Chapter 10: Evaluating Profit and Loss

I'm from the church down the street and I wanted to let you know that God's got a better plan than whatever plan your church figures He has.
Chapter 10: Evaluating Profit and Loss

Objectives:

1- Analyze how a change in market price affects the individual firm and its profit.

2- Graphically illustrate when a firm has an economic profit, a normal profit and an economic loss.

3- Explain why a firm may choose to operate at a loss.

4- Analyze profit maximization in the short run and long-run.

5- Practice applying profit and loss principles.
Economic Profit:

\[ TR > TC \]

\[ \text{Economic profit} = (200 - 150) \times 10 \text{ units} = 50 \times 10 = 500 \]
Normal Profit:

\[ TR = TC \]

Economic profit = 0
\[ ($125 - $125) \times 6 = 0 \]
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Economic Loss:

\[ TR < TC \]

Economic loss =
\[ ($100 - $130) \times 4 = ? \]
\[ $-30 \times 4 = $120 \]
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V) Operating at a loss:

A) A company may choose to operate at a loss. Why?

1- The key is to operate whenever \( P > AVC \).

B) When \( P > AVC \), some revenue will cover FC.

1- Continue operating!
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C) When \( P < AVC \), there is not additional revenue to cover FC.

1- Time to shut down!
VI) Profit Maximization in the Long Run:

A) Short-run: The # of firms in an industry stay the same.

B) Long-run: Everything/all costs will vary.
   1- Changing costs to produce, production space & # of firms eventually leads to long-run equilibrium.
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2- Other firms see economic $\pi$, induces entry by firms.

3- Smaller $\pi$ for producers created, but $\downarrow$ for consumers.
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4- There is no economic profit $\pi$ in the long-run.
   a- The firm can only earn a normal profit and no further entry occurs.

5- Firms will utilize resources as efficiently as possible to minimize costs (aka, production efficiency).

6- This leads to allocative efficiency: Society’s resources are efficiently allocated to produce goods desired most by society.

7- Producers pursuing their own self-interest (Yeah, Adam Smith!) are guided by presence or absence of profits.
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Time to apply our knowledge and work on test relevant practice Q’s!