

Economics essay sample

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



As a manager, I would continue with operations despite the short run loss. This is because keeping on with operations would enable our firm to reach its long term objectives instead of losing the entire business due to the short term losses (Arnold, 2008). The state of the product is that it is homogeneous. For the hypothetical numbers, the price is \$ 10 while the quantity of the product is 1, 000 units. The fixed costs are \$ 4, 000 while total costs are \$ 11, 000. In order to figure out the total revenue, the product quantity will be multiplied by the price per unit. In this case, it will be given by $1,000 * \$ 10 = \$ 10,000$. Total variable costs will be obtained by deducting fixed costs from total costs. This computation will be conducted by $\$ 11,000 - \$ 4,000 = \$ 7,000$. Average variable costs will be equal to total variable costs/ total units produced. This will be equal to $\$ 7,000 / 1,000 = \$ 7$.

Since this firm operates in a highly competitive environment, it cannot have an influence on price. Therefore, despite the short run loss, it cannot increase its price to make a profit. In addition, it means that the firm is a price taker, and at any output level, this firm has constant marginal revenue (Arnold, 2008). Consequently, its average revenue is equal to its marginal revenue and also price. Therefore, the value for each of these revenues is \$ 10. The output of 1, 000 is the maximum output, and it has been set at a point where marginal cost and revenue are similar. Since marginal revenue is \$ 10, the marginal cost is \$ 10.

This firm is making losses on a short run basis; therefore its total costs are more than its total revenues. The average variable costs amount to \$ 7. Since the marginal revenue is \$ 10, the firm covers its variable costs with

price. Since this output is produced at a profit maximizing level, where marginal revenue and marginal cost are similar, the firm can keep up with operations. The constraint, in this case, is that total revenues are less than total costs. The minimum loss is equal to total costs minus total revenues. This figure is obtained by $\$ 11,000 - \$ 10,000 = \$ 1,000$. At this production level, this firm has minimized total losses to $\$ 1,000$.

If it were to reduce its output to 800 units, for example, its total revenues would be $\$ 10 * 800 = \$ 8,000$. In this case, its loss would be $\$ 11,000 - \$ 8,000 = \$ 3,000$. Reducing the output would increase the loss. Since increments in output are infeasible with the equality between marginal cost and marginal revenue, the firm should stay in operation. The reason is that it is in a position of covering its variable costs with each unit of output. If it does not keep operating, the option will involve shutting down. As such, this firm will cover its variable costs instead of failing to cover any costs if it shuts down (Arnold, 2008).

The role that fixed costs play in this analysis is that they provide a floor for the revenues. Revenues for this firm should not decrease below the fixed costs of $\$ 4,000$ since the firm would be making huge losses. This scenario would be unsustainable in the long run. There exists no difference in this firm between shutting down and going out of business since the firm would be jeopardizing its operations by shutting down.

Reference

Arnold, R. A. (2008). *Microeconomics*. Connecticut: Cengage Learning.