Uncertainty Bearing Theory of Profit:

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This theory was propounded by an American economist Prof. Frank H. Knight. This theory, starts on the foundation of Hawley's risk bearing theory. Knight agrees with Hawley that profit is a reward for risk-taking. There are two types of risks viz. foreseeable risk and unforeseeable risk. According to Knight unforeseeable risk is called uncertainty beaming.

Knight, regards profit as the reward for bearing non-insurable risks and uncertainties. He distinguishes between insurable and non-insurable risks. Certain risks are measurable, the probability of their occurrence can be statistically calculated. The risks of fire, theft, flood and death by accident are insurable. These risks are borne by the insurance company.

The premium paid for insurance is included in the cost of production. According to Knight these foreseen risks are not genuine economic risks eligible for any remuneration of profit. In other words insurable risk does not give rise to profit.

According to Knight profit is due to non-insurable risk or unforeseeable risk.

Some of the non- insurable risks which arise in modern business are as follows:
(a) Competitive risk:
Some new firms enter into the market unexpectedly. The existing firms may have to face serious competition from them. This will inevitably lower down the profit of the firms.

(b) Technical risk:
This risk arises from the possibility of machinery becoming obsolete due to the discovery of new processes. The existing firm may not be in a position to adopt these changes into its organization, and hence suffer losses.

(c) Risk of government intervention:

The government, in course of time, interferes into the affairs of the industry such as price control, tax policy, import and export restrictions, etc., which might reduce the profits of the firm.

(d) Cyclical risk:
This risk emerges from business cycles. Due to business recession or depression, consumer's purchasing power is reduced, consequently demand for the product of the firm also falls.

(e) Risk of demand:
This is generated by a shift or change of demand in the market.

Prof. Knight calls these risks as 'uncertainties' and 'it is uncertainties in this sense which explains profit in the proper use of the term'. These risks cannot be foreseen and measured, they become non- insurable and the uncertainties have to be borne by the entrepreneur. According to this theory there is a direct relationship between profit and uncertainty bearing.

Greater the uncertainty bearing the higher the level of profit. Uncertainty beaming has become so important in business enterprise in modern days, it has come to be considered as a separate factor of production. Like other factors it has a supply price and entrepreneurs undertake uncertainty bearing in the expectation of earning certain level of profit. Profit is thus the reward for assuming uncertainty.

In the modern days production has to take place In advance of consumption. The producers have to face their rival producers and the future is uncertain and unknown. These are uncertainties. Some entrepreneurs are able to see it more clearly than others and therefore able to earn profit.

Criticism:

1. According to this theory, profit is the reward for uncertainty bearing. But critics point out that sometimes an entrepreneur earns no profit in spite of uncertainty bearing.

2. Uncertainty bearing is one of the determinants of profit and it is not the only

determinant. Profit is also a reward for many other activities performed by entrepreneur like initiating, coordinating and bargaining, etc.

3. It is not possible to measure uncertainty in quantitative terms as depicted in this theory.

4. In modern business corporations ownership is separate from control. Decision-making is done by the salaried managers who control and organise the corporation. Ownership rests with the shareholders who ultimately bear uncertainties of business. Knight does not separate ownership and control and this theory becomes unrealistic.

5. Uncertainty bearing cannot be looked upon as a separate factor of production like land, labour or capital. It is a psychological concept which forms part of the real cost of production.

6. Monopoly firms earn much larger profits than competitive firms and they are not due to the presence of uncertainty. This theory throws no light on monopoly profit.

Knight's theory of profit is more elaborate than other theories, because it combines the conception of risk, of economic change and of the role of business ability.