Answer on Question #39845 – Economics – Macroeconomics

Assignment

Having completed this course as part of your MBA program you have been hired by a medium sized company. You attend a meeting where the CEO explains that the goal of the company is to maximize profits, not total revenue. As such the firm must estimate both costs and revenues to determine the output where the difference between marginal revenue and marginal cost is the greatest. Will this output level maximize the firm's profits? Explain why or why not

Solution

In economics, profit maximization is the short run or long run process by which a firm determines the price and output level that returns the greatest profit. There are several approaches to this problem. The total revenue–total cost perspective relies on the fact that profit equals revenue minus cost and focuses on maximizing this difference, and the marginal revenue–marginal cost perspective is based on the fact that total profit reaches its maximum point where marginal revenue equals marginal cost.

As such the firm must estimate both costs and revenues to determine the output where the difference between marginal revenue and marginal cost is the greatest, the firm will not maximize the profit, because total profit reaches its maximum point where marginal revenue equals marginal cost.