a firm that makes zero economic profits

A Firm That Makes Zero Economic Profits: A Comprehensive Analysis

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Abstract: This article delves into the concept of a firm that makes zero economic profits, a scenario often associated with perfectly competitive markets but also possible in other market structures under specific conditions. We explore the various methodologies used to analyze such firms, contrasting economic profit with accounting profit and examining the role of opportunity cost. The article further investigates the implications of zero economic profit for firm behavior, market dynamics, and overall economic efficiency.

1. Understanding Economic Profit vs. Accounting Profit

Before diving into the intricacies of a firm that makes zero economic profits, it's crucial to differentiate between economic profit and accounting profit. Accounting profit represents the difference between a firm's total revenue and its explicit costs (e.g., wages, rent, materials). A firm with positive accounting profit appears successful by conventional measures. However, economic profit considers both explicit and implicit costs. Implicit costs represent the opportunity cost of using resources owned by the firm, such as the owner's time or capital that could have earned a return elsewhere. A firm that makes zero economic profits earns only a normal profit – meaning its revenue covers both explicit and implicit costs, yielding a return commensurate with the opportunity cost of the resources employed.

1. Zero Economic Profits in Perfect Competition

The classic example of a firm that makes zero economic profits is found within a perfectly competitive market structure. Key characteristics of perfect competition include numerous buyers and sellers, homogeneous products, free entry and exit, and perfect information. In this ideal scenario, firms are price takers; they cannot individually influence the market price. As firms enter a profitable market, the increased supply drives down the price until economic profit is driven to zero. Conversely, if firms are making losses, some will exit the market, reducing supply and increasing prices until normal profits are restored. This dynamic process ensures the long-run equilibrium of a perfectly competitive market is characterized by firms earning zero economic profits.

1. Zero Economic Profits in Other Market Structures

While perfect competition is the textbook case, a firm that makes zero economic profits can also exist in imperfectly competitive markets like monopolistic competition and even, under specific circumstances, oligopolies. In monopolistic competition, firms differentiate their products through branding, advertising, or other means. Even with some degree of market power, intense competition can still lead to zero economic profit if entry barriers are low and many firms compete for the same customer base. In oligopolistic markets, characterized by a small number of firms, zero economic profit might occur due to intense price competition or factors like high fixed costs leading to price wars that erase profitability.

1. Methodologies for Analyzing Zero Economic Profit Firms

Several methodologies are employed to analyze firms that make zero economic profits. These include:

Cost-Revenue Analysis: This involves comparing a firm's total revenue with its total costs (both explicit and implicit) to determine its economic profit. Break-even analysis is a specific application where the firm’s revenue equals its total costs, resulting in zero economic profit.

Market Structure Analysis: Examining the characteristics of the market structure (perfect competition, monopolistic competition, oligopoly, monopoly) helps determine the likelihood of observing zero economic profits. The degree of competition significantly influences pricing power and ultimately profitability.
Game Theory: In oligopolistic markets, game theory models can be used to analyze firm behavior and predict outcomes, including scenarios where intense competition leads to zero economic profits. This approach considers strategic interactions between firms.
Empirical Analysis: Real-world data on firm revenue, costs, and market conditions can be used to estimate economic profits and assess the prevalence of zero economic profit firms in various industries. Regression analysis and other econometric techniques are commonly employed.

1. Implications of Zero Economic Profits

The existence of a firm that makes zero economic profits has several important implications:

Allocative Efficiency: In perfectly competitive markets, zero economic profits indicate allocative efficiency – resources are allocated to their most valued uses.
Productive Efficiency: Zero economic profit firms in competitive markets are typically operating at the minimum point of their average cost curves, implying productive efficiency.
Dynamic Efficiency: While static efficiency is suggested by zero profits, long-term dynamic efficiency (innovation and technological advancement) may be hindered if firms lack the resources for investment due to low profitability.
Market Entry and Exit: The prospect of zero economic profits in the long run acts as a signal for entry and exit, preventing excessive profits or losses in the long run.

1. Case Studies: Examples of Firms Approaching Zero Economic Profit

Numerous industries show examples of firms operating near the zero economic profit margin. Highly competitive sectors such as farming (in some circumstances), certain segments of the restaurant industry, and some small-scale retail businesses often experience periods of intense competition leading to profits near zero. Analyzing these specific cases reveals the practical application of the theoretical concepts discussed above. Careful consideration of factors like economies of scale, product differentiation, and entry/exit barriers are crucial in these analyses.

1. The Role of Innovation and Competitive Advantage

Even within a competitive market, a firm can maintain profitability above zero economic profit through innovation and the development of a sustainable competitive advantage. Factors such as technological advancements, superior management, unique resources, or strong brand recognition can create a barrier to entry and allow for above-normal profits in the short to medium term. However, sustained competitive advantages are rarely permanent; competitive pressures typically erode these advantages over time, pushing profits towards zero in the long run, unless new innovations are implemented.

1. Conclusion

A firm that makes zero economic profits is not necessarily a failing business. Zero economic profit signifies that the firm is earning a normal return on its invested capital and resources, considering both explicit and implicit costs. While this scenario is most commonly associated with perfect competition, it can also arise in other market structures under specific conditions. Understanding the methodologies for analyzing such firms and the implications of zero economic profit for market efficiency and firm behavior is crucial for economic analysis and strategic business decision-making. Further research focusing on the dynamic interplay of innovation, competition, and profitability across different market structures remains vital for comprehending the complex realities of firm performance in the modern economy.

FAQs:

1. What is the difference between economic profit and accounting profit? Economic profit includes both explicit and implicit costs (opportunity costs), while accounting profit only considers explicit costs.

2. Can a monopoly earn zero economic profit? Theoretically, yes, if faced with extremely strong regulatory pressure or intense competition from substitutes.

3. How is zero economic profit related to allocative efficiency? In perfectly competitive markets, zero economic profits signal allocative efficiency, meaning resources are used where they are most valued.

4. What role does innovation play in avoiding zero economic profit? Innovation can create temporary competitive advantages, allowing firms to earn above-normal profits before competition erodes these advantages.

5. Can a firm intentionally choose to make zero economic profit? No, firms aim to maximize profit. Zero economic profit often arises due to market forces and competition rather than a deliberate choice.

6. What are some examples of industries where zero economic profit is common? Agriculture (certain segments), some areas of the restaurant industry, and small-scale retail businesses can experience periods near zero profit.

7. Is zero economic profit a sign of market failure? Not necessarily. In perfectly competitive markets, zero economic profit indicates efficiency. Market failure arises when markets fail to allocate resources efficiently.

8. How can a firm determine if it's making zero economic profit? Through detailed cost-revenue analysis, including both explicit and implicit costs.

9. What are the long-term implications of consistently making zero economic profit? It can lead to lack of investment and potentially hinder growth and innovation if the firm lacks resources for R&D and expansion.

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QUESTION 28 . 1 POINT Firm C makes zero economic profits and produces less than the quantity at which …

Solved There are only two firms in an industry with demand
If they behave as profit maximizing price takers, each produces 20 units and sells them at a price of 10 so …

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If they behave as profit-maximizing price takers, each produces 20 units and sells them at a price of 10 so …

Solved A firm that makes zero economic profits Multiple - C…
A firm that makes zero economic profits Multiple Choice O Must eventually go bankrupt and exit the industry. Does …

Solved QUESTION 34 - 1 POINTFirm C makes zero eco…
Question: QUESTION 34 - 1 POINTFirm C makes zero economic profits and produces less than the quantity at …

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Monopoly - Department of Economics
Feb 18, 2020 · A. Review of firm demand curve and marginal revenue under perfect competition B. Demand curve facing a monopolist C. Marginal revenue for a monopolist ... Zero Economic …

Multiple Choice questions (through monopoly only) - UMass
B) At output Q1 the firm makes zero economic profit. C) At an output above Q3 the firm incurs an economic loss. D) At output Q2 the firm incurs an economic

loss. Answer: D 21) The feature of …

CHAPTER 8 PROFIT MAXIMIZATION AND COMPETITIVE SUPPLY
summation of each firm’s output at each price. 800 40 Q P S 6. Suppose that a competitive firm’s marginal cost of producing output q is given by MC(q) = 3 + 2q. Assume that the market price …

Sample Exam Questions/Chapter 12 - Oakland University
A) an economic profit. B) zero economic profit. C) negative economic profits. D) The answer is impossible to determine based on the information given. 8. Suppose Sarah's pottery studio is …

Is Producer Surplus a Surplus to the Producer? Wenli Cheng
The firm supplies a quantity of output to the market if the market price is greater than P 0. When the market price is P 1, the firm supplies quantity Q 1 and the producer surplus is measured by …

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is essentially the same. The problem for the firm is to determine where to locate output, given costs and the demand for the product to be sold. In the simplest version of the theory of the …

Ch. 9 Price searchers – sellers who can choose a price so as to ...
Why does a firm only need to cover its variable costs instead of all of its costs in the short-run? Remember that TC = VC + FC. FC represents fixed costs which the firm will incur regardless if …

Eco201 Review questions for chapters 13-15 Prof. Bill Even
A) Firm 1 will give the application away free and Firm 2 will sell it at $30. B) Both Firm 1 and 2 will give the software application away free. C) Both Firm 1 and 2 will sell the software application …

Are You suprised - msu.ru
(ii) Economic profits (b) The government now wants to regulate the price. Indicate what price the government will set to achieve each of the following. (i) Normal profits only (zero economic …

Monopolistic Competition - Fairfax County Public Schools
Because existing firms now make profits, in the long run new entrants are attracted into the industry. In the long run, this results in a leftward shift of each existing firm’s demand curve …

12 - nationalparalegal.edu
Economic Profit and Revenue The goal of each firm is to maximize economic profit, which equals total revenue minus total cost. Total cost is the opportunity cost of production, which includes …

Chapter 9: Pure Competition in the Long Run - McGraw Hill …
and demand, so the firm’s short-term profit or loss depends on the firm’s cost structure. If a purely competitive firm achieves a profit, will it be able to sustain that profit in the long run? …

BUSI 100 Review & Discussion Questions: Answer Guide 7 …
equals average total cost at that point, the firm makes zero economic profit. Now suppose an increase in demand occurs, with the demand curve shifting to D2. This causes ... were initially …

MICROECONOMICS - AP Central
The firm will earn zero economic profits in long-run equilibrium. Advertising is an important tool of the firm. The firm will increase its total economic profits if it charges a price that is lower than …

Quiz 4- Costs of Production
Your firm makes zero economic profits every year. Why do you decide to stay in the market rather than to shut-down your firm? 2. What is wrong with this graph? 3. Why is AC bowl-shaped? MC …

Economics 1220 Chapter 9 Practice Questions Note that …
profits are better than negative profits, a firm would want to change its output decision when it is earning negative economic profits. So negative profits would result in a change and, if there is …

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TOPIC 19: COMPETITION II - d Youngberg
d. This continues until each producer makes zero economic profits—or normal profits: when P = ATC. The producer is covering all the operation and opportunity costs. i. Recall economic profit …

ECN 221 Practice problems for Chapters 7 and 8

1. _____ If a firm makes an economic profit greater than zero, it is making more than the normal profit. 12. _____ If the 3rd worker adds 5 units of output to total production and the 4th worker …

Chapter 14 Firms in Competitive Markets - hsto.info
Explain how a firm in a competitive market identifies the profit maximizing level of production. When should the firm raise production, and when should the firm lower production? ANSWER: …

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MULTIPLE CHOICE. Choose the one alternative that best …

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AP Microeconomics Sample Student Responses and Scoring …
representative firm. Part (a)(ii) asked -maximizing output for a firm earning zero economic profits. This part of the question tested market and ability to illustrate these concepts using graphs. …

Theory of the firm IB Cheat Sheet by egomezc - Cheatography
to zero Supern ormal profits: excess profit a firm makes above the minimum return necessary Economic loss: circum stances when individual or firm loses money Revenue max: firm …

MARKET STRUCTURE - Boston University

1. Describe how the situation facing the individual firm relates to the overall market situation, in perfect competition. 5. Describe why economic profits are driven to zero under perfect …

ECO201: PRINCIPLES OF MICROECONOMICS FIRST MIDTERM …
A)choose between economic efficiency and technological efficiency. B)devise incentives to get employees to work in the best interest of the firm's owners. C)choose between a managerial …

Intermediate Microeconomics - Purdue University
The erosion of economic profits in a perfectly competitive ... Even when the firm does its best, it makes losses under these conditions. This will be ameliorated in the long run by having some …

AP MICROECONOMICS 2015 SCORING GUIDELINES - College …
typical firm determines its profit-maximizing output level; 3) that the average revenue (AR) for the firm is constant and equal to the price determined by the market; 4) that when the firm is …

Context and concepts - New York University
Positive profits on the previous slide generate entry. As new firms enter, the supply curve shifts right until the industry supply function reaches S’ (and profits are zero). Price Price MC D Firm …

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short run it is possible for the firm to earn positive, negative, or zero economic profits. When a perfectly competitive firm earns positive economic profits in the short run this results in entry of …

Econ 201: Introduction to Economic Analysis - Reed College
•Owners of firm want to maximize profit •This is fine as long as laws and competition channel this goal to positive outcome •Managers might have conflicting interest: principal/agent problems …

FACULTY OF SOCIAL SCIENCF TITLE OF PAPER: PRINCIPLES …
d) Only if economic profits are zero 8. In the long run, aperfectly competitive firm a) Makes zero economic profits b) Makes an economic profit c) Can make an economic profit, zero economic …

AP Microeconomics Student Samples from the 2023 Exam …
In part (c) a government regulation on price was introduced that resulted in the firm earning zero economic profits. Part (c)(i) required students to identify the price and resulting quantity the firm …

2001 AP Microeconomics Questions - College Board

1. (a) Assume that a profit-maximizing firm in a perfectly competitive industry is earning economic profits. For a given market price, draw a correctly labeled graph and show each of the following …

PB 7e Ch12 - Simon Fraser University
each firm moves down its marginal cost curve so each firm decreases the quantity it produces. The firm's profit falls (or its economic loss increases). If the firm had been making zero …

15 - nationalparalegal.edu
If both comply, each firm makes $2 million a week. If both cheat, each firm makes zero economic profit. If Trick complies and Gear cheats, Trick incurs a loss of $1 million and Gear makes a …

Multiple Choice Questions. Choose the best answer
(33) The above figure depicts a firm in monopolistic competition. At the profit maximizing level of output, A) the firm is making economic profit. B) the firm incurs an economic loss. C) the firm is …

Chapter 9: Monopoly - deltatauscholarship.weebly.com
A) Economic profits are equal to zero. C) The firm should increase its output. B) The firm is maximizing profit. D) The firm should reduce its output. Answer: B Type: Complex …

Perfect Competition Questions Question 1 - Social Science …
means that firms are earning positive economic profits. f) In the long-run will a representative firm in this industry earn negative economic profits, positive economic profits, or zero economic …

PRINCIPLES OF MICROECONOMICS - University of Houston
Economists' calculations of profits are different from those used by businesses in their accounting systems. Economic profit = total revenue - total economic cost • Total economic cost includes …

Sample Exam Questions/Chapter 12 - Oakland University
In the short run, we expect that the typical firm is likely to begin: A) earning an economic profit. B) incurring an economic loss. C) experiencing no

change in its economic profit. D) experiencing …

Economics 101 Midterm Exam #2 April 9, 2008 Instructions
firm's marginal revenue function is . a.-2. b. 100 - 4Q. c. 200 - 4Q. d. 200 - 2Q. 3. If the inverse demand curve a monopoly faces is p = 100 - 2Q, and MC is constant at 16, profits are …

MONOPOLY PROFITS, EFFICIENCY PROFITS, AND TEACHING …
The cause of competitive advantages/economic profits in this ex post definition are a firm’s “comparative advantages.” The comparative advantage of firms that gen-erate monopoly …

MULTIPLE CHOICE. Choose the one alternative that best …
18)When Swanky, Inc. makes exactly zero economic profit, Sidney, the owner, A)is taking a loss. B)will shut down in the short run. C)will boost output. D)is receiving compensation for the time …

CHAPTER 8 PROFIT MAXIMIZATION AND COMPETITIVE …
between economic profit and producer surplus is the fixed cost of production. 5. Why do firms enter an industry when they know that in the long run economic profit will be zero? Firms enter …

Econ 1013 2nd MT F 2013 - compilerpress.ca
A perfectly competitive firm with zero economic profits is depicted in diagram A) A. B) B. C) C. D) D. E) B or D 17) 18) When a monopolistically competitive industry is in long-run equilibrium, the …

Lesson-36 Profit Maximization and A Perfectly Competitive Firm
The result is that this firm produces 10 units and makes zero economic profit. Graphically, one may find this result by comparing P and AC. P comes from the action of the market (as a …

A Job Market Signaling Game with Productivity Enhancing …
also assumed that labor markets are perfectly competitive. Any attempt by a firm to compensate a worker anything less than their full optimal productivity is met by another firm offering higher …

M01 BROO6651 1E SG C01 - Kimoon
Then, that firm’s economic costs and economic profit will be the same as all the other firms in the industry. So all firms will earn zero economic profit in the long run. 4. What is the difference …

A Firm That Makes Zero Economic Profits

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