OCR Economics A-level

Microeconomics

Topic 3 – Business Objectives

Definitions and Concepts

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3.1 – Business objectives

Conglomerate integration - The merger of firms with no common connection.

Corporate social responsibility (CSR) - When firms take responsibility for consequences on the environment and behave more ethically.

Diversification - When firms grow by expanding their production through increasing output, widening their customer base, developing a new product or diversifying their range.

Growth maximisation - When firms aim to increase the size of their market share, for example through mergers.

Horizontal integration - The merger of firms in the same industry at the same stage of production.

Maximisation - Consumers aim to generate the greatest utility possible, firms aim to generate the highest profits possible.

Principle-agent problem - Where the agent makes decisions on behalf of the principal; the agent should maximise the benefits of the principal but have the temptation of maximising their own benefits.

Profit maximisation - When firms produce at a point which derives the greatest profit; MC=MR.

Profit satisficing - When a firm earn just enough profit to keep its shareholders happy.

Sales revenue maximisation - When firms produce at a point which derives the greatest revenue; MR=0.

Sales volume maximisation - When firms produce at a point where they sell as many of their goods and services as possible without making a loss; AR=AC.

Utility maximisation - When firms aim to maximise social utility.

Vertical integration - When a firm merges or takes over another firm in the same industry, but at a different stage of production.

3.2 – Costs and economies of scale

Average cost / average total cost (AC/ ATC) - The cost of production per unit, calculated by: total costs/ quantity produced.

Constant returns to scale - Output increases by the same proportion that the inputs increase by.

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Decreasing returns to scale - An increase in inputs by a certain proportion will lead to output increasing by a smaller proportion.

Diseconomies of scale - The disadvantages that arise in large businesses that reduce efficiency and cause average costs to rise.

Economies of scale - The advantages of large-scale production that enable a large business to produce at lower average cost than a smaller business.

External economies of scale - An advantage which arises from the growth of the industry within which the firm operates, independent of the firm itself.

Increasing returns to scale - An increase in inputs by a certain proportion will lead to an increase in output by a larger proportion.

Internal economies of scale - An advantage that a firm is able to enjoy because of growth in the firm, independent of anything happening to other firms or the industry in general.

Law of diminishing returns - If a variable factor is increased when another factor is fixed, there will come a point when each extra unit of the variable factor will produce less extra output than the previous unit; after a certain point, marginal output falls.

Long run - The length of time when all factors are variable.

Minimum efficient scale - The lowest level of output necessary to fully exploit economies of scale.

Short run - The length of time when at least one factor of production is fixed.

Sunk cost - Costs that cannot be recovered once they have been spent.

Total cost (TC) - The cost to produce a given level of output

Total fixed cost (TFC) - Costs which do not vary with output.

Total variable cost - Costs which change with output, calculated by: total variable costs+total fixed costs.

3.3 – Revenue and profit

Accounting profit - Total monetary revenue minus total monetary costs.

Average revenue - The price each unit is sold for, calculated by TR / quantity sold.

Economic profit - Profit which considers the opportunity cost of production as well as monetary costs.

Individual demand - Demand of an individual or firm, measured by the quantity

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bought at a certain price at one point in time.

Joint demand - When goods are bought together.

Loss - When revenue does not cover costs.

Market demand - Sum of all individual demands in a market.

Normal profit - The minimum reward required to keep entrepreneurs supplying their enterprise, the return sufficient to keep the factors of production committed to the business; TC=TR.

Supernormal profit - The profit above normal profit, TR>TC.

Total revenue - Revenue generated from the sale of a given level of output, calculated by: price x quantity sold.

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