Class B.Com - I

Subject: Business Economics and Environment.

Paper : II

Unit : V

Topic : Factor Pricing.

Lecture sequence no : 1

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Factor Pricing:
Theories of Distribution:

Factors of production can be defined as inputs used for producing goods or services with the aim to make economic profit.
In economics, there are four main factors of production, namely Land, Labour, capital and enterprise. The price that an entrepreneur pays for availing the services for these factors is called factor pricing.

According to: Chapman: "The economics of distribution accounts for the wealth produced by a community among the agents, or the owners of the agents which have been active in its production.".
According to: "Boulding" Here the economist is immediately at home for the problem of functional distribution is merely part of the general theory of price. The wage of Labour, the rent of Land, or of capital equipments are the prices of the services properly".

Concept of Factor pricing.
[What is theory of factor pricing]

Meaning :-

Factor pricing is associated with the prices that an entrepreneur pays to avail the services rendered by the factor of production.

In other words: The principles which determine the price paid by a firm to a factor of production. It is known as the theory of factor pricing.

eg. A entrepreneur needs to pay wages to labour, Rent for availing land, and interest for capital so that he/she can earn maximum profit. These factors of production directly affect the production process of an organisation.

Functions of the Theory of factor pricing:

The following are the main functions of the theory of factor pricing:

1. Allocation of factors:
   The theory of factor pricing studies the allocation of factors across their different uses.

2. Distribution of value added among the owner of factor of production.

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The theory of factor prices explains how value added is distributed among the owners of factors of production. It explains the determination of rent, interest, profit and wages:

Why a separate study of factor pricing?

The theory of factor pricing deals with the price determination of different factor production.

This is because is both the cases, the prices are determined with the help of demand and supply forces. Moreover the demand for factors of production is similar to the demand for products.

(A) Difference in demand for factors and goods.
(B) Difference in supply for factors and goods:

(A) **Difference in demand for factors and goods:**

The two main difference between the demand for factors and goods are as follows:

(1) **Derived demand:**

The demand for a factor is a derived (or indirect) demand as distinct from direct demand for commodities. The factor is demanded by the producer because it helps in the production for a commodity for which there is direct demand from consumers in the market.

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Joint demand:

The demand of a factor is that the demand for factors of production is necessarily a joint demand. Two or more factors have to be jointly used with various degrees of substitutability and complementarity among them.

(B) Difference in Supply for factors and goods:

(i) Estimation of cost of factor:

Supply of a goods is closely related to its cost of production. Cost of production of goods can be calculated but it is not very easy to estimate the cost of factors.

(ii) Relation between price and Supply.

There is difference also in the relation between the price and supply of factors and the price and supply of goods. With rise in the price of goods generally their supply also increases. So the supply curve of goods is upward sloping but there is no definite relation between the supply and price of factors.