CHAPTER FOUR
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PROFITABILITY ANALYSIS: A CONCEPTUAL STUDY

4.1 Profitability – Defined:

Profit is essential for survival of business. It is also required by a person to meet one’s individual needs as well as social responsibilities. Profit earning ability is considered to be the index of business success. It measures the net effectiveness and soundness of business efforts and is the test of business performance. It also provides against unforeseen loss and risks. It ensures supply of future capital for innovation and expansion either in the form of self financing by ploughing back of profits or attracting new capital. It is an absolute necessity for the business enterprise to produce at least that much profit which it would require to cover its own future risks arising out of uncertainties inherent in business, to enable it to stay in business and to maintain intact the wealth producing capacity of the resources. Hence, no one can disagree with the concept that business must give a certain minimum rate of profit. But then, it does not imply maximisation of profits for that may lead to concentration of wealth in a few hands and the evils arising therefrom. Besides the question of minimum profit, it is also important to see that the methods adopted to earn profits may be fair.

Profitability is the profit earning capacity of a product, process, plant, or an undertaking; profitability measurement is an important guide to proper and effective management in various fields. In the complexities of modern business – management is very often confronted with the problem which needs a policy decision. Profitability is the rate at which profit of an industrial undertaking is generated. The quantum of fund (profit) generated depends on:-

1. Liquidity of investments.
2. Environmental and economic risks.
3. Productivity capacity- capacity utilisation and optimal level followed by market growth.
4. Technology, its life style and technical skills.
5. Size of enterprise and capital structure.
6. Technological obsolescence.
7. Effectiveness of managerial skills to deal with risks of investment depends much on the effectiveness of the business house in trading of the risky investments. It is always said that the height of profitability depends on the ability of the management of an industrial unit to deal with intelligently and effectively to tide over risks and uncertainties through shifting them or hedging benefits. Capital productivity arises from (a) cost reduction (b) revenue expansion (c) risk reduction (d) improved productivity of human resources (e) Optimal utilisation of available resources (f) managerial effectiveness. So profit is considered to be a vital tool or the best yardstick for judging managerial efficiency and optimal utilisation of all available resources at every level of activity of the business or of an organisation.

4.2 Profit Theories:

It is common understanding that the sole aim of business is to earn profit. In capitalistic economy every businessman tries to maximise his profits. Businessmen go on searching more profitable channels of investment, they divert their capital from lesser profit earning avenues to investments yielding higher returns. Some times they may try to increase their profits by creating artificial shortage of supplies or by reducing production. They may adopt unfair means of reducing the quality of the goods. In this connection Karl Marx mentioned that “Today’s businessman does not try to satisfy the requirements of the society but his attention is always concentrated towards the profit and for the fulfilment of this object, he produces”.¹

Business is made to provide not only goods but also services. Only those businessmen are able to succeed who try to provide service to the society. Profit and service must go hand in hand. No one can succeed over a long period of time if he gives up one for the other. A Businessman who keeps his customers satisfied by service will definitely earn good profits. Besides business must aim at meeting the needs of the society by ensuring continuously supply of quality goods at reasonable price.
Today business is regarded as a social institution forming an integral part of the social system. As Davis and Blomstorm observe, business is "a social institution, performing a social mission and having a broad influence on the way people live and work together."²

Business provides to the society to the things it needs in order to survive, enjoy life and improve its material well being. Besides, "it undertakes productive utilisation of wealth producing resources of the society."³ According to modern thinking, business is an integral part of the social system. It is a social system to accomplish the social goals. As such its activities and attitudes are subject to public judgement which may have far reaching implications. A business enterprise shall make profit only by accomplishing the socially acceptable goals and satisfying the society.⁴

Thus, today, business is not only a pursuit of economic gains resulting from the satisfaction of the needs of the consumer, it is a social function involving certain obligations.⁵

Henry Ford, who declared "the best way to make is not to think too much about making it."⁶

Drucker has written that "the problem of any business is not the maximisation of profits but the achievement of sufficient profits to cover the risks of economic activity and thus to avoid loss".⁷ Profit is required to reward various factors of production and to maintain intact the wealth or capital of the business. Producers must take all possible efforts to supply at cheaper rates. Profits are essential but it would be wrong to presume that every action initiated by management of an enterprise should be aimed at maximising profits, irrespective of social consequences.⁸

Profit should not be the objective of business but the result of business. Along with the profit objective, business has also to adopt certain social objectives for the welfare and advancement of the society. In economics profits has been defined as the share of income that the entrepreneurs receive in the process of distribution is called
profit. In modern society, the entrepreneur plays an important role; he makes production decisions, combines the other factors of production and bears all risks associated with production. Thus for the entrepreneurial functions that he performs in the process of production, he gets a reward which is known as profit.

Increase in productivity leads to greater profitability. With an increase in production, an enterprise can improve its profitability. Productivity and profitability relationship has an effect on the economic growth of a country. With constant improvements in productivity and profitability there is a scope for increasing investment to throw greater employment opportunities.

In modern business, profit centre system is a means to accomplish the objective of profit maximisation in industry with responsibility delegated to divisional authorities with operational autonomy.9

Under the profit centre system: (1) Profit responsibility must be delegated to the managers of segments who have considerable autonomy; (2) An income statement for the centres must be regularly prepared on a systematic basis; and (3) the result of the profit calculation must be used by the top management as an index for evaluating the performance of the profit centres and their managers. The profit centre idea is widely used in the United States and some studies10 have been attempted there which highlights the incidence of profit centres in American business and provide evidence of practices used by firms for their performance evaluation.

“Profit is a mixed and vexed income” because a number of other elements are included in profit. It is “vexed income” because there is a lot of difference of opinion regarding the definition and determination of profit. In order to understand the accurate meaning of the concept we have to distinguish between gross profit and net profit.

**Gross Profit:**
In general language profit means the difference between total revenue and total cost. This is called Gross profit.
After meeting all the expenses of production, whatever remains in the hands of the entrepreneur is called Gross profit. For producing anything he needs raw materials, labourers etc. After meeting all these expenses whatever remains is called Gross profit.

Net profit:
If we analyse further, we will find that it includes certain other earnings and expenses like rent, interest, commission etc. received and also salaries, interest on capital and extra profits earned from other sources.

If we deduct all expenses from Gross profit and add all other incomes we will get net profit. It is also called pure profit.

Normal Profit:
Normal profit is the minimum profit expected by the entrepreneur or the owner of the business. It is also called necessary profit as it is the minimum amount which an owner should be capable of earning in order to maintain his business. Normal profit is the supply price of business ability. Normal profit is received by an entrepreneur in the long run, when an industry is in equilibrium.

Abnormal Profit:
It is also known as super normal profit or excess profit; such excess profit may be earned only when the market is an imperfect one. It is not the part of the cost of production, but in normal profit, cost will be included Abnormal profit arises due to chance or luck of the entrepreneur.

Characteristics of Profit:
i. It is Non-contractual income:
A non-contractual income is one which is not known in advance. No businessman can know in advance what income he will earn.

ii. Profit may be zero or negative:
There is every possibility of fluctuations in profit. It may be Zero, negative or positive, but other forms of income like Rent, wages, interest, these will never be negative.
iii. Abnormal profit is non functional returns

Wage, rent, interest, are functional returns where as abnormal profit is non functional returns, because it is earned due to chance of monopoly market. Of course, normal profits may be considered as functional return because it undertakes risk.

Theories of Normal Profit:

(a) Uncertainty Theory of profit:

An American Economist Prof. Knight has developed this theory. According to him, Profit is the reward of uncertainty-bearing. Profit accrues to the entrepreneur because he bears uncertainty. There are two types of risks in business.

i. Insurable

ii. Non-Insurable

Insurable risks are known in advance and are insured. Due to accident or fire these risks arise. These risks are undertaken by the insurance companies not by the entrepreneur. But the uninsurable risks are never known in advance. Those risks are the basis of profit. These uncertain risks arise due to sudden fall in demand. Government’s intervention in fixing price. Change in competitors technological change in production may bring a reduction in price and this will suddenly reduce the profits. A successful entrepreneur is one who reduces these risks and maximises his profits. This theory is criticised on the ground that uncertainty bearing is not the only functions of the entrepreneur. He plans, co-ordinates, innovates and manages production, Secondly, uncertainty is not objectively measured and it is not an independent factor. Thirdly uncertainty not only gives profits but also losses.

Theories of Abnormal Profit:

(a) Innovation Theory of profit:

This theory elucidates how abnormal profit arises and how it is determined. This theory is introduced by Joseph Allops Schumpeter, an American Economist. According to him, profit is the reward of innovation. It reduces the cost of production and increases profits.
Innovation means discovering something new. It may be in the different forms, for example, introducing a new technique of production by bringing a new type of machine discovering a new market, where things are great demand finding an alternative means of transport or bringing finally a new product which will be in excess demand. All these innovations reduce costs. Profit is the reward for discovering innovations. The greater is the degree of innovations, the greater will be the degree of profit. Once the innovations are initiated by others, new innovations should be made. Of course, this theory has got certain limitations. First, innovation is not the only function of the entrepreneur, secondly sometimes even without innovations profit arises.

(b) Dynamic theory of profit:
J.B. Clark was the propounder of this theory. He opined that profit arise due to dynamic changes in source or due to the fact that society is dynamic because of social change. Due to dynamic change profit arises. He divided the entire society into two types. (i) Static and (ii) Dynamic. In a static society population, taste, technology, fashion, products and inventions do not change where as in a Dynamic society every thing changes. Changes in fashion and invention of product increase the level of the demand. If supply decreases, price rises and profit increases. Change may be general like war or inflation or may be particular like production of machine in a firm. All these changes increase demand and profit, profit is the result of dynamic changes.

4.3 Profit Policies:

Policies and strategies furnish the frame work for plans by channelising decisions and often pre-deciding them. The more strategies and policies are clearly understood, the more consistent and effective becomes the frame work of enterprise plan.

Policy remains a guiding force to the thinking and action of those who make decisions. It does not actively require action but acts passively as a stimulant to guide managers when they are faced with problems of making decisions. Strategies show direction in which human and physical resources are deployed and are applied in
order to maximise the chance of achieving deleted objectives in the face of difficulties.

The most logical source of policy and strategy is that which is originated by top management for the express purpose of guiding sub-ordinates in their operations. Originated policy and strategies flow basically from the objectives of the enterprise, as these are defined by the top executive authority. In order to develop practical and useful policies and strategies, a business should recognise its strengths and also its weakness. It should first ask what kind of company it is. Is it a single product or product line company, such as automobile shoes or furniture, or is it a process company such as certain chemicals and electronic company or is it an end-use company, such as transportation, communications or defence. Each organisation should set up its own policy in order to maximise profits. Policies should be framed keeping in mind the cost factor. In the complexities of modern business management is very often confronted with the problems of many policy decisions that determine the ultimate goal of any business to earn a considerable amount of profit. It is the profit that maintains business. Therefore the business establishment prepares budget in the expectation of planned rates of profit and thus seeks to improve its performance overtime.

The business units, while fixing the profit policies face the following two problems of:

1. What is the rate of profit they are intending to earn?
2. How far the public reactions to be raised if the rate of profit is higher?

Setting profit standards:

The companies can fix up profit standard by studying the following criteria.

1. What it takes to attract capital?
2. What earnings are needed to finance the firm’s development solely from the retained profits?
3. What the company or comparable firms have normally earned?

There are three methods to measure profits (1) aggregate value (2) as a percentage of sales (3) as a percentage of net return on investment.
While fixing up the rate of profit the following points should be taken into consideration.

i. The new company intending to issue shares must earn sufficiently to protect the interest of ordinary shareholders.

ii. The competitor's price must be carefully analysed.

iii. Normal or historical profits should also be considered. It may be relevant if such rates are sufficient to attract capital and provide adequate return to shareholders and have not encouraged excessive competition in the past.

iv. A rate which is sufficient to finance growth from internal sources is an important factor. Such a "ploughing" back rate may be appropriate for adoption.

If the firm's planned expansion is to be financed from:

1. Introduction of a new product.
2. Replacement of a new existing product is a new one.
3. Suitable product or sales mix.
4. Make or buy.
5. Price reduction.

The above mentioned policy decisions, if adopted, affects positively the profit earning capacity of a company.

4.4 Measurement of the profit:

Accountants measure income by finding the difference between net assets at the beginning of the year and at the close of the year. Among the assets, they list cash outlays that were made for inventory, land, plant and equipment and long term investments together with cash on hand, near cash (marketable securities) and claims that will soon be cash (accounts receivable, accrued income) or goods and services (prepaid expenses). From the total they deduct some future cash outlays. They also deduct part of the amount that had been spent for long lasting plant and equipment. The total assets minus reserves and liabilities constitute net worth, the year to year change in net worth depicts annual income or profit.
### 4.5 Profit Planning:

Break-even-analysis has been considered as the most effective tool of profit planning. It is the technique of integrating costs revenues and output of firm so as to depict the probable effects of alternative courses of action up on net profits.

The production cost indicates variable cost plus fixed cost. When the production cost is less than the market price the firm earns profits conversely when the production cost is more than the market price it sustains losses, when it is equal, it indicates firms break even point, where the total revenues are equal. The total cost is composed of variable or (prime) cost and fixed cost or overhead cost. Thus it is clear that sales are equal to variable cost plus fixed cost plus profit and break even sales is equal to Fixed cost plus Variable cost.

### 4.6 Evaluation of Profitability:

The overall profitability of a concern can be found out by the analysis of financial statements. It can be done through three ways

A. Adoption of standard costing and variance analysis.

B. Through Profitability ration analysis with figures collected from various financial statements and records where standard costing system is not in practice.

C. Financial statement analysis:-
   - Trend analysis
   - Comparative profit and loss statement.
   - Common size statements.

**A Profitability analysis through standard costing pattern:**

In the modern advanced industrial units, the standard costing pattern provided considering more accurate and realistic profitability analysis. It has been developed because of change in emphasis from cost ascertainment to cost control. Standard costing is a system of cost accounting which is designed to find out how much should be the cost of a product under the existing conditions. The actual cost can be
ascertained only when production is undertaken. The pre-determined cost is compared to the actual cost and a variance between the two, enables the management to take necessary corrective measures. The basic purpose of standard costing is to determine efficiency or inefficiency in manufacturing a particular product. Generally, the following steps are involved in standard costing.

(i) The determination of standard cost.
(ii) The recording of actual cost.
(iii) The comparison between standard cost and actual cost.
(iv) The finding out of variance; i.e., difference between standard cost and actual cost.
(v) The reporting of variance in order to find out efficiency or inefficiency and take necessary corrective measures.

If the standard cost is more than actual cost, it is positive variance and then the management need not be worried. On the other hand, if the actual cost is more than the standard cost, then the management should take remedial measures to check inefficiency. Standard costing helps to locate wastage, pilferage, theft or raw materials, idle time or labour and wastage of overheads.

(B) Profitability analysis through profitability ratio from financial figures collected from organised information system:

It is the most realistic and important technique for profit analysis. It creates a numerical relationship based on financial statements. A direct examination of magnitude of two related items can facilitate comparison. This technique of comparison was first introduced by Alexander Wall in 1919.\(^{14}\)

The most important ratio relating to profitability is discussed below:-

i. **Gross Profit margin Ratio:**

Gross profit ratio is calculated by dividing the gross profit by sales. It measures the relationship between gross profit and net sales and represent as a percentage. Gross profit is arrived at after deducting cost of goods sold from the net sales. Higher the gross profit ratio, better the result. A low gross profit ratio, generally indicates high cost of goods sold due to unfavourable purchasing policies, lesser sales, lower
selling prices, excessive competition, overinvestment in plant and machinery etc. A comparison of gross profit ratio over a period of time or for different firms in the same industry is a good measure of profitability. The Gross Profit Ratio can be presented in the following manner:

\[
\text{Gross Profit Ratio} = \frac{\text{Gross Profit} \times 100}{\text{Net Sales}} = \frac{\text{Sales} - \text{Cost of Goods sold} \times 100}{\text{Net Sales}}
\]

ii. Net Profit Ratio:

Net profit ratio establishes a relationship between net profit (after tax) and sales. It implies what portion of sales is left to the proprietor after all costs, charges and expenses have been deducted. It indicates the efficiency of the management in manufacturing, selling, administrative and other objectives of the firm. This ratio is widely used to measure overall profitability and is very useful to the management. This indicates the firm’s capacity to face adverse economic conditions such as competition, low demand etc. It is calculated as follows:

\[
\text{Net profit Ratio} = \frac{\text{Net profit after taxes} \times 100}{\text{Net Sales}} = \frac{\text{Net operating profit} \times 100}{\text{Net Sales}}
\]

iii. Operating ratio:

Operating ratio establishes the relationship between cost of goods and other operating expenses on the one hand and the sales on the other. This ratio is calculated by dividing operating costs with the net sales and is generally regarded as a percentage.

Operating ratio indicates the percentage of net sales that is consumed by the operating cost. Higher the operating cost ratio, it is less favourable as small margin reserves. This ratio is considered to be a yardstick of operating efficiency. It can be presented in the following manner:

\[
\text{Operating ratio} = \frac{\text{Operating cost} \times 100}{\text{Net sales}} = \frac{\text{Cost of goods sold} + \text{operating expenses} \times 100}{\text{Net sales}}
\]
The two requirements of this ratio are operating cost and net sales. Operating cost can be derived by adding operating expenses to the cost of goods. Operating expenses consists of administrative and office expenses like rent, salaries, insurance, directors’ fees etc. and selling and distribution expenses like advertisements, salaries of salesmen etc.

iv. Expenses Ratio:

Expense ratio reveals the relationship of various expenses to net sales. The operating ratio shows the average total variations in expenses. But some of the expenses may be increasing while some may be falling. So, expense ratios are calculated by dividing each item of expense or group of expenses with the net sales to analyze the cause of variations of the operating ratio. This ratio can be calculated for each individual item of expense or a group of items of a particular type of expense like cost of sales ratio, administrative expense ratio, selling expense ratio, material consumed ratio etc. the lower the ratio, the greater is the profitability and the higher the ratio, lower is the profitability. It can be calculated as follows:

\[
\text{Particular Expense Ratio} = \frac{\text{Particular Expense}}{\text{Net Sales}} \times 100
\]

v. Return on Shareholders’ Investment or Net worth:

Return on shareholder fund or investments creates a relationship between net profits (after interest and tax) and the proprietor funds. The two basic requirements of this ratio are net profits and shareholders’ funds include share capital, free reserves such as premium, revenue reserve, capital reserve, retained earnings and surplus less accumulated losses, if any. Net profits in long term borrowings and income tax because these will be the only profits left for shareholders. This ratio is one of the most important ratios used for measuring the over all efficiency of a firm. As the primary objective of any business is to measure profits, this ratio indicates the extent to which this primary objective of business is being achieved. As this ratio reveals how well the resources of a firm are being used, higher the ratio, better are the results. This ratio is calculated as follows :-

\[
\text{Return on Shareholder investment} = \frac{\text{Net profits after interest and tax}}{\text{Shareholders’ fund}}
\]
vi. Return on equity capital:

In reality, shareholders are the real owners of the company. They assume the highest risk in the company. Preference shareholders have a preferential rights over the ordinary shareholders in the payment of dividends as well as capital. Preference shareholders get a fixed rate of dividend irrespective of the amount of profits earned by the company. The rate of dividend varies with the availability of profits in case of ordinary shareholders only. So, the ordinary shareholders are more interested in the profitability of a company and the performance of a company should be assessed on the basis of the return on equity capital of the company. Higher the ratio, better is the performance. Return on equity capital creates a relationship between profits of a company and its equity capital.

It is calculated as follows:

\[
\text{Return on equity capital} = \frac{\text{Net profit after tax} - \text{Preference Dividend}}{\text{Equity Share Capital}}
\]

vii. Earnings per share:

Earnings per share is a small variation of return on equity capital and is calculated by dividing the net profits after taxes and preference dividend by the total number of equity shares.

Thus,

\[
\text{Earnings per share} = \frac{\text{Net profits after tax} - \text{preference dividend}}{\text{No. of equity share}}
\]

The earning per share is a good measure of profitability and when compared with earning per share of similar other companies, it gives a view of the comparative superiority or earning power of a firm. Earning per share is calculated for a number of years shows the company’s in improving earning power.

viii. Return on capital employed:

Return on capital employed establishes the relationship between profits and the capital employed. It is the primary ratio and is used to measure the over all profitability and efficiency of a business. The term ‘capital employed’ refers to the
total of investments made in a business and can be defined in a number of ways. The three most widely used definitions of this term are:

a. Gross Capital Employed
b. Net Capital Employed
c. Proprietor's Net Capital Employed

a. Gross Capital Employed: The term “gross capital employed” usually comprises the total assets, fixed as well as current used in a business.

b. Net Capital Employed: The term “net capital employed” comprises the total assets used in a business less its current liabilities.

c. Proprietors' Net Capital Employed: Proprietors’ net capital employed means shareholders’ fund or investments in the business. This includes equity share holders capital, preference share capital, reserves and surplus less accumulated losses, if any.

(C) Financial Statement Analysis:

Financial statements are prepared for the purpose of presenting a periodical review or report on progress by the management and deals with the investments and the results aspects during a particular period. In other words, it provides a summary of the accounts of a business, reflecting the assets, liabilities and capital on a certain date and the income statement showing the result of operations during a certain period. The preparation of financial statements is not an end in itself. It requires further analysis and interpretation to arrive at a conclusion and for decision making. The following methods of analysis are generally used:

i. Trend analysis.
ii. Comparative analysis.
iii. Common size statements.
I. Trend Analysis

The financial statements may be analysed by studying the trends of series of information. This method of analysis may show upward or downward and involves the computation of percentage relationship that each statement item bears to the same item in the base year. The base year, may be the earliest year or the latest year or any intervening year. The figure of the base year are taken as 100 and trend analysis lies in the fact that the analyst can know the direction of the movement, whether the movement is favourable or not. For example, by studying net sales for a number of years, the analyst can draw conclusions whether the trend is increasing or decreasing. On this basis, he can make forecast for the future.

II. Comparative Financial Statements:

The comparative financial statements are statements showing the financial position over a period of time. The elements of financial statements; i.e., balance sheet and income statement are shown year wise in different columns. The comparison of the different elements of two or more periods of balance sheet and income statement enables an in-depth study of the financial position and operating results. The comparative statements may show the following:

1. Absolute figures (amount in rupees).
2. Changes in absolute figures; i.e., increase or decrease in absolute figures.
3. Absolute data in terms of percentages.
4. Increase or decrease in percentages.

The comparative balance sheet analysis is the study of the trend of different items in two or more periods. It reflects the conduct of a business. The changes may be observed by a comparison of the balance sheet at the beginning and at the end of a period and these changes can help to know the progress of a business. The comparative balance sheet has two columns for the data of organized balance sheets. A third column is used to show increase or decrease in figures. The fourth column may be added to show percentage of increases or decreases.

The income statement provides the results of the operations of a business. The comparative income statement helps to know the progress of a business over a period
of time. The changes in absolute data in money values and percentage can be calculated to analyse the profitability of the business. Like comparative balance sheet, income statement also has four columns. First two columns give figures of various items for two years, third and fourth columns are used to show increases or decreases in figures in absolute data and percentages, respectively.

III. Common size Statements:

Common size statements reflect the percentage occupied by different items of assets, liabilities, incomes and expenses, out of total assets, total liabilities, total incomes and total expenses. The figures are shown as percentages of total assets, total liabilities and total sales. The total assets are taken as 100 and different assets are expressed as a percentage of total. Similarly, various liabilities are taken as a part of total liabilities. The common size statements may be prepared in the following way:

i. The total of assets and liabilities are taken as 100.

ii. The individual assets are expressed as a percentage of the total assets; i.e., 100. For example, if total assets are Rs. 10 lakhs and inventory value Rs. 1 lakh then it will be 10% of total assets.

\[
\frac{100000 \times 10}{1000000}
\]

iii. Similarly, individual liabilities are expressed as percentage of the total liabilities; i.e., 100. For example, if total liabilities are Rs. 5 lakhs and sundry creditors Rs. 50,000, then it will be 10% of total liabilities

\[
\frac{50000 \times 10}{500000}
\]

iv. The total sales are taken as 100.

v. The individual expenses are expressed as a percentage of the total sales; i.e., 100. For example, if total sales are Rs. 5 lakhs and office expenses, Rs. 20000, then it will be 4% of total sales.

\[
\frac{20000 \times 10}{500000}
\]
4.7 Summary:

Any business organisation is designed to make profits and profits are the primary measures of success. It is essential as it ensures supply of future capital for innovations and expansion. The method adopted to earn profits should be fair. Profitably measurement is an important guide for effective management, Drucker has written that sufficient profit is necessary to cover the risks of economic activity and to avoid loss, but maximisation of profits should be avoided. According to Blounstrom business is a social institution, it is a social organ to accomplish social goals. In Morden business increase in productivity helps to accomplish profit objective in Industry. After meeting all expanses of production, whatever remains in the hands of the entrepreneur is called gross profit if we deduct all expanses from gross profit and add all other expanses from gross profit and add other profit expected by the business. Abnormal profit arises due to chance or luck of the entrepreneur. The main characteristics of profit are

i. It is a non contractual income

ii. Profit may be zero or negative

In theory of normal profit includes uncertainty theory, prof. Knight has developed this. There are two types of risks in business i. Insurable and ii. non insurable, Insurable risks are known in advance and are insured like accident, like sudden fall in demand etc. The theories of abnormal profit includes i. innovation theory of profit ii. dynamic theory pf profit. Innovation theory of profit implies profit arises due to introduction of new technique methods. J.A. Schumpeter. According to dynamic theory profit arises due to social change, like fashion etc. This theory introduced by J.R. Clerk, Profit policies and strategies furnish the fame work for plans by channel sing decisions. The companies should fix up profit standards. While setting up profit standards, the following points should be kept in mind (i) protecting the interest or shareholders, if it is a new weapons (ii) the competitors price and profits. (iii) earning required for development of the companies, the profits can be measured by finding out the difference between net assets at the beginning of the year and net assets at the close of the year. The overall profitability of a concern can be found out by the analysis financial statements. IT can be done through (i) adoption of
standard costing and variance analysis. (ii) through profitability rations. (i) the predetermined cost is compared to the actual cost and a variance between the two, enables the management to take necessary corrections measures, (ii) A ratio creates a numerical relationships between two items, It facilities comparison and analysis. There are different types of profitability ratio, like gross profit ratio, net profit ratio, operating ratio, expanse ratio, return on shareholders investments or net worth, return, return on equity capital, financial statements are prepared for the purpose of by the management and deals with the investments. there are three methods of financial statement analysis, like trend analysis, comparative statements, Common statements, The financial statements may be analysed by studying the trends of series of informality. The Comparative Stalemates showing the financial position over a period of time of common size statements, reflects the percentage occupied by different items of assets, liabilities, income and expanses out of total assets, total liabilities, total income and total expanses.

References
7- Drucker, F. Peter, op cit., P-36.


