



Profit policy, Planning and Control

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Role of Profit

- Profit is considered as a significant element of a business activity
- The success of the firm is usually rated in terms of profit earnings
- Index of business efficiency and managerial acumen
- Profitability of the product indicates that the product well demanded in the market
- High profits earned by existing players in the market indicates opportunity for new entrants
- Possibility of high profitability provides incentives for investment by outsiders in the company/industry



Profit Maximization

- The profit maximization theory suggests that firms carry out those activities where they see highest total Profit
- Profit Maximization is the process by which firm determines the price and output level at which it earns maximum profit
- Profit is maximum if $MR = MC$
- Equalizing Marginal Revenue with Marginal Cost helps firms to check whether they are maximizing profit at the given level of output by comparing additional costs and revenues generated by production of additional unit of output



Profit Control: Profit Policy

- In practice rarely, firms seek to maximize profits and aim at different objectives
- Firms believe in controlling profit instead of maximizing it
- Reasons for profit control are—
 - Keeping profit margin restrained to win appreciation of consumers and maintain goodwill
 - To control wage levels, as extremely high profits would lead to demand for higher wages by unions
 - High profits attract high taxes. It may indicate monopoly power and attract government intervention and restriction



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- To control risk as high profit leads to greater risk
- To avoid new competition, as high profit attracts new entrants who share the market control
- To achieve goal of leadership and domination firms may aim at maximizing sales and capture the market rather than maximize profits
- Sustainability



Problems in Profit policy

- Firms seek to earn a target return of profit on investments but there are problems that may arise due to confusion about—
 - Reasonable rate of profit
 - How to determine it?
- Basic problem is to determine a profit standard through the target rate of return on investment



Profit Planning

- Profitability and success of the firm depends upon firm's accurate profit planning
- It is a sign of good business as it promises profit consistency
- Profit planning requires efficient risk control and management
- Profit policy is implemented through profit planning
- Profit planning includes regulation of profit-sales volume and cost control

