Marginal Revenue

Marginal revenue is the change in revenue a firm can expect with a change in price. If a firm faces a downward sloping demand curve, marginal revenue is ***not*** equivalent to the demand curve. Marginal revenue will always be to the left of the demand curve.

The reason for this is that when a firm lowers its price to generate more revenue, it cannot just lower its price for those consumers who are only willing to pay a lower price. It must lower it even for those consumers who want its product and would pay a higher price. Consequently, the marginal revenue curve is to the left of the demand curve, and marginal revenue is always less than the price.

An accurate calculation of marginal revenue is important because a firm will maximize its profits where marginal revenue just equals marginal costs. If marginal revenue is greater than marginal costs, the firm should lower its price and sell more of its good or service; if marginal revenue is less than marginal costs, the firm should raise its price and sell less of its good or service.