

## **Factors of Production**

All firms require one or a combination of Land, Labour, Capital & Enterprise in producing a good or service.

<b>Factor</b>	<b>Definition</b>	<b>Return/Payment</b>	<b>Example</b>
Land	Anything provided by nature used in the production of goods & services	Rent	
Labour	The human effort involved in producing goods and services	Wages	
Capital	Anything man made that helps in the production of goods & services	Interest	
Enterprise	A person who combines the other three factors, takes a risk, sets up a business, in the hope of making a profit	Profit/Loss	

### **Derived Demand**

A factor is said to be in derived demand when it is demanded not for its own use, but its use in the production process of other goods.

Example:

### **Specific versus Non-Specific Factors**

- A specific factor is so specialised that it has few, if any, alternative uses. Eg: a lawnmower
- A non-specific factor has a wide variety can have a variety of different uses. Eg: land

### **Demand for Factors of Production**

The amount of a factor of production that is demanded is based on the MPP (Marginal Physical Product) and MRP (Marginal Revenue Product) of the factor.

- **Marginal Physical Productivity**
  - The extra output generated by employing an extra unit of a factor of production

- Eg: if you bought a new machine that increased annual production at your factory increased from 6000 units annually to 10000 units annually, the MPP of the new machine is 4000 units.
- **Marginal Revenue Productivity (MPP X MR)**
  - The extra revenue generated by employing an extra unit of a factor of production
  - Eg: if you hired a new machinist, and annual turnover at your business increased from €60,000 annually to €100,000 units annually, the MRP of the new machinist is €40,000 (4000 units X €10 per unit).
- **Factors that influence MPP**
  - Quality/Specialised nature of the factor
    - If the quality of the factor improves, then they will become more efficient and produce more output
  - Training/Education Provided
    - Proper training can upskill the factors to work more efficiently
  - Expertise of the Entrepreneur/Manage
    - The ability of the entrepreneur to manage their factors will affect the efficiency of the factor
  - Law of Diminishing Marginal Returns
    - As each quantity of a variable factor, is added to fixed quantities of a fixed factor the additional output from the factor will begin to diminish.
- **Factors that influence MRP**
  - The productivity of the factor
    - The more productive a factor is the more MRP it will earn.
  - The MR/Price of the output
    - As the selling price changes so too will the MRP as  
 $MRP = (MPP \times MR/Selling\ Price)$
  - The law of demand/elasticity
    - As a firm increases or decreases its selling price to earn more this will affect the MR. The elasticity of the product or service will also impact on the quantity of the product sold. If the firm faces an inelastic demand curve the price maybe increased with quantity demanded falling disproportionately, leading to an increase in revenue.

### **Supply Price**

The supply price of a factor of production is the minimum payment required to bring the factor into use and maintain it in that use.

Eg:

## **Transfer Earnings**

The transfer earnings of a factor are the earnings that a factor could make from its next best alternative employment.

### **Factors influencing Transfer Earnings**

- **Productivity of the Factor**
  - The transfer earnings of a factor can depend on how productive the factor would be in alternative uses.
- **Length of Time**
  - The longer the time period under consideration, the greater the transfer earnings. Training can improve adaptability and access to information on alternative uses of the factor

## **Economic Rent**

Any earnings a factor makes above its supply price.

Eg:

- **Circumstances under which a factor can earn economic rent**
  - **Shortage in the supply of any factor of production**
    - If land / labour is in short supply, its price will increase.
  - **Possession of a rare skill or talent (Rent of Ability)**
    - If a person has a skill which is in great demand e.g. a professional soccer player then they can command high fees.
  - **Completely specific factors of production**
    - There is no opportunity cost in the use of an existing factor of production which is completely specific (not adaptable to other uses e.g. a railway station) . If a payment is made for the use of this specific factor then this entire payment would be economic rent as the opportunity cost is zero.

## **Quasi Economic Rent**

Refers to economic rent of a temporary nature.

Eg: