Supply: production, costs, and profits

Literature, Russian Literature

Supply: Production, Costs, and Profits Supply: Production, Costs, and Profits How do firms benefit from economies of scale? Harrison and St. John (2009) define economies of scale as the cost benefits derived by a company as a result of expansion. The cost benefits are mainly achieved in that as a company expands it begins to produce its goods and services in large quantities thereby resulting in reduced costs.

Basically, a company can realize two types of economies of scale according to Alfred Marshall namely internal and external economies of scale. Internal economies of the scale are realized when a firm increases its production and reduces its cost. External economies of scale, on the other hand, is realized when a firm expands its scope of operation outside a firm, such as improving its transport network thereby resulting in decreased cost for a firm working within the industry (Harrison and St. John, 2009).

There are several ways through which a firm can benefit from the economies of scale. Firstly, a company can benefits from the economies of scale through reduced input costs. This is achieved because when a firm purchases its inputs in large quantities, this enables it to take advantage of discounts offered as a result of bulk purchases (Harrison and St. John, 2009). Secondly, a firm will benefit from large economies of scale since it results in reduced average production and selling cost. For instance, certain costs such as advertising, research and development, skilled labor and expertise are generally expensive for small firms. However, economies of scale enhance the efficiency of these inputs thereby resulting in reduced cost of selling and production (Harrison and St. John, 2009).

Thirdly, a firm is likely to benefit from the economies of scale in that as the

production capacity of a firm increases, it will be able to acquire specialized machineries and labor resulting in improved efficiency. This is because employees would be better qualified on their jobs, thereby spending less time on their work, with greater accuracy resulting in reduced wastages (Harrison and St. John, 2009).

2. What might be some potential disadvantages of being part of a large corporation?

As much as a company can benefit from being part of a large corporation, there are also disadvantages associated with being part of a large corporation. Firstly, large corporations are subjected to many legal and tax work, which might be disadvantageous to subsidiaries (Pride, Hughes, and Kapoor, 2012). For instance, large corporation as subjected to double taxation whereby all profits are taxed once. Secondly, there is a lot of limitation as regards management and strategic decision-makings, which are mainly made by a large company (Pride, Hughes, and Kapoor, 2012). This is disadvantageous because subsidiaries are not able to make a major decision concerning how the company is being managed and run. It is also noted that issues are often subjected through long chains of commands within the parent corporation before any action can be taken.

3. Assume your firm operates in a very competitive market. What might happen to long-run profits of your firm?

A perfectly competitive market is a market typified by identical output in the market by all firms; consumers have perfect knowledge of prices charged by all sellers who are many. In addition, all firms are assumed to have equal access resources, and there are no barriers to entry of new firms. Based on

the characteristics of this market, the company will only realize normal profits in the long-run since the company cannot sustain its economic profits in the long-run. This is because since there is no barrier to entry of new firms in the market, the entry of the new firms will cause the demand curve of the company to shift downwards thereby resulting in a fall in price, marginal revenue and average revenue curves. As a result, there will be no economic profit in the long-run, which will only see the company realize normal profits (Mankiw, 2011).

References

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