A GLANCE THROUGH A PRODUCER’S GUIDE:

Studying the dynamics of a business environment and laws of microeconomics to list the factors that influence the decision making process of a rational producer.

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ABSTRACT:

This paper is a narrative form of review writing that give its readers scientific answers to the never-ending questions like- what to produce, how to produce, for whom to produce, why to produce, when to produce and where to produce.

It details the dynamics of a business environment (emphasizing on the significance of conducting periodic scanning), analyze the laws of microeconomics- consumer’s behavior (factors effecting their demand and consumer’s equilibrium); production function (input-output relation, producer’s equilibrium in both short run and long run); cost and revenue equation (negative profit, normal profit and super normal profit) and list the demographic factors that influence the decision making process of a rational producer.

Guiding producers at all stages of the business (startup entrepreneur aiming sales maximization and market stability, established manufacturer perusing wealth maximization and others minimizing their cost, risk or losses), it will not only help them in achieving maximization objectives but also establishing harmony between the inputs and outputs of production (ensuring fullest utilization and least wastage of the limited input factors available).

Moreover, the real life implications of the economic theories will prove educational to students of economics, commerce and business studies opening them to constructive and critical thinking.
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INTRODUCTION:

In general a producer is referred as “the one in charge of production”, which leads us to another question- what is production?

Microeconomics explains production as the systematic process of assembling the input factors (factors of production) and transforming it into output (final product) such that the marginal utility (additional unit of satisfaction derived from the consumption of the product) of the final goods tends to increase.

Hence we conclude that production is the art of establishing a functional relationship between the inputs and outputs factors of production. Accordingly, a producer is the artist who regulates the process.

However, with the existing economic problems, the job of establishing this input-output relationship doesn’t remain that simple. In the real world, producers face issues pertaining to the scarcity of input factors (raw material, capital, skilled human resources etc) with alternate usage. Hence, he is not only suppose to assemble his inputs but also manage them efficiently ensuring minimum wastage and maximum benefits.

Moreover, the never ending questions like- what to produce, why to produce, how to produce, for whom to produce, when to produce and where to produce remain on his shoulders. To understand what motivates a rational producer in making these basic production decisions, we take a glance through his guide:

A rational producer not only analyzes the internal and external aspects of his business but also studies the laws of micro-economics to make basic production decisions.

A glance through a producer’s guide:

- **SWOT Analysis**: abbreviation for Strength Weakness Opportunities Threats Analysis is a systematic technique of scanning the business environment at both internal and external levels to identify the positives and negatives available.
If analyzed efficiently, it gives the producer relevant data for strategically planning his production functions. While the positives available are used wisely to his advantage, predetermining the problem areas help him in taking the necessary actions to curb them.

- **Laws of Microeconomics**: a branch of economics that studies the behavior of an individual consumer and producer under ideal economic conditions detailing the theories that contribute to their decision making process.

Analyzing these theories- consumer behavior, production functions in both short and lost run, cost and revenue analysis, market structure etc a rational producer take wise decisions ensuring fullest utilization of input factors with least wastage. He also achieves his maximization objectives (profit maximization, sales maximization and wealth maximization) with minimized cost, risk and loss.

**I. WHAT TO PRODUCE?**

This issue of what to produce further splits to two major heads- what goods and services to produce and in what quantity.

A rational producer intending to produce goods that not only have high market demand but also yield better profits, analyze the external (demand analysis, dependent goods etc) and internal (input factors- land, labor, capital etc) structure of his firm to determine what to produce.

- **Market Demand**: it refers to the sum total of the commodity that all the consumers in a market demand at a particular price, at a given period of time. A rational producer aiming to retain consumers at a long run analyzes both the market demand at the point of time and the marginal utility derived from the consumption of the demanded product.

  1. **Demand analysis**: systematic scanning of the quantitative and qualitative aspects of the existing market structure that not only determines the properties (physical, chemical and functional) of the products demanded in the market but also the quantity of the same.

  2. **Marginal Utility Approach**: the law of diminishing marginal utility says that with every additional unit of the product, the marginal utility goes through following stages.

<table>
<thead>
<tr>
<th>STAGE 1</th>
<th>TOTAL UTILITY: Increases at an increasing rate</th>
<th>MARGINAL UTILITY: Decrease (positive)</th>
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<tr>
<td>STAGE 2</td>
<td>Reaches maximum and remains constant</td>
<td>Becomes zero</td>
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<tr>
<td>STAGE 3</td>
<td>Starts to decline</td>
<td>Becomes negative</td>
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Based on the law of equi-marginal utility, a rational consumer is said to attain its equilibrium at the point when the marginal utility derived consumption of a product is equal to the price paid. (MU of X= P of X). Here, he not only maximize his utility instantly, but also demands the product in a long run.

- **Dependent goods:** a rational producer prefers to study the consumer’s response to the goods that are closely related to their own. It helps them estimate the demand prevailing in the market at a given period of time and thereby take decisions accordingly. Dependent goods (often referred as related goods) can be categorized into two:

  1. **Substitute Goods:** goods with equivalent functional properties such that they can be consumed interchangeably are called substitute goods. The demand for these goods is inversely related. This means that when the demand for one substitute increases, the demand for the other good decreases. Popular examples of substitute services include coca-cola and Pepsi. This can be graphically explained as below:

    The above data explains that substitute goods with a good market demand are a major competition to the producer. He must therefore analyze the substitutes well in advance and ensure that his product has a unique distinguishing property that helps him to attract consumers and stand the high market competition. This could otherwise act as a hindrance in achieving desired sales and establishing a decent goodwill.

  2. **Complementary Goods:** goods that typically complement each other (used together) are referred as complimentary goods. The demand of the two is directly related such that when the demand for one rises, it encourages the sale of other product, vice versa.

They are therefore said to work like a team. Here the producer must study the demand of his complimentary goods and assure that he invest his resources wisely.
- **Inputs:** while the economic problem of limited resources with unlimited wants remains unsolved, a rational producer must ensure that the inputs available are employed to the best usage such that they yield output with high marginal utility. He analyzes the Production Possibility Curve (PPC) to determine the same.

Production Possibility Curve or Production Possibility Frontier is the graphical representation of various combinations of two outputs that a producer can produce with the inputs available.

![Production Possibility Curve](image)

II. **HOW TO PRODUCE?**

The economic question of how to produce lays emphasis on the techniques adopted by a producer to conduct production activities. Given the economic issues (limited resources with unlimited wants); a producer being a rational business man aims to maximum his output at minimum cost and incur least wastage of resources. He adapts strategies that assure him the same.

- **Input management:** both art and science of strategically assembling, organizing and coordinating the input factors, allocating them to the best usage in the production process.

Inputs are the factors of production used by the producer to undergo production function and yield output (finished goods serving higher consumer utility). In economics, it is the combination of two-variable inputs and fixed inputs.

1) **Variable Inputs:** factors of production that contribute to the everyday working of the firm are called the variable inputs. They may easily vary in the short run period. Hence, a producer regulates his variable factors to achieve the desired output. This is explained:

![Variable Inputs Graph](image)

The graph explains that in a short run, with every additional unit consumption of the variable input (here: labor), the total output tends to increase until it reaches maximum and becomes constant.

2) **Fixed Inputs:** factors of production that involve a high rate of investment such that they cannot change over a short run period (remain constant).
Graph explains that in a long run when both the fixed and variable factors of production change, there is a massive change in the entire scale of production. It is studied under the Laws of Economies.

- **Cost Minimization:** Cost refers to the sum total of the expenditure incurred by the producer while conducting business activities—production, distribution, warehousing, marketing etc. It is the combination of the fixed cost (incurred in consumption of fixed inputs) and Variable Cost (incurred in consumption of variable inputs).

In a short run production function, while the fixed factor cost remains constant the variable factor cost alone determines the shape of the total cost curve.

The graph implies that a rational producer aiming to minimize his cost of production must adopt strategy to optimize his variable factor cost.

Cost minimization is a calculative strategy that helps a producer determine what combination of two variable factor inputs (say labor $L$ and capital $K$) yield maximum output at minimum cost. Mathematically speaking, cost is minimized at the point when the ratio of marginal product of labor and wages paid is equal to the marginal product of capital and the rental price.

$$\text{cost minimized where } \frac{MP_L}{w} = \frac{MP_K}{r}$$

- **Risk Minimization:** Risk refers to the probability of incurring failures (losses). It is usually the other side of the success coin. Like any other project with promising returns, production functions too involves high risk-taking (investment risk, market risk, inflation risk, business risk, liquidity risk etc).

However, a producer being a rational businessman aims at executing his business at a point where he has to bear minimum risk. Risk minimization is a calculative objective that aims at minimizing risk. He adopts the Risk Management techniques to assure the same. Risk management is the identification, evaluation, and prioritization of potential risks in the business and taking precautionary measurements to curb them.

It is a forward looking activity that involves:
  a) Identify the threads in the external business environment.
  b) Prioritize the risk.
  c) Plan business activities accordingly.
d) Conduct a quality control test to ensure product reliability.

e) Optimize loans and other credits.

f) Buy insurance against causality that impacts the business.

g) Keep the cost of production minimal.

III. FOR WHOM TO PRODUCE?

For whom to produce is another significant economic question that urges a producer to decide the section of the market (consumers) his product will target on? This also helps him to estimate the sales.

Moreover, it must be noted that the decision majorly relays upon consumer’s behavior under the ideal market conditions. Hence assuming the price of the commodity being constant, we analyze the other factors that determine market demand:

- **Income of the Consumer**: demand of an individual household majorly depends upon the financial capability. Hence, based on the income of a consumer the products can be categorized into following groups:

1. **Normal Goods**: these are consumer goods that indicate a direct income-demand relation. As the consumer’s income (financial capability) increases, their demand increases. Smart phones and other electronic gadgets, branded clothing, personal automobiles etc are some good examples of the same.

   ![Normal Goods Graph]

   Hence while dealing with normal goods, a rational producer studies the income distribution curve in the given market and estimates the percentage of the potential consumers, accordingly. This not only helps him to predetermine the average sales but also the class of consumers he has to target.

2. **Inexpensive goods**: a sub category of normal goods that indicates a direct income-demand relation up to a point and thereafter remains constant. In other words, these are the class of consumer goods that form the basic necessity for human existence such that irrespective of the change in the consumer’s income, their demand is always constant.

   ![Demand for Salt Graph]

   Moreover, here the producer doesn’t have to put extra efforts in analyzing potential consumers in the market but on the activities of the co-producers. It is an oligopolistic (close substitutes) form of market with intense competition. Salt is the most popular example for the same.
3. **Inferior Goods**: goods that indicate an inverse income-demand relation are referred as inferior goods. Here, keeping the price constant, the demand of a commodity tends to decrease with the increase in the income of the potential consumers.

This is because the consumer’s real income (purchasing power) has increased. Now he wisely substitutes his demand from the inferior quality goods to the superior one. Switching from black and white TV to plasma screens is a good example of the same.

![Effect on Demand Curve of Inferior Good](image)

Dealing with this category of products, a rational producer not only studies the income distribution and potential consumers, but also the various macroeconomic indicators that effects income of an individual-inflation (WPI and CPI), monetary policies, fiscal policies, pay commission etc.

4. **Superior Goods (Veblen Effect)**: luxury goods indicate an abnormal demand curve (direct price-demand relation) such that irrespective of the hype in the price, their demand is always high.

![Demand Curve of a Veblen Good](image)

American economist Sir Thorstein Veblen studied concept of *conspicuous consumption* in the late 19th century. He explained that the class of consumers demanding these goods is too wealthy to be affected by the price change. They buy this product to maintain their social prestige. This is called the Veblen effect. Rare coins, luxury cars, designer handbags, Swiss watches, jewelries etc are popular examples of the same.

While dealing with such goods, producers do not have to bother about the quantitative aspects (cost of production, price of the commodity, price of substitutes, income of the target consumers etc.) but on tracing the potential consumers and analyzing their qualitative aspects (taste and preference, changing trends, improvising the quality, etc)

- **Taste and Preference**: it is a dynamic concept that deals with the taste of an individual consumer that further determines his preference (demand) in an ideal market with close substitutes. It is backed by the consumer’s right to choose what suits his requirements. While the taste of the consumers is in favor of the product can boost the sales rapidly. An unfavorable taste can affect the sales adversely.
Hence, a rational producer must not only update himself with the demand prevailing in the market but also analyze the multi-dimensional requirements of his potential consumers (affordable price, good quality, updated specifications etc). If designed accordingly, his products can not only ensure maximum marginal utility (satisfaction) to the consumers but also earn their loyalty (sustainable marketing). Otherwise, the sales are affected adversely.

- **Socio-cultural aspects:** part of the external factors of a business environment that determine the production decisions in an indirect manner. Here, the social (income distribution, geographical variation, population distribution, sex ratio, age groups etc) and cultural (education, family background, ethics, religion, etc) aspects of the potential consumers impact the market demand.

While dealing with production, analyzing the socio-cultural aspect of the market is significant. It helps a producer wisely determine the section of the market his product will target based on age, gender, geographical variation, education etc.

### IV. WHY TO PRODUCE?

The question of why to produce is bi-angular in nature. While one aspect of the question addresses the producer’s interest to produce, the other highlights the economy’s necessity produce. A producer being socially responsible coordinates between the two such that his production decisions not only serve his purpose but also catalyze economic growth.

**Producer’s Interest:** while executing production activities, a producer aims at achieving certain goals depending upon factors like- the nature of the business, size of the business, stage of production etc. These goals are studied under the Maximization Objectives:

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<th>MAXIMIZATION OBJECTIVES:</th>
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<tr>
<td>• Profit Maximization</td>
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<tr>
<td>• Wealth Maximization</td>
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<td>• Sales Maximization</td>
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- **Profit Maximization:** in economics, profit refers to the difference between total revenue over total cost. It could be categorized into three:
  - Negative Profits: deficiency of total revenue over total cost (loss)
  - Normal profits: when total revenue is equal to total cost (no profit/ loss)
  - Super natural profits: excess of total revenue over total cost (real profit)

Profit maximization is not only the traditional approach of conducting a successful business but also the primary objective of a capitalist. Like any businessman, a producer aims at maximizing his profits such that he conduct his production at a point on the graph where he incurs least cost and yield highest revenue.
However, producer often fails to address the demerits that come along - risk maximization, compromising with the quality of the product etc. In essence, it is naked profit that may fetch instant gains but long term loss to sales.

Hence, to ensure sustainable business growth, a producer must take all the aspects of business into consideration. Decisions pertaining to financing, investing, producing etc must be coordinated on maximizing profits to an optimum level.

- **Sales Maximization:** In the words of an American economist Prof Baumoul, “sales maximization is the theoretical objective of a producer that aims at maximizing the sales without taking loss (earning satisfactory profits).”

Graphically speaking, it is the technique of executing business at the breakeven point (point on the graph where the total cost incurred on production is equal to the total revenue earns such that the business earns no profit/loss; i.e. normal profits).

This forward looking approach is usually adapted by new business organizations that aim at retaining consumers in a long run. Here they overlook the instant gains to fetch long term stability. Reliance Jio is the best example for the same.

Producers adapting this as their ultimate goal must not only adapt the modern marketing techniques (scanning the market structure, analyzing the consumer demand, consumer feedback, assuring after sale services, etc) but also keep its cost of production minimal.

- **Wealth Maximization:** while wealth or value of a business refers to the market price of the capital invested by its shareholders (owners of the business), wealth maximization refers to the modern approach of maximizing the net worth of the company.

Unlike profit maximization, it takes a broader arena into consideration- adequate management of the available resources, smart investment, high quality output, ensures sustainable marketing, avoid unnecessary risk, high returns to the shareholders, establishing goodwill. It is a long term concept that is not only sensitive to the time value of money but also follows cash flow accounting (avoiding any ambiguity associated with accounting profits).
Here, decisions pertaining to the investment of the shareholder’s capital play a significant role. A rational producer must analyze the nature of his industry (nature of the product, size of the market, market competition, barriers to exit and entry if any etc), recognize the various strength and weakness available and take the investment decisions accordingly.

**Economy’s Requirements:** production forms the basis of economy at both micro and macro level. While dealing with production, a producer not only create both goods and services to satisfy market demand accelerating trade, but also contributes to economic growth.

- **Gross Domestic Product:** Gross Domestic product (GDP) is an indicator to evaluate the national income. It is the sum total of monetary value of all the finished goods and services produced within the geographical boundaries of an economy in the given period of time. Production being the basis of GDP plays a significant role. An increase in production at micro levels further increase the annual GDP at macro level.

- **Employment Opportunities:** production is an economic activity that not only opens employment opportunities at manufacturing levels, but also accelerates demand for human capital at managing, marketing and other distribution levels. It not only curbs problems like unemployment, underemployment and hidden employment but also boost the per capita income.

- **Income Equality:** promoting job opportunities, production not only helps the unemployed people fetch a livelihood but also regulates the uneven distribution of wealth in the economy. It allows strategic flow of money from the high concentration sector (rich) to the low concentration (poor) helping the economy attain equality.

- **International Trade:** a rise in the production (both quantity and quality) helps an economy open to international market. It promotes export (encouraging foreign currency inflow) and substitute imports (preventing foreign currency outflow).

- **Economic Growth:** economic growth refers to the quantitative increase in the economy’s index. Production being an integral part of an economy accelerates the flow of currency in the economy, boosts the national income, and promotes export etc together encouraging economic growth.

- **Economic Development:** economic development is the qualitative increase in the economy’s social infrastructure- quality of life, education ratio, population, sex ratio, etc. While opening job opportunities and regulating income inequality, production helps the individuals in an economy boost the quality of their life.

**V. WHEN TO PRODUCE?**

The economic question of when to produce refers to the ideal time when a rational producer must execute his production functions to ensure that he achieves his business objectives—maximum output at low cost ensuring minimum loss.

A rational producer must analyze the laws of economics to not only determine when to produce, but also when not to produce:

- **When to Produce?**
  Taking into consideration the economic issues (limited resources with unlimited wants), a producer not only aims to produce maximum output but also utilize his input factors to the fullest (ensuring least wastage). He studies the input-output equation to determine when it is ideal for him to produce.

  (1) **In a Short Run:** In short run, the Law of Variable Proportion states that with every unit change in the variable factors, production function undergoes several stages:
Rationally speaking, the second stage of variable proportion; i.e. *Constant Return to the factors* is the ideal time for a producer to execute his production functions. Here, not only the Total Product reaches maximum and remains constant indicating maximum output production but also the Marginal Product becomes zero indicating that fullest utilization of the variable inputs.

(2) **In a Long Run**: in long run production function, both variable and fixed factors of production changes such that the total production changes tremendously. Here, decision of when to produce depends on the two- Isoquants and Iso-cost lines.

*Isoquants*: graphical representation of different combinations of two input factors yielding same units of output, at different cost. They are also called iso-products or equal product curves.

*Iso-cost*: graphical representation of various combinations of two factor inputs, yielding different levels of output.

When studied together, the two help a producer estimate the point of product optimization (point E) when the producer incurs minimum input cost to produce maximum outputs.
When not to produce?

Generally speaking, a producer must shutdown his factory when his cost exceeds his revenue (negative profits/losses). However, the laws of economics explain that a rational producer must execute his business until he cannot resist the losses incurred. To determine the shutdown point, he must analyze the negative profit (loss) of his firm in detail.

i) **Running Loss**: when a producer incurs loss such that his revenues can cover the fixed factor cost but not the variable factor cost, he is recommended to execute his production.

![Running Loss Graph](image)

ii) **Shutdown Loss**: when the loss incurred by a producer fails to cover the fixed factor cost, he is advised to shutdown his production. In the graph, both the variable and fixed factor cost exceeds the price of the commodity (revenue) making the producer loose more than he could resist. These are called shutdown loss.

![Shutdown Loss Graph](image)

VI. WHERE TO PRODUCE?

The question of where to produce lays emphasis on the geographical aspect of production. A rational producer aiming to execute his production functions at a location where he not only gets cheap and easy access to the input factors but also has a market of potential buyers nearby such that it helps him to cut down other unnecessary cost (transportation cost- carriage inward/outward etc.)

Industrial Geography, a study that helps a producer to understand the geographical aspect of an industry, emphasizing on how the industry manifests across space, interacts with and helps shape the experience of the people. It is the combination of the past experiences, social relationships and technological eras that determines where is it ideal for the producer to execute his production functions. It is based on the following factors:

- **Accessibility of Inputs**: aiming to reduce his cost of production, a rational producer sets up his production unit (factory, tannery, mills, etc) at a place where he gets an easy, quick and cheap access to factor inputs- labor and raw material.

Saudi Aramco- world’s leading oil producing company situated in Saudi Arabia is the best example available. Wisely using the natural supply of crude oil, it has a major control in the world’s oil supply.
• **Environmental Factors**: suitable environmental factors like landforms, climatic conditions etc are important to encourage production. A rational producer aiming to maximize the output to his inputs tends to set up the production outlet at the area where he can get all the essentials required to produce.

Setting up tea industry in Assam, West Bengal, Tamil Nadu and Kerala than any other state is a good example of the same. Friendly with both climatic conditions and the landforms, these states together contribute to around 566.66 hectares of area under tea production in 2015 making India the second largest tea producer (around 13 lakh tons) in the world economy.

• **Demand for Outputs**: not alone the accessibility of inputs, but also the availability of potential buyers nearby is a relevant point that helps a producer in determining the ideal location to set his factory.

Setting up industry for production of air conditioners in region with tropical and temperate climatic conditions like India, Brazil, Arabian nations etc than those with sub polar climate like Canada, Russia etc is a suitable example for the same. This way the producer approaches the consumers easily and maximizes its sales.

• **Geographical Risk**: risk pertaining to geographical calamities like earthquakes, floods, etc is studied under this point. Prior to making big industrial investment, a rational producer ensures that the location he chooses to set his production unit is not prone to disaster. Further, via adapting the disaster management measures he can avoid the danger wisely.

• **Ecological Factors**: a producer not only plays a businessman, but also ought certain responsibilities to the ecosystem he lives in. While determining the geographical location for his production unit, he has to take into consideration the danger his production process can cause to the environment. Apart from taking essential measures to curb the toxic waste (waste management), he must set-up his production unit in the outskirts of the city to minimize risk for the residents.

**CONCLUSION:**

In the real world, the task of executing production functions does not remains simple. With the existing economic issue (limited resources with unlimited uses), a producer struggles establishing an input-output relation that yield maximum product at minimum cost.

This study (a narrative form of review paper) explains that a rational producer adapts the theories of business studies and microeconomics to find reasonable answers to questions like what to produce, how to produce, for whom to produce, why to produce, when to produce and where to produce, but also manage resources efficiently to.

He scans the business environment (SWOT Analysis) listing down both strength and weakness of the internal structure and opportunities and threats available in the external structure.

Analyzing and implying the laws of microeconomics on phenomenon like: Consumer behavior in an ideal market condition; i.e. factors that impact his demand (price of the product, price of related goods, income, taste and preference, etc) and consumer equilibrium (point on the graph when the marginal utility derived from the consumption of a product is equal to the price paid) are few of the subheads. Production functions; i.e. functional relationship between the input and outputs of production, stages of production in short run (returns t to factor) and long run (returns to the scale) and producer’s maximization objectives (profit maximization, sales maximization or wealth maximization). Cost and revenue analysis to estimate the profits earned (negative profit, normal profits and super normal profits) and accordingly deciding on the point of equilibrium (point on the graph when marginal cost cuts marginal revenue from below).
Giving a detail glance through the scientific factors that affect a producer’s decision making process, this report will not only be beneficial to all dealing with production but also students of economics, commerce and business studies in adapting a constructive approach.

**LITERATURE REVIEW:**

This report aims at finding answers to major economic questions from a producer’s perspective, namely:

- What to produce: choosing the best alternate output that can be produced using the limited input factors such that has both high market demands (maximize sales) and ability to withstand the competition.
- How to produce: techniques of production to adapt ensuring maximum output at minimum cost and efficient input management (least input wastage).
- For whom to produce: scanning the potential consumers (in a market of heterogeneous buyers) based on demand defining factors like income, taste and preference, socio-cultural grounds etc.
- Why to produce: determining the interest (maximization objectives) that motivates a producer to undertake production functions and guiding him through it.
- When to/not to produce: analyzing the stages of production to identify the points that yield long term gains (break even point) and unbearable loss (shutdown point).
- Where to produce: the ideal geographical location to setup the production outlet such that he has both input factors and potential consumers at his reach.

Studying multiple sources (Google Search and Google Scholar) business studies and business economics, this report gave me a detail understanding of the real life implications of laws and theories pertaining to environment scanning, consumer’s behavior, production function, cost revenue analysis etc.


