Dear Mr. Hill:

There is one basic fact of economic life which hasn't yet discussed in any depth, though it has come up in many student letters to me. This is profit.

Students think about "profit" when they consider business as a career or as a social force. A student who shuns a business career because he feels: "there is more to life than making money" may also be one who thinks "businessmen will do anything to make a profit" or "businessmen make profits at someone's expense."

The overwhelming majority of American businessmen today would agree enthusiastically with this student's first statement. They would reject emphatically the others.

But what is profit? Profit of all, business does not do things in order to make a profit; business makes a profit in order to do things. I will illustrate this with some Motorola facts and then refer to the view of a college professor who also has served the government.

Motorola's 1965 net profit amounted to just over 5% of our sales. Because we made a profit, we were able to put $114 million into our employees' profit-sharing fund and pay Federal income taxes of $26 million. We retained $26 million to invest in our future growth.

The funds a company needs to fill growing consumer demand come, in the last analysis, from retained earnings and from depreciation. Depreciation is the cost of buildings or equipment wearing out; each year, we charge against income part of the original cost and thus ultimately recover it. Our 1965 depreciation was $10 million.

To pay for the expansion needed to fill 1965's increased demand for our products, we had $26 million of retained earnings plus $10 million in depreciation—a total of $36 million. Buying new equipment and plants during 1965 took $25 million. We also needed $20 million in "working capital" to finance larger inventories, higher accounts receivable, and meet payroll payoffs. $45 million was needed. $36 million was available. The $9 million difference came from earnings previously retained just such a use.

Motorola manufactures radios, television sets, record players, semiconductor products, industrial and hospital communications systems, military and automotive electronic hardware, electronic control systems, space equipment and some other things.

We started with only a car radio. Without profit, we could not have expanded or diversified into all these other lines—and the demand for these products showed the need for them. Profits cannot do the whole job here, but making a profit does qualify you to borrow funds to grow on. We have done this several times. And because we were profitable, we sold additional common stock several times.

Here are earnings reports of some other companies, each of whose 1965 profits set new records: Bethlehem Steel, Standard Oil (Indiana), Sinclair Oil, and Westinghouse Electric. Their earnings, as a per cent of sales, ran 6.4%, 6.7%, 6.7%, and 4.65% respectively. If you were selling on commission, would you think these percentages were too high? Could these companies continue to serve their customers without the retained profits to finance new plants and for working capital?

Motorola is owned by shareholders who advanced their money and share the risks. To them, during 1965, we paid $6 million in dividends—less than 7% of the year-end market value of their stock. Does this rate seem excessive? The employees' profit-sharing plan received nearly double this amount.

Profit has been a catalyst in an economy which has raised the per capita share of the gross national product 42% in your lifetime (to $3110) and has prospects of doubling this figure by the year 2000 (both in constant 1959 dollars). Average corporate profits, for companies in all industries, have gone up 67% in the year-end market value of their stock. Does this rate seem excessive? The employees' profit-sharing plan received nearly double this amount.

In his recent book, Economic Myth and Reality, Professor Delbert A. Snider, chairman of the Department of Economics at Miami University, Oxford, Ohio, examines the myth that: "Profits are an unearned and unnecessary 'grab' on the public's purse." The reality, he concludes, is that: "Profits are an essential part of our economic system, guiding the use of resources and providing the base for increases in the standard of living. The best safeguard against excessive profit is competition."

Professor Snider sees profits as reward for risk-taking, innovation, and the organizing of production. Profits encourage business "to be as economical and efficient as possible in the use of society's productive resources" (material and human). Profits are also "extremely important as a signal device informing business of the kinds of products the public desires."

New developments in every field of endeavor are funded from profits. Many schools and universities are sustained substantially by the ability of business to make a profit. Just over half of most corporate profits are paid to the Federal government in income tax alone; whatever government agencies or programs you consider excellent are able to function only because the country's economic system produces wages and profits to be taxed.

Like every tool of man since fire, profit can be misused. In the developing history of mankind, however, no economic system has yet been devised that brings as much benefit to as many people as ours does. Our challenge is to minimize the misuse and maximize the benefits.

Making a profit should be neither the primary reason a business exists nor the primary reason a businessman works. Profits are not the purpose of a business but profits must be earned if the business is to continue to serve the needs of society. And that is its purpose.

—Robert W. Galvin
Chairman, Motorola Inc.

PROFITS AND YOU

This open letter about profits and their function is written by a businessman to one of six student correspondents on six different campuses. It is part of a continuing series of open letters published in 28 student newspapers across the country.

James Hill is a student at Harvard. Robert W. Galvin is chairman of Motorola Inc. If you have comments or questions, write to Mr. Galvin at 8501 West Grand Avenue, Franklin Park, Illinois 60131.