# Chapter 9 Organising production

**Opportunity cost** of any action is the highest valued alternative forgone

A firm's opportunity cost of production is the sum of the cost of using resources that are:
- Bought in the market
- Owned by the firm
- Supplied by the firm's owner

## Firms Decisions to achieve maximum economic profit:
- What to produce and in what quantity
- How to produce
- How to organise and compensate its managers and workers
- How to market and price its goods
- What to produce itself and what to buy from others

## Firm's Constraints:
- Technology - production
- Information - making decisions
- Market - price /demand

## Technological and Economic Efficiency
- Technological efficiency occurs when the firm produces a given output by using the least amount of inputs

- Economic efficiency occurs when the firm produces a given output at least cost

## Information and Organisation
Command system - uses a managerial hierarchy, commands pass downward through hierarchy and information passed upward - military

Incentive System - uses a market like mechanism inside the firm
- Instead of issuing commands managers create compensation schemes that induce workers to preform in ways that maximise profit
(Sales people)

Mixed System - both command and incentive system to maximise profit

Principle-agent problem - problem of devising compensation rules that induce AGENT to act in best interest of PRINCIPLE
eg. Shareholders - P manager - A

- Each principle must create incentives that induce each agent to work in interests of principle - unsupervised

Three way of coping: Ownership, Incentive Pay, Long-term contract

Ownership - principle goes in part ownership with agent to induce better result

Incentive pay - pay related to performance

Long term contract - tie the long-term fortunes of managers and workers to the success of the principle

TYPES OF BUSINESS ORGANISATION
- Proprietorship, - Partnership - Company

Proprietorship - Single owner - unlimited liability - liable for debts

Partnership - two or more owners have unlimited liability

Company - One or more limited liability shareholders - liability for value of invest

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# Chapter 9

## Economists identify four market types:

Perfect Competition - there are many firms that sell an identical product, many buyers and no restrictions on the entry of new firms to industry rice, wheat

Monopolistic Competition - a market structure in which large number of firms comple by making slightly but slightly different products - product differentation
- fierce in competition - Shoes.

Oligopoly - market structure in which small number of firms comple
- Aeroplane Manufacturing

Monopoly - one firm which produces a good, no close substitutes and protected by high barriers to entry - electricity, pcs

## Identifying a Market Structure

Measures of concentration - total revenue and puts five firms in the group of largest firms - five firm concentration ratio