AQA Economics AS-level

Microeconomics

Topic 4: Competitive and Concentrated Markets

4.2 The objectives of firms

Notes

- Profit is an important objective of most firms. However, firms can have other objectives, which affect how a firm will behave.
- Profit is the difference between total revenue and total cost. It is the reward that entrepreneurs yield when they take risks.

- Firms break even when TR = TC.

- **Profit maximisation** occurs when marginal cost = marginal revenue (MC = MR).

- This would give employees higher wages and shareholders larger dividends.

- Additionally, retained profits are a cheap source of finance. If firms want to invest at some point in the future, they can use their profits rather than taking out a loan, which could potentially be expensive and have high interest rates.

- PLCs are particularly keen to profit maximise, because they could lose their shareholders if they do not receive a high dividend. They are more likely to have **short run profit maximisation** as an objective, because they need to keep their shareholders happy.

- Other important objectives of a firm include survival, growth and increasing their market share.

- **Survival:** Some firms, particularly new firms entering competitive markets, might aim to simply survive in the market. This is a short term view. During periods of economic decline such as the 2008 financial crisis, when consumer spending plummets, firms might have survival as their objective, until there is economic growth again. Firms might aim to sell as much as possible to keep their market position, even if it is at a loss in the short run.

- **Growth:** Some firms might aim to increase the size of their firm. This could be to take advantage of economies of scale, such as risk-bearing or technological. This would lower their average costs in the long run, and make them more profitable. Firms might grow by expanding their product range or by **merging or taking over** existing firms. Large firms are also more able to participate in research and development, which might make them more competitive and efficient in the long run.

- **Increasing their market share:** This helps increase the chance of surviving in the market, and it can be achieved by maximising sales. For example, Amazon aimed to increase their market share in the e-reader market, by trying to sell as many Kindles as possible. They did this at a loss in the short run, but they gained customer loyalty and now they are a leading e-reader producer.

- Other objectives of firms include:

    - Society
    - Environmental
    - Ethical where there are philanthropic owners
    - Managerial for personal gains e.g. luxury cars and holidays
    - Worker welfare

- The objectives of a firm will influence its behaviour.