Edexcel Economics (A) A-level

Theme 3: Business Behaviour and the Labour Market

3.2 Business Objectives

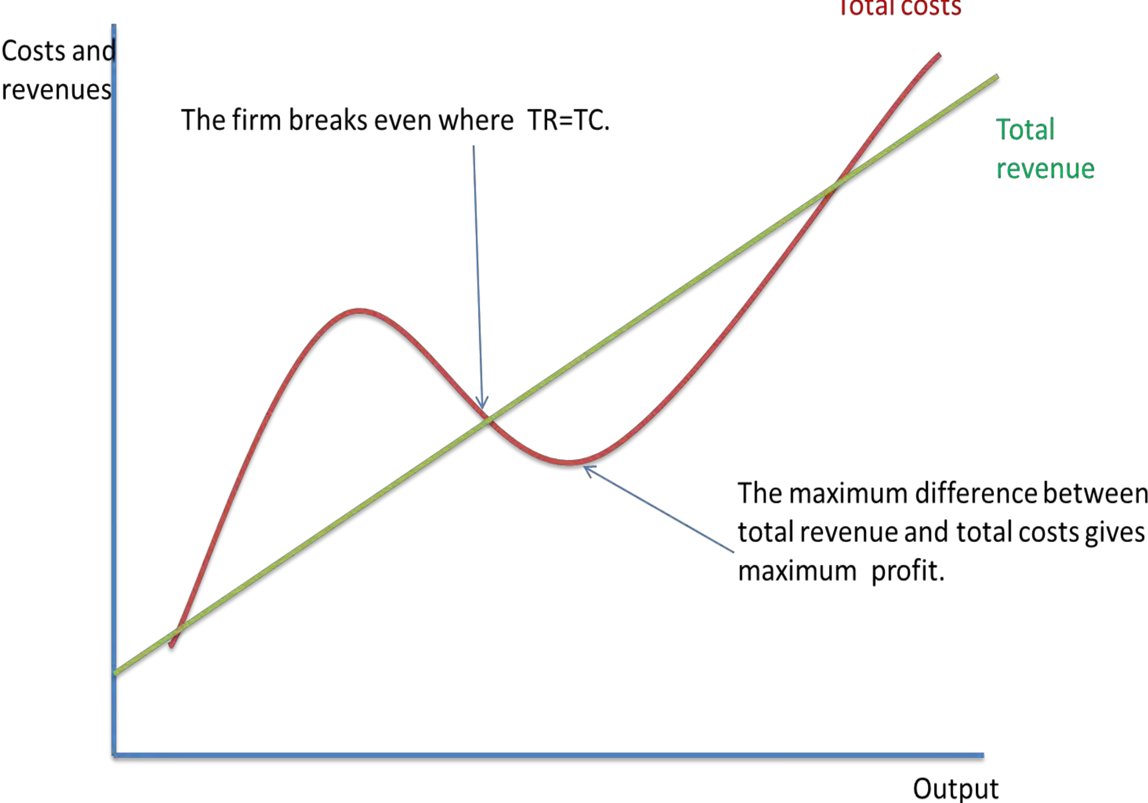
Summary Notes

3.2.1 Business objectives

Different business objectives and reasons for them

Profit maximisation:

A firm's profit is the difference between its total revenue (TR) and total costs (TC). A firm profit maximises when they are operating at the price and output which derives the greatest profit. Profit maximisation occurs where **marginal cost (MC) = marginal revenue (MR).** In other words, each extra unit produced gives no extra loss or no extra revenue.



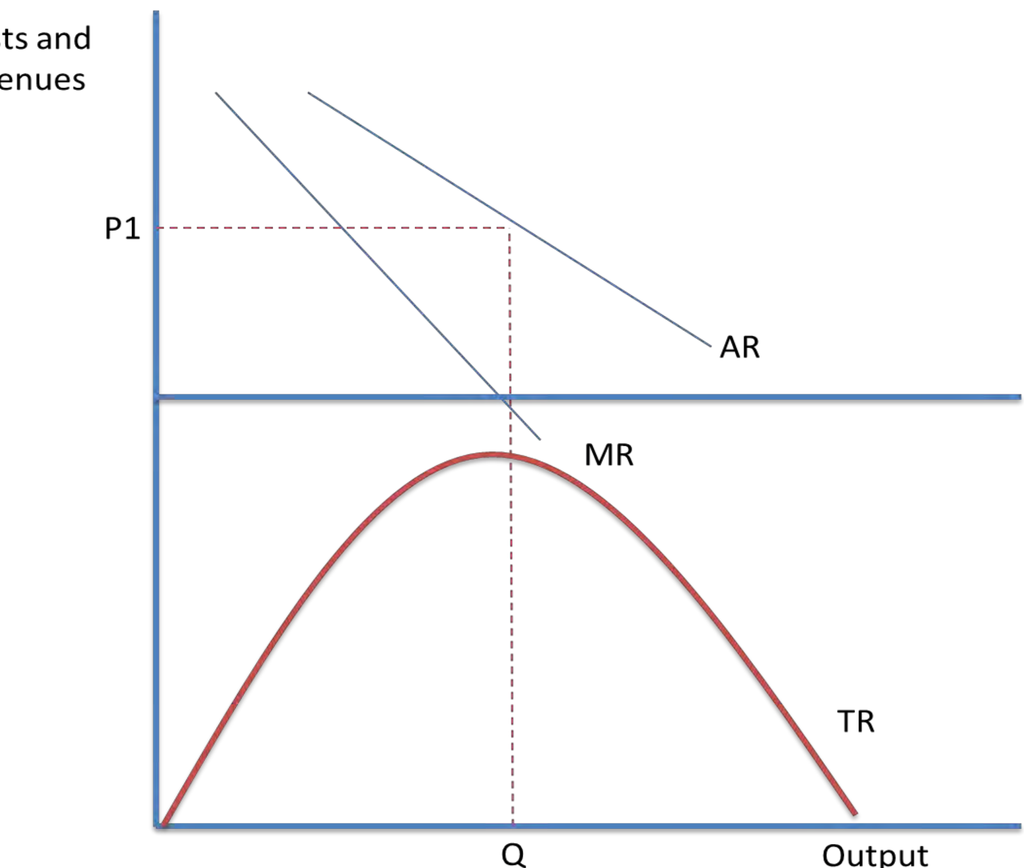
Profits increase when MR > MC. Profits decrease when MC > MR.

Some firms choose to profit maximise because:

- It provides greater wages and dividends for entrepreneurs
- Retained profits are a cheap source of finance, which saves paying high interest rates on loans
- In the short run, the interests of the owners or shareholders are most important, since they aim to maximise their gain from the company.
- Some firms might profit maximise in the long run since consumers do not like rapid price changes in the short run, so this will provide a stable price and output.

Revenue maximisation:

- This occurs when MR = 0. In other words, each extra unit sold generates no extra revenue.

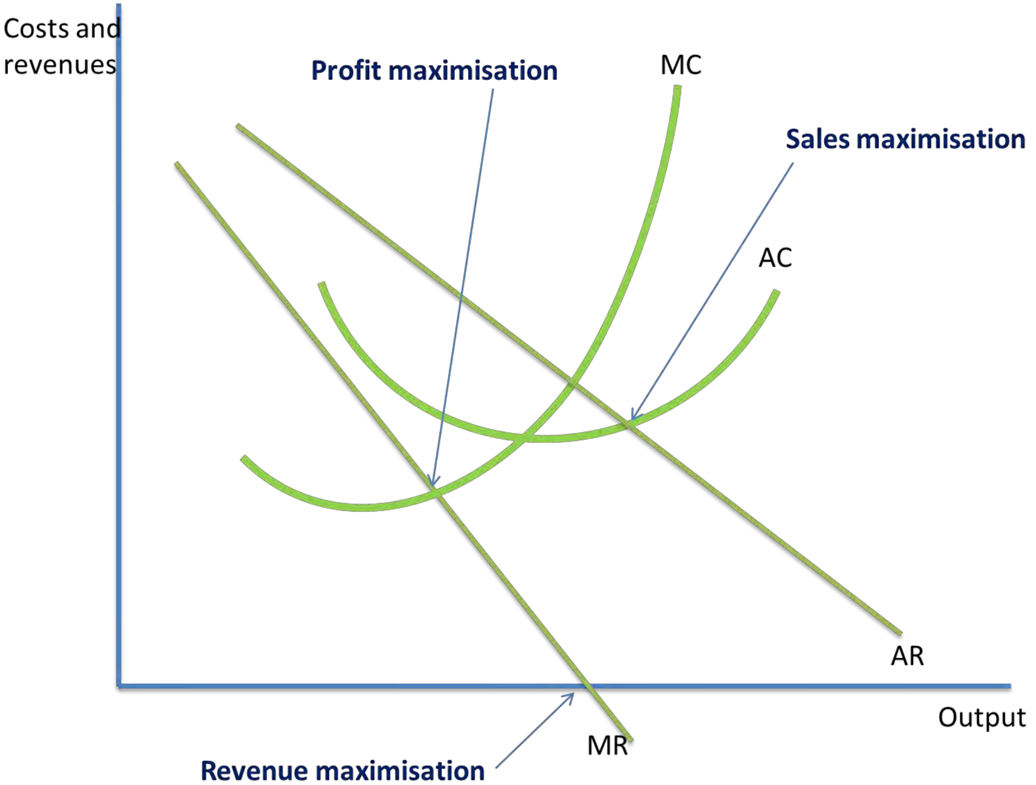


- At the point Q P1, the firm is operating at MR=0, where revenue maximises. The curve shows how the point of maximum total revenue is MR =0.

Sales maximisation:

- This is when the firm aims to sell as much of their goods and services as possible without making a loss. Not-for-profit organisations might work at this output and price. On a diagram this is where average costs (AC) = average revenue (AR).
- An example of sales maximising is Amazon's Kindle launch. They sold as many Kindles as possible to gain market share, so they can earn more profits in the long run. It helps keep out and deter competitors.

This diagram summarises each objective:



Satisficing:

- Another objective a firm might have is satisficing. A firm is profit satisficing when it is earning just enough profits to keep its shareholders happy.
- Shareholders want profits since they earn dividends from them. Managers might not aim for high profits, because their personal reward from them is small compared to shareholders. Therefore, managers might choose to earn enough profits to keep shareholders happy, whist still meeting their other objectives.

  This occurs where there is a divorce of ownership and control.

Synoptic point:

- The state of the economy can affect a firm's objectives. For example, a firm may be less likely to adopt a profit maximising objective if the economy is in a recession.