

Edexcel (B) Economics A-level
**Theme 1: Markets, Consumers and
Firms**

**1.1 Scarcity, Choice and Potential
Conflicts**

1.1.2 Business objectives

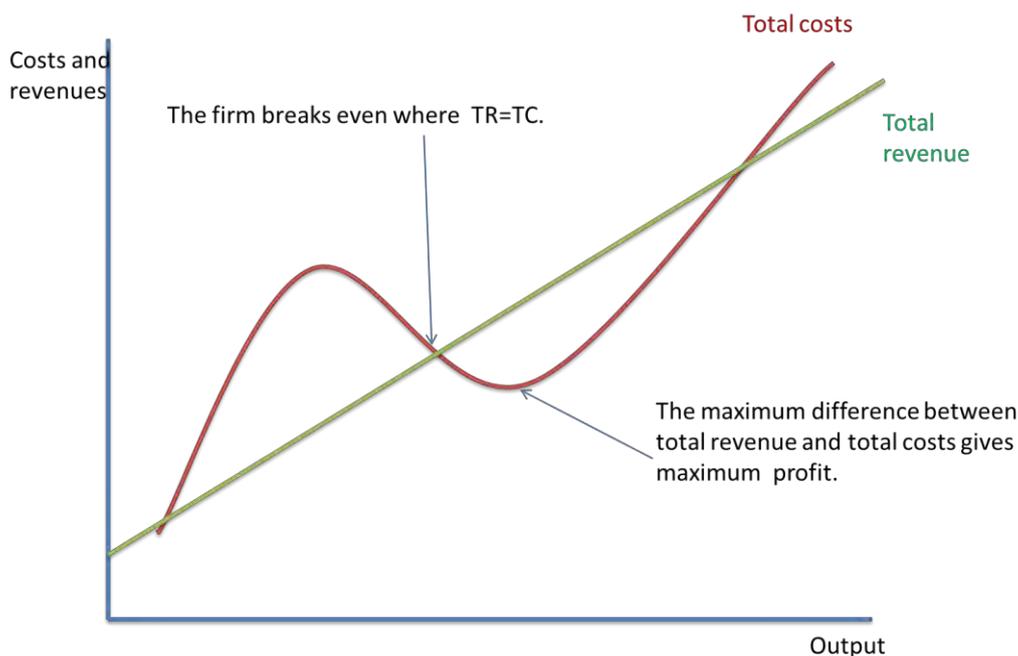
Notes



 **Different business objectives and reasons for them:**

○ **Profit maximisation**

-  Profit is an important objective of most firms. Models that consider the traditional theory of the firm are based upon the assumption that firms aim to maximise profits.
-  Profit is the difference between total revenue (TR) and total cost (TC). It is the reward that entrepreneurs yield when they take risks.
-  Firms break even when $TR = TC$.
-  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.

 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.

- **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. 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.

- **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, whilst still meeting their other objectives.

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

 **Other objectives:**

- **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.

- **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.

- **Cost efficiency**

 The more cost efficient a firm is, the lower its average costs. This gives the firm a competitive advantage, since they can afford to charge consumers lower prices. Firms operating in competitive markets will need to be cost efficient to ensure they are not competed out of the market by more efficient producers.

- **Return on investment (ROI)**

 Entrepreneurs take risks by making investments. The reward for taking these risks is profit, which is the return on their investment. The higher the ROI, the more attractive the investment is. The ROI can give firms an idea of how profitable an investment is, which is important for planning.

- **Employee welfare**

 Some firms might try and ensure their employees are well looked-after. When employees are happy, they are more likely to be productive and do a good job. It also increases loyalty towards the employer, so the employee is less likely to leave the job. Google is renowned for their employee perks such as on-site physicians and travel insurance.

- **Customer satisfaction**

 Firms might aim to increase their competitiveness by improving their quality and increasing their customer satisfaction. Firms might consider improving their customer service or the quality of the good they produce. This could be achieved through innovation. If firms can gain a reputation for high quality goods, they could potentially charge higher prices, since consumers might be willing to pay more for them.

- **Social objectives**



 Some firms might focus on **social welfare** and their **Corporate Social Responsibility (CSR)**. They might take responsibility for consequences on the environment and aim to maximise social welfare. Firms might try and perform more ethically, especially if they have a philanthropic owner.

