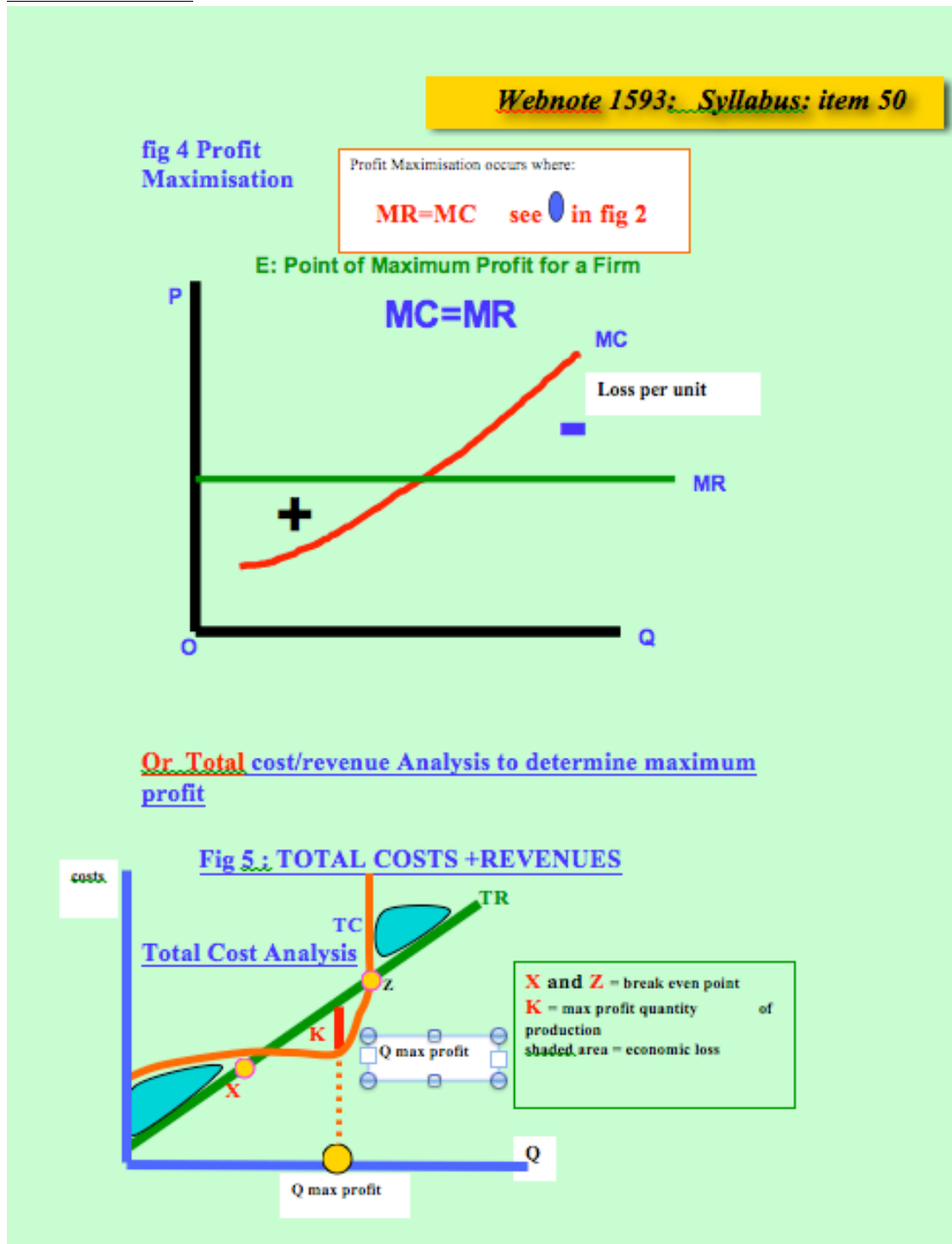


Big Ideas:

1. Price taker
2. Profit maximisation
3. Supernormal profit
4. Normal profit
5. Supernormal profits result in entry into the market of new firms and therefore more competition

Webnote 1592
Syllabus: Items 49-56

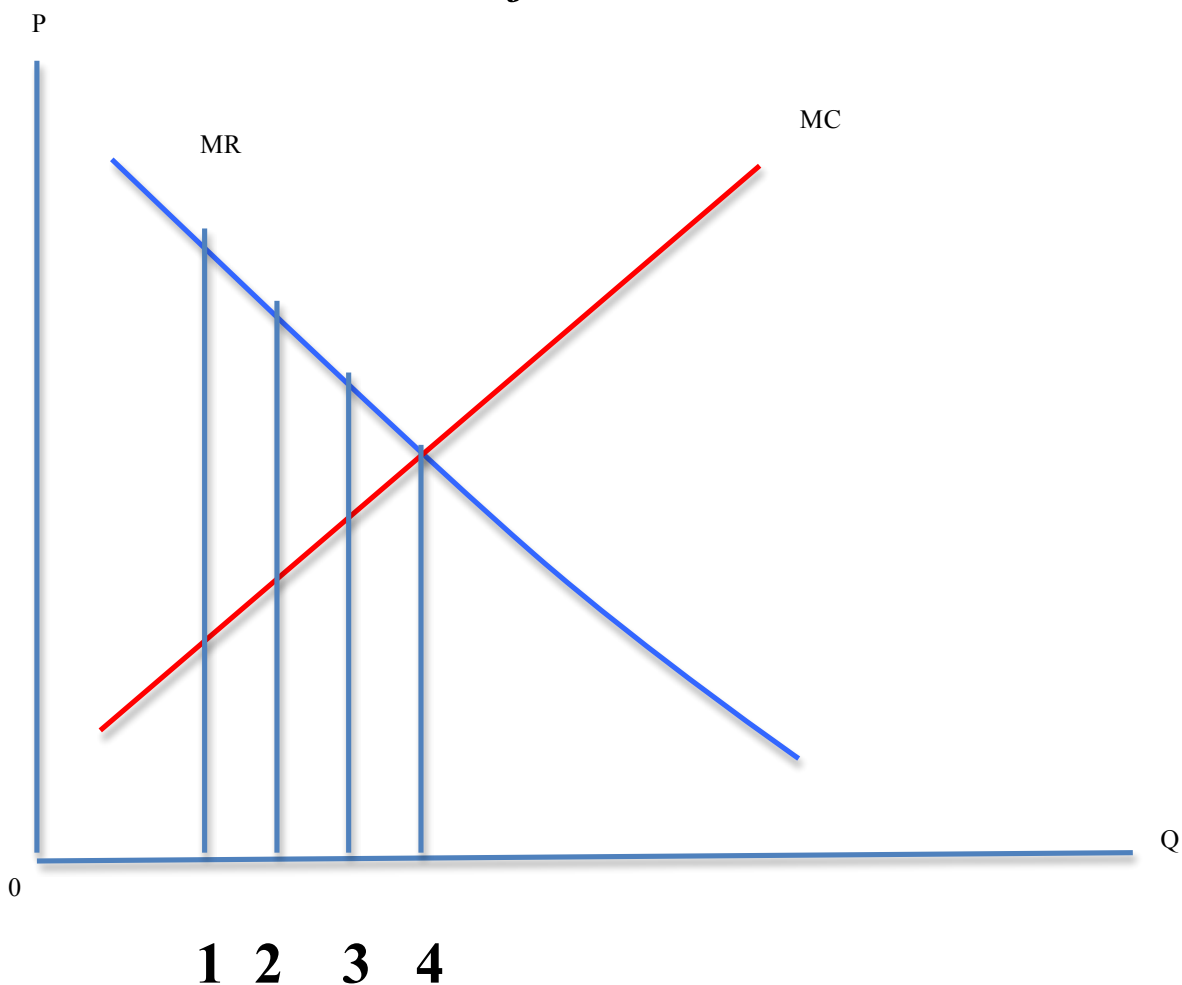
FIG 1: PROFIT- BIG IDEA 1 : MAXIMUM PROFIT



Why produce where $MC = MR$? Some level of profit is the goal of every firm. Why $MR=MC$? Remember that if a firm produces 10 units. It is only at the 10th that $MR = MC$. For all other units $MR > MC$. Firms benefit from output 1-9 and the 10th is the cut off point. It may be of benefit to the firm in the context of economies of scale i.e. larger factory, larger output. Make sense?

Why $MR = MC$? Zero profit?

The Production of 200.000 tonne oil tankers



- 4th Oil tanker produced: $MR = MC$. Why produce the 4th? Because it might allow the firm to benefit from economies of scale and produce nearer to the lowest point on the LRAC
- 3rd Oil Tanker: $MR > MC$. Firm benefits
- 2nd Oil Tanker: $MR > MC$. Firm benefits
- 1st Oil Tanker: $MR > MC$. Firm benefits

**FIG 2: PROFIT- BIG IDEA 2 : NORMAL
PROFIT+Supernormal Profit**

Syllabus Reference 2.2: Profit^{HL}¹

Task:
Draw s/n profits for the following models:
1. perfect
2. monopolistic
3. monopoly
(draw short run and long run curves)

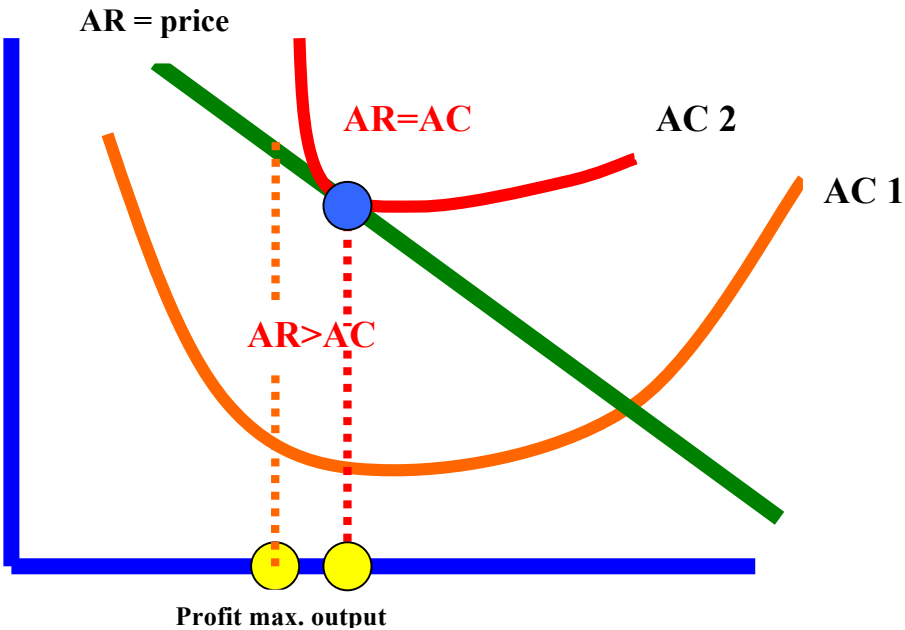
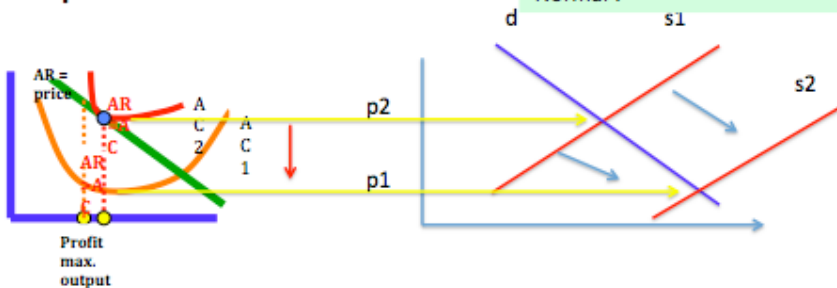


FIG 3: Supernormal profits will result in 'Entry' into the industry forcing price down:

Barriers to Entry...resources follow profits!

- Normal or supernormal?

High S/N profits cause entry and if barriers are absent then price will fall from P2 to P1. $AR=AC$ and profits will be 'Normal'.





Industry increases in size as output increases shown by S1 shifting to S2 resulting from new firms entering the market / industry.

...Of course if firms can set up barriers then the S.N profits can be protected into the long run and this is typical in oligopoly and monopoly.

¹ See Glanville p161. See also Webnote 242

PROFIT- BIG IDEA 2 : SUPERNORMAL PROFIT

Key Terms:

- **Max Profit occurs where**
MR = MC
- ❖ **Normal** profit see in Fig. 2 
- AR=AC**
(at this point economic profit = Zero)
- ❖ **Economic profit =**
- ❖ **Abnormal =**
- ❖ **Excess =**
- ❖ **supernormal** profit see in Fig 2 where $AR > AC$ 
- Ar > Ac**



Profit maximisation is the key goal for many firms but there are other goals that influence firms

Goals of firms:

1. **maximum profit (tr-tc or mr=mc)**
see webnote 1593

Other goals for firms:

1. growth based strategies:
2. sales volume/growth maximisation
3. sales revenue maximisation

note: environmental

4 'Windows' to explain and evaluate competitive firm and how they behave:

1. **Size: Price and output** of 4 models in the SR + LR
2. **Profit Maximisation:** 'profit finder' where $MR=MC$
Supernormal/abnormal profits?
3. **Efficiency** (AC) (lowest point)
4. **Barriers** to Entry (anti - competitive)

Others focus points include: economies of scale, non profit maximisation goals + price discrimination



1. Size
2. Profit
3. Efficiency
4. barriers