid to the entrepreneur for his ability to bear uncertainty and not for risk-taking.

Risk Bearing Theory of Profit

According to Professor Hawley, profits are the rewards for risk taking, which is an important function of an entrepreneur. Production is carried on in anticipation of demand. However, the risks due to theft, accidental damages, price changes (which may again be due to change in fashion, tastes, preferences, etc), labour strike and so on may cause losses. Hence, the entrepreneur has to reduce these risks wherever it is possible. The risk taking is an unpleasant work, though an essential job, for which the entrepreneur has to be suitably rewarded. That reward is called profit. However, there are certain risks for which the consequences are not known well in advance and such risks cannot be insured against. The remuneration for known risks is not profit. Profit arises on account of assumption of unknown risks and it is explained by the uncertainty theory.