

# **A Model On Generation Of Profit And The Role Of Money-A System Dynamics Approach**

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## **INTRODUCTION**

Once upon a time, money was supposed to be the only medium of exchange. But now, we see it is not only the medium of exchange, but the basis of production and also the intriguing basis for creating the profit. It is the general belief of the people that a business will exist if there is a profit and it vanishes if the business incurs losses. The profit is made in the business, if the selling price is more than the cost, but the business incurs a loss if the selling price is less than the cost and there is a breakeven point when the total cost equals the total sales and there is no profit and no loss.

But what is profit? How it is created? Is there any link with the issue of money? When we answer some of these questions, we may observe something interesting in the manufacturing process and profit creation or realization.

## **REVIEW OF LITERATURE**

Capitalists desire to produce a commodity whose value shall be greater than the sum of the value of the commodities used in its production, that is of the means of production and the labour power that he purchased with his good money in the open market. His aim is to produce not only a use value, but at the same time, surplus value. In Marx's '*Das Capital*', the generation of profit has not been related to the issue of money and the purchasing power of the producers. He has talked only of surplus value and again, profit is not equal to the surplus value (Page.37 Vol.1, *Das Capital*).

## **OBJECTIVES OF THE STUDY**

- 1) To know how profit is created.
- 2) To know how to arrive at the cost of the products.
- 3) To look into the manufacturing of products in relation to introduction of money/ capital.

## **THE SCOPE OF THE STUDY**

In order to properly understand the concept, let us take an example of a manufacturing unit, right from the beginning of the process till the end of the process - that is the realization of profit. The scope of the study is confined to some hypothetical examples of manufacturing unit, as it is beyond the scope of this paper to link the issue of money to an ongoing manufacturing unit; precisely because the money is issued or withdrawn from the market on over all adjustments of all the units, and not for a single manufacturing unit.

## **ANALYSIS**

Everybody knows that currency notes are printed and issued by a central bank, and in India, the central bank is the Reserve Bank of India (RBI). To simplify the understanding, let us assume that Mr. A opens a manufacturing unit on a place called Island where no other manufacturing processes are present. Altogether, the population of Island is 200 people. RBI opens one mini unit of RBI or sends the required no. of printed notes for Mr. A, so as to introduce capital on Island for the first time. Further, it is assumed that all the products produced by Mr. A will be purchased by the people living in Island only and no other people buy from Island or lend any money to people living in Island.

Now, Mr. A started a dry fish manufacturing unit by getting Rs.1, 00,000 from the RBI. Mr. A picked up 99 persons out of 200 and advanced Rs.1000 each for catching fish from the sea and he himself kept Rs.1000 for coordinating and providing technical know how for making dry fish. 99 people started catching fish and caught 100 fish all together and

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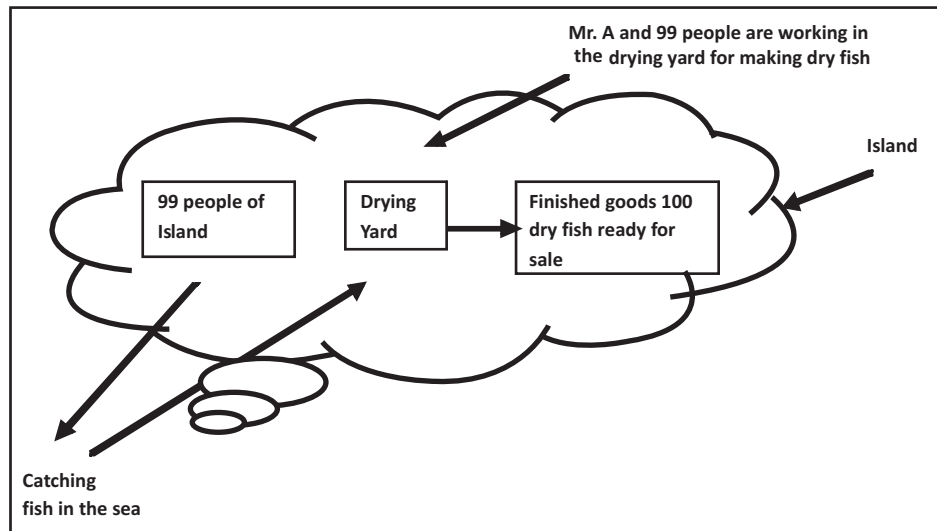
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brought those fish to Mr. A for making dry fish. These 99 people and Mr. A worked according to the required process and 100 dry fish were ready for sale by Mr. A.

Now, Mr. A has to fix the selling price of these dry fish and sale them for getting a profit. As we know, the total cost of these 100 fish is Rs.1, 00, 000 or we may say the cost of each dry fish is Rs1000. Suppose Mr. A wants to add 100% profit to the cost, the total sales value would be Rs.2, 00,000 and selling price of each dry fish is Rs.2000.

**Figure 1 :The Manufacturing Process Of Mr. A**

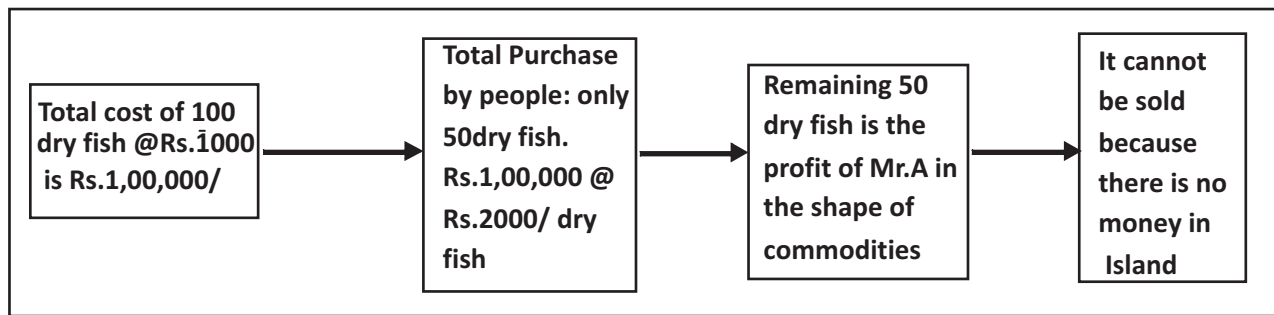


Now the question is, who is going to purchase this dry fish from Mr. A.? We make an assumption that dry fish is very much in demand. Though everybody is having the need for dry fish, but who can purchase the product? The answer to this question is that only those persons who are having money can purchase the product. We understand that the total money available in Island is Rs. 1, 00,000 and the total money required for purchase of dry fish is Rs.2, 00,000. It may be recalled here that we have assumed no money will come to Island from outside and RBI will not issue additional capital unless & until one cycle of production and sales is complete. If we look at the entire process, we find that Rs.1, 00,000 is available with 100 people who worked in the manufacturing process and this much is also the total money available in Island. It is obvious that these are the 100 people who are having money to purchase the dry fish. Now, they must purchase the dry fish, because now in Island, they are the producers. But are they really able to purchase all the dry fish they have produced? The answer is No. If it is seen closely, one can see that by adding profit, Mr. A has disabled 99 people to the extent of 50% or in other words, their purchasing power got reduced to the extent of 50%. That means that 99 persons plus Mr. A are having Rs.1, 00,000 in total and they all together can purchase 50 dry fish only, because now the selling price of one fish is Rs.2000 and the rest of the 50 fish are in possession of Mr. A. These 50 fish are nothing but the extra share that has been cornered by Mr. A for himself without the knowledge of anybody (even perhaps without the knowledge of Mr. A himself). This could be done by adding profit to the cost. Now, if 100 people (including Mr. A) decide to purchase with all the money they have, they can purchase only 50% of the dry fish and Mr. A will get Rs.1, 00,000 from the sale proceeds. Now Mr. A has got back his Rs.1, 00,000 (what he had invested in the beginning) plus 100% profit in the shape of dry fish.

***Incidentally, at this point, the total sales are equal to the total cost. In traditional accounting or accounting system, this is known as the break-even-point. It is apparently not correct, because Mr. A, apart from realizing the total cost, has also realized 100% profit, but the profit is in the shape of commodity and not in the shape of cash. Next, we will discuss the new concept of BEP.***

In traditional accounting/ costing, it is called the B.E.P (Break Even Point), because this is the point of no profit and no loss. This concept is wrong, because at this point also, there is 50% profit but the profit is in the shape of commodity i.e. 50 fish. However, now there is a problem with Mr. A. He does not want to consume this much dry fish. Infact, he does not want to consume even a single dry fish. Nor is he interested to save these dry fish for future consumption. He is only interested to take a bigger share in the dry fish and convert this share as early as possible to cash. Why? Why

**Figure 2: When Selling Price Is Rs.2000 Per Dry Fish**



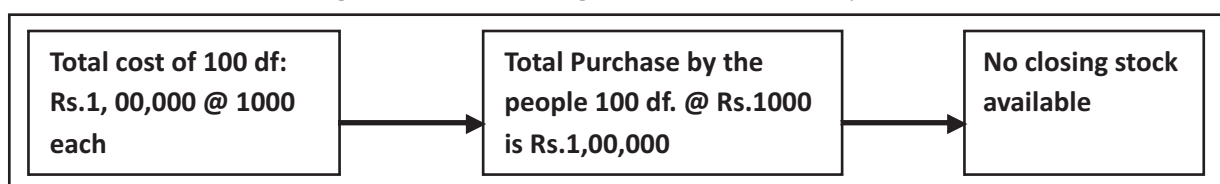
#### **Traditional Break- Even Point**

does Mr. A does wants cash and not the commodity? It seems that Mr. A is more interested in the needs of others. Not more, rather, he is completely interested in the needs of others.

In the past, people used to work for commodities individually and jointly, (they did not work for cash) and if there was some surplus, they used to exchange it. However, there was no scope for them to corner a bigger share -what Mr. A has done in the present manufacturing system.

One may say that at this point, unless Mr. A converts this share of profit into cash, how can the process continue? There is no problem in continuance of the process. The process can even continue without converting the profit into cash. For continuing the process, what does Mr. A have to do? Mr. A has to advance again Rs.1,00,000, -the amount he has received from the sale proceeds to catch the fish. Again, those 99 people may come with 100 fish or something more or less. Again, by fixing the selling price of the dry fish, Mr. A can corner the major share of the dry fish. If the process continues like this again, Mr. A can pile up the profits in the shape of dry fish. Not only this, the process can also continue with the break-even-point contrary to the concept that the process can't continue without the profit. However, **here the concept of break-even point is different**. There can be a break-even point in the process not only when the total sales are equal to the total cost, but also when the cost price is equal to the sales price. In our example, **Mr. A has to fix the sale price at Rs.1000/- each not Rs.2000/- (not with a profit), so that, there will be a break-even-point when total sales are equal to the total cost**. In our example, everybody will get his due share -Mr. A also gets his share by paying Rs.1000 for purchase of dry fish, that he got in the beginning for technical know how and coordination work. When all the output of the processes are sold, the output is distributed evenly among all the producers, hence, there is a break-even-point. Not only this, the process can continue again and again. However, things to be produced in the process are to be decided as per the needs of the producers, not as per the needs of the outsiders.

**Figure 3:When Selling Price Is Rs.1000/ Dry Fish**



#### **New Break-even Point**

Not only that, how much is to be produced can also be easily decided as the output is to be consumed by the producers themselves. Hence, always there is a break-even-point. There is no inflation or deflation. But Mr. A is not interested in this. Mr. A desperately wants his lion's share to be converted into cash as early as possible. For this, he is even ready to give some portion of his share to the marketing people or advertising agency or anybody who comes & helps him in disposing his extra share as early as possible.

What is the reason why Mr. A so eagerly wants his share to be converted to cash is perhaps mentioned nowhere in the business literature. Some may say without converting his share to cash, how Mr. A can maximize his wealth? If looked into the process closely, one observes that Mr. A can diversify his business as well as maximize his wealth.

Anyhow, to our mind, Mr. A not only wants his share to be converted to cash as early as possible, but he also wants that

the manufacturing should be done for the outsiders and not for the insiders because of the following advantages:

1) By converting the commodity profit into cash profit, a belief is created in the minds of insiders & outsiders that the profit is realized by sales, and not by manufacturing. The belief that the profit is coming from outside and is not being generated inside, has already been conditioned in the minds of the people. Conditioning of this belief is very much necessary or else, 99 people inside the process may not tolerate Mr. A's keeping the extra ordinary share for himself. Another belief that has to be conditioned in the minds of the people, in particular in the minds of the insiders, is that all products manufactured in the process have to be purchased from the market, and not from the process. This conditioning can be easily done if products are manufactured for outsiders and not for insiders, or else the same intolerance may creep in the insiders to the extraordinary share taken by Mr. A- that is why Mr. A is more concerned for outsiders than for himself.

2 ) Another advantage to Mr. A, converting commodity profit to cash profit, is to become the virtual owner of that much of cash or Mr. A becomes virtual/ mini RBI for all purposes. This portion of cash is not to be returned to the bank/ RBI. Mr. A is accountable to return to the bank only Rs1, 00,000, which he has already collected from the sale proceeds by selling 50% of the dry fish. Further, he need not pay for the portion of cash relating to extra share, any share of profit in the shape of interest. He is required to pay interest on cash what he has borrowed from the bank, and not on the cash which he has received by converting the commodity selling into profit.

## RELEVANCE OF THE STUDY

Having gone through the above findings, some people might think that the money has created an advantageous position for Mr. A or Mr. A is very cleverly taking the major share in the output by hoodwinking the other co-producers. At this stage, we cannot jump to this conclusion. Taking a major share in the output does not necessarily mean an advantageous position- Mr. A does not take the major share once, he has been taking it continuously, that too in the shape of cash, not in the shape of commodity. If someone always takes a major share in sugar, what will happen? Sometimes when Mr. A, despite all his efforts, fails to convert the commodity profit into cash, he has to take bitter gourd also. Either he is taking the sugar or he is taking bitter gourd. What about the balanced diet? Has Mr. A defined the requirements of his life before entering into a wealth maximizing programme? Has he defined the wealth in terms of gain achieved in family relations; gain achieved in terms of his health and the health of his family; in terms of gain in social relations, in terms of gain in spiritual relations with God or his religion? The relevance of the study is to focus the attention of the people towards higher achievements in life confirming to positive relation with nature, health, God, family, happiness and so on and so forth.

## CONCLUSION

At this point in our social life, we may take a pause and look at the role of money and people- Whether people have become money minded or mean minded for wealth maximization? It seems we are living for eating only, that to, with degenerative diseases and tension for nothing. Can we find the life beyond eating? Therefore, it is suggested to carry on further studies in such areas to analyze whether the wealth maximization objective has created any gain in terms of the above mentioned aspects. People blindly run after money- but the million dollar question is- the money is earned, but at what cost?

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