

Unprofitable company

[Business](#), [Company](#)



Given a specific product version in our plant, production costs fall into three categories according to their responsiveness to different levels of production attained. Fixed costs are costs that simply not responsive to production levels (Piana, 2003). If there are only fixed costs, the total costs follow this rule: For instance, the cost of renting an office is a fixed cost, since usually the contract fixes it for a certain period of time (say one year), without any reference to the income produced by the operations that take place in the same office.

Meanwhile, variable costs are ones that change as the production activities changes. Variable costs grow with higher levels of production (proportionally or not). If there are only variable costs, at zero production the total costs will be zero. Total costs will follow for instance this rule (Piana, 2003): Furthermore, understanding type of costs every activity in our plant attains will give lots benefits as we can maximize contribution margin for every products we produce.

For examples, for low levels of production, fixed costs are major determinants of average costs whereas for high levels of production, variable costs dominate. Therefore, we should bear products that give us income greater than our fixed and variable costs to increase our net margin. II. Shutdown Rule In addition to the idea that we should ensure income is greater than fixed and variable costs, there is a rule, named shutdown rule, stating that a firm should not produce any output in the short run if price is less than average variable cost in order to minimizes economic loss (AmosWeb 2005).

In other words, we can explain and describe the short run shutdown rule in the following sentences: If P (Price) $>$ AVC (Average Variable Cost) operate in the short run. If price of a unit produced is above average variable cost, it means the firm earns enough revenue to pay variable costs (since price is greater) and has added revenues to offset fixed costs. If P (Price) $<$ AVC (Average Variable Cost) shut down in the short run. If price of a product is below average variable cost, the firm earns less revenue than the added variable costs.

In this manner, the added revenue is less than the added cost, so losses are greater than just fixed costs ('Perfect Competition'). III. Should we Shutdown Our Unprofitable Operation Before deciding whether or not closing unprofitable operation, first, we will calculate total revenue and total variable cost. Daily Revenue = 300 units per day \times \$30 = \$9,000 Daily Variable Costs = (70 workers \times \$100 per worker/per day) + (\$500) = \$7,500 In addition, we also obtain information although daily revenue is higher than variable cost; the firm's total costs exceed its total revenue since there is a high fixed cost.

In this manner, according to short run shut down rule, we should not shutdown our unprofitable operation since in the long-run the price might increase that it can offset fixed cost as well.

Bibliography

AmosWEB. 2005, 'Shutdown Rule', [Online] Available at: <http://www.amosweb.com/cgi-bin/gls.pl? fcd= dsp&key= shutdown+rule> 'Perfect Competition', [Online] Available at: <http://www.econweb.com>

<https://assignbuster.com/unprofitable-company/>

com/Sample/PerfectCompetition/ShutDownSR7.html Piana, Valentino. 2003, 'Costs', [Online] Available at: