Foundations of microeconomics essay

Economics, Microeconomics

Consumers and FirmsIntroduction: A firm should always run profitably no mater the nature of the market, if the firm fails to break even for a prolonged period then it would be advisable to close down the firm if all other solutions have failed to work, the break-even point is the point where the total revenue is equal to total cost.

There are factors that one hand to consider when determining the best solution that will lead to a firm realizing profits, this factors include the marginal cost curve, marginal revenue curve and other cost curves, economies of scale must also be tapped for a firm to realize high levels of profits, revenue increments can be done through increasing the prices of the products but this will depend on the type of market the firm is operating in. If the market is highly competitive then the increment in price will not be a solution, increasing production to realize economies of scale will also be a possible solution. Therefore the firm should not close down but strive to achieve high levels of profits using various economic theories and concepts. The firms' current situation: The firm produces 200000 units, it uses 50000 units of labor whose wage rate is 80 dollars, the output price is 25 dollars and other variable cost is 400, 000. The following is summary of the cost of producing and the revenue: Revenue: 200000 X 25 = 5000000Variable cost of labor: 50000 X 80 = 4000000Other variable cost: 400000Fixed cost is unknownProfit = revenue minus cost of productionCost of production = fixed cost + variable costsVariable cost = 400000 + 400000 = 800000Revenue = 5000000Profit = 5000000 – (800000 + fixed costs)Profit = 49200000 – fixed costTherefore if fixed costs exceed 49200000 then the firm is likely to shut down. Solutions: Failing to pay fixed costs: The firm may opt not to pay up its fixed cost in order to stay in business for a longer time, through the expression that Profit = 49200000 – fixed cost and that fixed costs exceed 49200000, and then the firm may opt not to pay its fixed costs. Variable cost reduction: The firm may also opt not to pay all its variable cost, due to the fact that Profit = 5000000 – (variable cost + fixed costs) then the firm may fail to pay up its variable costs in order to stay in business, the firm may also reduce its production capacity in order to reduce variable costs, the variable costs may also be reduced by laying off some of unproductive labor and therefore reduce the variable costs of the firm.

All this will lead to a reduction of the firms cost of production and therefore increase its profits. References: Arthur O'Sullivan and Steven Sheffrin (2001) Macroeconomics principles and tools, Prentice hall press, New York