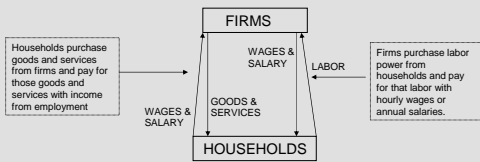


The Business Enterprise

Blending Firm, Household, and Society

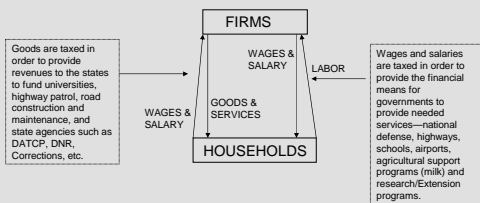
1

Firms and Households



2

Firms and Households



3

Farms are examples of the family firm—the firm and the household are unified

- Much (all?) of the labor is unpaid so there is no circular flow as in the previous slides;
- All members of the family contribute to the operation of the firm;
- The family firm avoids many of the problems that exist in the labor market where firms must go out and “hire in” labor power;
- The family firm also tends to have a higher level of trust and accountability among those who work in it;

4

Other aspects of the family firm

- Working inside of the family may carry a high opportunity cost—the “firm” saves on paying wages/salary to family members, but must balance that savings against the opportunity income foregone;
 - That is, if one adult member of the family has the opportunity to work off the farm, household income may be higher even though labor must be hired in and paid to replace those who work off the farm;
 - It is common that more than one-half of total household income of farm families arises from off-farm work (school teacher, accountant, clerk, office manager, salesperson);
 - Another benefit to the household of off-farm work may be access to benefits such as health insurance that is often too expensive for the family to afford.

5

The Task of Management

- The management problem concerns employing what we call factors of production (you saw these yesterday);
 - Land;
 - Capital (buildings and machinery);
 - Labor (muscle);
 - Management (brains);
- The economic problem is to deploy these factors such that their individual contribution to the economic well being of the firm is maximized;
 - Their use is optimally arranged if any change in that allocation will reduce the net well being of the firm.

6

This is the problem of factor proportions

- In a calendar (tax) year we can regard the quantity of land as fixed, and the quantity of buildings is likewise fixed;
- But labor and machinery can be used a great deal, or very little;
- In this "short run" the management problem is to combine labor and machine time so that this additional use of labor and machinery in some fixed proportion yields an increment of costs for their use that is at least matched by the gross revenue that is expected to arise from their use.
 - If these costs are NOT matched then you are losing money by deploying that labor and machinery;
- This is the marginal return principle.
 - If labor costs \$25.00 per hour, and the operating cost of a piece of machinery is \$13.00 per hour (gas, maintenance, depreciation) then you want to make sure that the use of those inputs for an additional hour of the day will return at least \$38.00.

7

The firm and the market

- Notice that the revenue from an additional hour of use by labor and machinery is a product of the quantity of what is produced with that labor and machinery, and the market price of what is produced:
 - Gross revenue = Price x Quantity of Output
 - Net revenue = Gross revenue – production costs
- What determines price?
 - Price is determined by the market conditions for what you wish to produce.

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Market Prices

- The individual firm is called a "price taker" by which we mean that the firm must accept the prevailing market price for its product;
 - No individual firm produces a quantity that is large enough to drive down the prevailing market price;
 - The manager/owner of a firm must take that price as fixed and adjust management activities with careful attention to the variable costs of using inputs, and the expected change in total production from an additional use of labor and machinery.

9

The Efficiency Conditions

We refer to this as the balancing of marginal costs with the value of the marginal product:

$$\Delta \text{VMP} = \Delta \text{MC}$$

We read this as production is optimal (efficient) at that point where the value of the marginal product made possible by the marginal application of variable inputs (labor and machinery) is just equal to necessary costs of using those variable inputs.

10

Examples of private choices at the margin: Identify the Tradeoffs

- Whether or not to call in a veterinarian for a sick 7-year old cow;
- Whether or not to increase the seeds planted per acre;
- Whether or not to rent in an additional 40 acres available from a neighbor;
- Whether or not to reduce pesticide application by 25% per acre;
- Whether or not to reduce application of available N,P,K by 20% per acre.
- Whether or not to increase your work hours and have less leisure time;
- Whether or not to study tonight or do something else.

11

Examples of social choices at the margin: Identify the tradeoffs

- How much to spend on promoting energy conservation versus additional (renewable?) energy production;
- Value of a tax cut versus government expenditure on energy conservation or renewable production;
- How many troops to send to Afghanistan versus keeping them in Iraq;
- How many troops to keep in Iraq or Afghanistan versus tax cut or supporting scholarships or health care for uninsured;
- How much to spend on rebuilding roads, bridges and schools in Iraq versus spending the same amount of money to rebuild roads, bridges, and schools in America.

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