

Marginal Analysis

Marginal analysis is the study of the incremental effects of a business decision. Fixed costs and other sunk costs are totally irrelevant. Of primary concern is the effect of a business decision on marginal product, cost, output, sales, etc.

Marginal revenue and marginal cost are very important concepts in business because firms maximize their profits when marginal revenue equals marginal costs. Furthermore, marginal costs reach a minimum when marginal product of inputs is at a maximum.

The different marginal costs and principles (e.g. marginal revenue, marginal cost, and marginal product, etc.) are intricately linked. And understanding the relationship between these different numbers goes a long way toward understanding the inner workings of a firm and predicting its future performance.