A Campaign on Profits

Much of the strength of the opponents of free enterprise is derived from unfounded suspicions in the public mind about the facts of business life. These suspicions are in part a consequence of false propaganda; but to a not small extent they arise from the failure of business enterprises to explain and to justify their activities before the tribunal of public opinion.

In no case are the suspicions more pronounced than in that of business profits; for the whole socialist argument is very largely built on the supposed evils of profits and on the naive generalisation that industry should be operated in the public interest instead of for private gain; (as if the two were inevitably in diametric opposition)! This kind of argument, with its powerful superficial appeal, has rallied tens of thousands of people to the support of the socialist cause.

A DENT IN THE PUBLIC CONSCIOUSNESS

Over the last few years some businesses have published fuller information about their profits than that normally submitted to their shareholders. But these efforts, which have been on a very restricted scale, have probably succeeded in making little more than a dent in the public consciousness, and it is safe to say that today the misconceptions that exist about profits are just as strong as ever they were.

Many large companies still labour under the impression that there is no need to explain their profits to the public — profits are the concern of shareholders and of no one else. Others that the task of justification can be more satisfactorily performed through a central organisation such as the I.P.A. which will serve to relieve them of the worry. The first group should stop to think about the great advances that socialism is, at present, making in all the democratic countries; the second should realise that a central body can do little more than evolve a general strategy, that the real fighting job of explaining and justifying the facts of business life over a very large range of problems can only be successfully done at the front lines of industry—that is, by individual businesses them-

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selves, through their own direct and intimate contacts with their executives, employees and customers.

In their approach to the problem of providing information about profits nothing less than a revolution in business thinking is required. For the business attitude towards profits and other matters is still largely a product of traditional ideas of privacy and secrecy; that the very minimum of information that can be given to the very smallest number of people will, in the end, be in the best interests of all concerned, particularly in those of business itself.

THREE GREAT MISCONCEPTIONS

There are three major misconceptions abroad about business profits:

First, that they are excessively large:

Second, that they benefit only a comparatively few wealthy people:

Third, that they perform no useful function in the economic process, and that if they were eliminated everyone would stand to benefit greatly through lower prices and higher incomes.

Of these misconceptions the third is by far the most important, for if the public can be convinced that profits perform a valuable and indispensable function, it will be less disturbed about their size and less concerned who gets the benefit from them. Many people are at present only too ready to believe fantastic stories about the size of profits and the huge incomes made from them because they dislike profit itself. They think it represents an unfair and unjustifiable exaction from their work and wages for the benefit of a few inactive wealthy shareholders. *If they can be shown the need, in their own interests, not only for profits, but for good profits, they will be far less inclined to heed every piece of exaggerated propaganda about the exorbitant earnings of business, and to indulge in an outburst of abuse when they read of rising profits in the financial columns of the daily press.*

WHAT ARE PROFITS?

What, then, are profits, and what do they do?

It should first be made clear that those who criticise profits usually have in mind the profits of large public companies whose accounts are published in the press. They do not worry about the profits of the local confectioner, or grocer, or garage proprietor, for their common sense tells them that these people cannot exist unless they earn a profit—that is what they are in business for—and that their profits are largely the reward for their work. But the profits of public companies are not a direct reward for work; they go in the main to shareholders who do not take any active part in the business, but merely contribute their money by investing in the company. Why should these people get any reward?

A large element in the reward of the company shareholder represents interest on his money, just as a fixed rate of interest is paid to people who put their savings into government bonds or into deposits in a savings or trading bank. Governments borrow money for public works which are designed to increase the productive power and wealth of the community, whilst companies float share issues to finance a new industry or for purposes of expanding existing plant and equipment in order to produce more, better and cheaper goods for sale to the public. In essence "borrowing" by governments and public companies is identical in purpose. Very few question that governments should pay interest on the money they borrow or savings banks on savings lodged with them. Why, then, should there be any doubt that companies should earn at least sufficient money to pay interest to those who have entrusted them with their savings? How can it be good for governments to pay interest on the money they borrow and bad for businesses?

"But," many will protest, "the shareholder in a company generally gets a much higher return on his money than the investor in government bonds." That is true, and the reason is that Mr. Smith who invests his savings in company shares takes a far greater risk of losing both his interest and his original capital contribution than Mr. Brown who plays safe

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by putting his money into government securities. If Mr. Smith did not stand to get this higher return then there would be no incentive for him to shoulder the risk; he would be satisfied to follow Mr. Brown's example and invest his money in bonds. What are these greater risks?

In the first place the investor in government bonds is guaranteed the interest on his investment in wet weather or fine. He is also guaranteed the monetary return of his capital at the termination of the loan. He cannot lose—or lose very much. On the other hand, the shareholder is assured neither of his interest nor of the security of his capital. In some years he may receive no dividends at all. In fact the high dividends received in prosperous years by shareholders in public companies often do no more than counter-balance the low dividends paid in the lean years. Not infrequently investors in company shares lose a very large part of their capital investment. *The return received by the company investor over and above the interest paid to the holders of government bonds is thus to compensate him for the risks he takes. If his company thrives and prospers he stands to get a correspondingly high reward. If, however, his company fails to prosper, he may be involved in very heavy losses.*

Company dividends thus may be said to consist partly of interest on the capital investment and partly of a reward for risk-taking. Without this extra payment for risk, there would be no inducement for people to invest their savings in company shares, and there would be no capital forthcoming for the purposes of business expansion. An essential function of business profits is therefore to attract the "risk capital" necessary for commercial and industrial development.

If company profits were eliminated, or so cut down as to reduce the return of the shareholder to close to that received by the investor in government bonds, some other method would have to be found of providing the capital required for industrial growth. Since people would not be prepared to do it voluntarily in a private capacity, it would have to be achieved either through compulsory methods by heavy taxation or by means of government loans. In the first instance, the capital would not represent an investment. The government would, in effect, extort money from the community which would otherwise have represented personal savings. In the second instance the risks of industrial expansion would be taken by the government. They would therefore be spread over the whole community instead of over that section which was in a position to and prepared voluntarily to undertake them. Where losses were incurred they would have to be met through heavy taxation which the community would, of course, have to pay.

PROFITS SET ASIDE

There is, however, one other vitally important function performed by business profits. All company profits are not paid away as dividends to shareholders. It is the practice of all well-run companies to set aside quite a large proportion of their yearly earnings for modernising their plant and equipment and for expanding their businesses. This practice of using a part of profits to finance further expansion has played a very significant part in the industrial progress of the community. Some of the largest industries in the United States, Great Britain and Australia have been developed by this means. And the community as a whole of course benefits in terms of new or better products, lower prices and costs of production, and industrial and military strength. *There is every reason, therefore, in the interests not so much of companies themselves as of the whole community, why this practice of "ploughing back" profits into fresh development should be encouraged to the utmost.*

The basic functions of profits are therefore threefold—to provide the interest required to finance the capital necessary for business development; to provide an extra return over and above this for the relative degree of risk taken by the investor; and to provide part of the finance necessary for the purposes of industrial and commercial expansion.

ARE PROFITS TOO LARGE?

The question may now be asked whether, in general, company profits are higher than is necessary for the performance of these functions?

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In the first place most people have no other grounds for thinking so than what they have been told by others. Very few of them have taken the trouble to examine the figures for themselves and have really no sound basis for thinking as they do. This assertion is borne out by the results of a recent Gallup Poll. The Poll showed that one-third of those interviewed were not able even to give an opinion as to what they considered would be a reasonable average profit for companies. Half of those who expressed an opinion thought that something less than 10% on shareholders' funds was a reasonable rate of earnings. The prevailing impression however was that the usual rate was something like 20%.

What, in fact, is the average ruling rate? In 1948 the average rate of company profits was 8%, and of company dividends 6%, on shareholders' funds. But this was a year of exceptionally good profits; in fact, of the highest "money" profits for two decades. The average profit over these decades was substantially less than 8%—slightly over 6% on shareholders' funds. Average dividends were just on 5%. The investor in company shares at today's high valuations would, however, have to be prepared to receive on average little more than 4% return on his money, or something like 1% above what he would get from gilt-edged securities.

In general, it hardly appears that the average return paid by public companies gives any ground at all for the view that these institutions make excessive or over-large profits. Indeed when the extra risk is taken into consideration the average return appears remarkably low by comparison with that to be obtained from gilt-edged securities.

PROFITEERING

To argue that company profits over the whole of industry are, on average, no more than reasonable, is not of course to argue that there are no instances of excessive profit. Let it be frankly admitted that some companies do make more profit and pay their shareholders higher dividends than can be fairly regarded as a reasonable return for the risks they take. But there are not many companies that do this, and it is utterly unfair and unthinking to condemn the great majority for the sins of the very few. Because a few boards in the house are rotten provides no reason for pulling down the whole house.

Exorbitant profits, however, are indefensible, on any count, and wherever they exist should be roundly condemned. *And those who should be strongest in their condemnation are the supporters of free enterprise itself, for the unscrupulous individual or company does incalculable political damage to the reputation and prestige of all businesses.* Irresponsible greed, whether it comes from companies or trade unions, is utterly reprehensible and deserving only of the strongest condemnation.

In order to prevent profiteering it has many times been proposed that an arbitrary limit should be imposed on all company profits. Any attempt to do this would result in tremendous economic harm and inflict gross injustices between companies; and for the simple reason that risks taken by different businesses vary enormously. Why should the highly competitive business be allowed no greater profit than a company in a comparatively safe monopolistic position? A rate of profit that might be reasonable for banking or insurance would probably be grossly unreasonable for a company with wasting assets engaged in gold or oil mining. Why should a company that has been incurring losses for a number of years, in attempting say to market a new product, not be allowed a greater rate of profit than a company which has earned a profit in season and out of season? Is the efficient company striving all the time to improve its productivity to be permitted no greater profit than the company prepared to coast comfortably along?

The closer one examines the matter, the clearer it becomes that the real interests of the community do not lie so much in low or even moderate profits, as in efficient production at low cost. *It is plainly better, from the community's point of view, to have a highly efficient company which can sell its products at low prices and still make a big profit, than an inefficient company which in spite of its high prices only makes a moderate profit.*

WHEN PROFITS ARE HIGH, WAGES ARE HIGH!

Moreover, if we look at the economic scene as a whole, years of good profits are also invariably years of good wages. When profits are low, wages are low, and when profits are high, wages are high. In 1947/48 the money profits of companies were high, but so were wages—indeed the latter were at all-time record levels.

And this is not surprising. When the prospects of profit are good, businessmen will be encouraged to launch new ventures, to expand their activities, to spend money on improvements to increase their efficiency, to produce more, better and cheaper products for the enjoyment of the community. Profits, indeed, are an almost infallible index of the degree of economic prosperity a community is enjoying. In 1947/48 profits in the United States were unusually high; but so were wages, and the American people were never in an economic sense better off. *The time may come, if business will embark on a campaign of education about its profits, when the public may acclaim the high profits it reads of in the financial columns of the press as evidence of its own prosperity.*

OTHER MISCONCEPTIONS!

There are other misconceptions about the size of company profits. One is that they comprise an abnormally large part of the total of all incomes. But look at the figures. In 1947/48 the Australian national income amounted to £1,635 m., but the total dividends paid to shareholders in Australia—before taxation—were only £35m., and the total income of companies after payment of tax only £108m. The total wage and salary bill was just on £900m. If it were practicable to divide up all company profits among the community without decreasing production—and of course it is not—there would not be enough to make other than a very small addition to the incomes of wage and salary earners. These are the hard facts of arithmetic; they cannot be altered by all the "high profit" propaganda in the world. A great Labour leader in Britain, Sir Stafford Cripps, said recently that a drastic cut in profits by one quarter would mean an addition to wages and salaries of only 4d. in the £1.

Another misconception is that company profits take the predominant proportion of the revenue made from the sale of their products. An analysis is made on p. 89 showing the split-up of every £1 of revenue for a number of prominent companies. On average, wages take 5/- of every £1 of revenue, dividends about 6d. Purchases of materials account in most cases for over 10/-.

THEY BENEFIT ONLY THE FEW ?

The third major misconception about company profits is that they benefit only a comparatively few wealthy shareholders. There is no truth in this. In 1943 the Labour Prime Minister, the late Mr. Curtin, stated that there were 300,000 shareholders in Australian industry with incomes under £250 a year. Over all there are probably about half a million shareholders in Australia.

The overwhelming majority of shareholders in Australian companies are people of small or moderate means. This is not fiction but fact, and can be proved by any fair-minded examination of the figures. The table on p. 90 sets out the number of shareholders in some of the largest Australian companies, the average size of their holdings, the average dividends paid, the number of employees, and the average wage. Average holdings are about 500 shares, and average dividends less than £1 a week. In most cases, and quite contrary to popular opinion, the number of shareholders exceeds the number of employees.

Sometimes public companies are criticised on the grounds that control is vested in small groups of shareholders who between them hold the predominant proportion of the shares. A survey of some of the larger British companies disclosed that holdings of more than £500 constituted less than 10% of total capital; moreover, that these large holdings were often held not by individual investors but by institutions such as banks, trustee and investment companies. Hundreds of shareholders had usually to lump together to give a voting majority. There is no reason to think that the position would be much different in Australia.

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A TASK FOR BUSINESS

Profit is at the core of the free enterprise way of life, and the socialist attack on this way of life is, in the last analysis, largely directed at business profits. If free enterprise is worth defending, profit is worth defending, and the defence can no longer be delayed. *There is an urgent and over-riding need for the business community to re-establish in the public mind the economic and moral justification of profits.* For when this has been done, one of the central pillars of the socialist argument will have been destroyed.

The task is a big one. Success will not be achieved in a day. Nor will it be achieved by the spasmodic attempts of a few of the larger business enterprises in this country. It is a task in which every business of any proportions must participate, and they should commence to participate by starting to think about it *now*.

NOTE: The I.P.A. has published other material relating to profits in:—
"Looking Forward," Ps. 36-40 (a booklet).
"Profit, Income and Living Standards" (a booklet).
"Taxation in the Post-War Years," Ps. 41-49 (a booklet).
"Profits and the Profit Motive" (Article in "Review," August, 1947).
"Company Taxation" (Article in "Review," April, 1948).
"Profits and Prices" (Article in "Review," June, 1948).
"Taxation and the Economy" (Article in "Review," December, 1948).

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TABLE I.

SPLIT UP OF REVENUE £—AUSTRALIAN PUBLIC COMPANIES.

Company	Payroll	Materials	Other Exs.	Taxation	Dividends	Reserves
Manufacturing						
Textiles—						
Felt & Textiles of Aust. Ltd.	3/7	13/2	2/3	5½	6½*	
Valley Worsted Mills Ltd.	5/5	7/5	3/2	2/4	1/8*	
Yarra Falls Ltd.	5/11	8/11	3/2	1/0	1/0*	
Clothing—						
Holeproof Ltd.	6/11½	9/9	1/10	9½	4½	3½
Jantzen (Aust.) Ltd.	6/6	7/7	5/2	†	6	3
Pelaco Ltd.	5/3½	11/5	1/9	9	5½	4
Radio, Electrical, Etc.—						
A. G. Healing Ltd.	3/4	12/11	2/3	8	3½	6½
Electronic Inds. Ltd.	3/8	12/7	2/10	7	4*	
Tecnico Ltd.	7/6	3/4	2/3	1/1	6½	3½
Motor Vehicles—						
General Motors-Holdens Ltd.	4/5	12/11	1/11	†	9*	
Farm Machinery—						
Howard Auto-Cultivators Ltd.	8/9	†	9/8½	10	5½	3
Steel Equipment—						
E. T. Brown Ltd.	7/0	7/3½	3/7	11	6	8½
Printers' Requirements—						
Sidney Cooke Ltd.	4/10	10/5	2/7	7	1/7*	
Chemicals—						
I.C.I.A.N.Z. Ltd.	3/0	15/2	9	5	6	2
Paper—						
Aust. Paper Mfrs. Ltd.	4/2½	9/0	5/2½	7	9½	2½
Rubber—						
Dunlop Rubber Aust. Ltd.	4/7½	11/1	1/6½	1/6½	11	3½
Olympic Tyre & Rubber Co. Ltd.	3/7	11/10	2/7	1/2	10*	
Coalmining						
Hetton Bell Bird Collieries Ltd.	11/11	2/3	4/1	1/2	7*	
Retailing						
Manton & Sons Ltd.	3/7	12/4	1/4	2/2	5	2
Myer Emporium Ltd.	2/0	15/0	1/8	9	5	2
Transport						
Adelaide Steamship Co. Ltd. ..	14/0	†	6/0	†	†	†
Ansett Transport Inds. Ltd.	5/4	4/5	8/9‡	8½	5	4½
Newspapers						
Advertiser Newspapers Ltd.	5/8	4/11	5/6	1/7	2/4*	
Associated Newspapers Ltd.	6/10	6/4	4/5	1/1	1/1	3
Herald & Weekly Times Ltd.	5/11	6/2	5/1	1/1	1/7	2

NOTES: *includes reserves. †included with other expenses. ‡includes 3/4 covering costs of purchase of accommodation for tourists.

The data is compiled from information published or furnished by each company and is not necessarily for the latest financial year. However, the ratios vary little from year to year. Classifications are not entirely uniform, e.g., some companies include indirect as well as direct taxation under the item "taxation." As profit margins and expenses vary with the type of business conducted, inter-company comparisons should be treated with reserve.

TABLE II.

AVERAGE SIZE OF SHAREHOLDING, AVERAGE DIVIDEND AND AVERAGE WAGE OF AUSTRALIAN PUBLIC COMPANIES.

Company	No. Shareholders	No. Employees	Average Shareholding £ Paid up Cap.	Average Dividend £ p.a.	Average Wage £ p.a.
B.H.P. Co. Ltd.	23,377	11,400(1)	594	49	450
British Tobacco Co. (Aust.) Ltd.	12,881	5,730	860(2)	74(2)	N.A.
Aust. Consolidated Inds. Ltd.	7,300	7,100	638	45	335
Dunlop Rubber Aust. Ltd.	12,140	4,342	387	33	415
Electrolytic Zinc Co. of A'sia Ltd.	11,065	N.A.	271	24	N.A.
Aust. Paper Manufacturers Ltd.	12,310(3)	5,000	294	21	468
Metropolitan Gas Co. Ltd.	5,706	2,687	290(4)	23	464
Associated Newspapers Ltd.	5,998	1,637	401	21	593
Felt & Textiles of Aust. Ltd.	5,400	5,773	377	44	324
Myer Emporium Ltd.	4,500	6,600	550	53	182
Repco Ltd.	1,700	1,500	350	45	424
Adelaide Steamship Co. Ltd.	4,100	N.A.	567	34	N.A.
Elec. Meter & Allied Inds. Ltd.	4,330	N.A.	384	29	N.A.
Bradford Cotton Mills Ltd.	2,081	N.A.	613	41	N.A.

NOTES: The data has been derived from information furnished or published by each company and covers financial years ending in 1947 and 1948, except for Electrolytic Zinc which is for 1944. In some cases it is very approximate.

Average dividends and average wages are shown before taxation is paid by the shareholder and wage-earner.

Average wages vary with the proportion of females and juveniles.

Debenture holders have been excluded.

(1) Employment in B.H.P. and allied and subsidiary companies is about 30,000, but total investment in the group represents many more shareholders besides B.H.P.

(2) Average shareholdings and average dividends are generally overstated because of the presence of corporate or joint interests. This is very important in the case of British Tobacco where average holdings are reduced to £387 and average dividends to £31, with the exclusion of corporate interests.

(3) Includes shareholders in Australasian Paper & Pulp Co. Ltd. which holds a majority interest in Australian Paper Manufacturers Ltd.

(4) £537 if premium capital included.

TABLE III.

DISTRIBUTION OF SHAREHOLDINGS OF SELECTED PUBLIC COMPANIES.

Shares held by	Metro. Gas % Total Shares	A.C.I. % Total Shareholders	Electrolytic Zinc % Total Shareholders
Females	42	48	53
Males	31	43	46
Estates, Corporations, etc.	27	9	1

Nominal Value of Holdings		Metro. Gas % Total	Olympic Tyre % Total	Sidney Cooke % Total
Under	£50	23		
,,	100		45	
,,	125	49		
,,	250	73	75	
,,	500	88	86	72
,,	1,000	96	94	86

SOURCE: Information published or furnished by companies concerned.

TABLE IV.

SHOWING HOW THE TOTAL INCOME OF ALL AUSTRALIAN COMPANIES IS DIVIDED BETWEEN TAXATION, DIVIDENDS AND RESERVES—1947/48.

	£m	%
Company Taxation	70	39
Reserves	64	36
Dividends to Residents	35	20
Dividends paid Overseas	9	5
Total Company Income	178	100

SOURCE: Estimates of National Income and Expenditure, 1947/48.

NOTES: This table shows that by far the largest proportion of company income goes to governments in taxation—probably over half, after allowing for personal taxation on dividends after they reach the hands of shareholders.

A further large share of company income is ploughed back into companies for capital development. A comparatively small proportion (25%) goes directly to shareholders in dividends, and this becomes very much smaller after shareholders have paid their tax.