WJEC (Wales) Economics A-level
Microeconomics

Topic 2: Market Structures
2.2 Business objectives

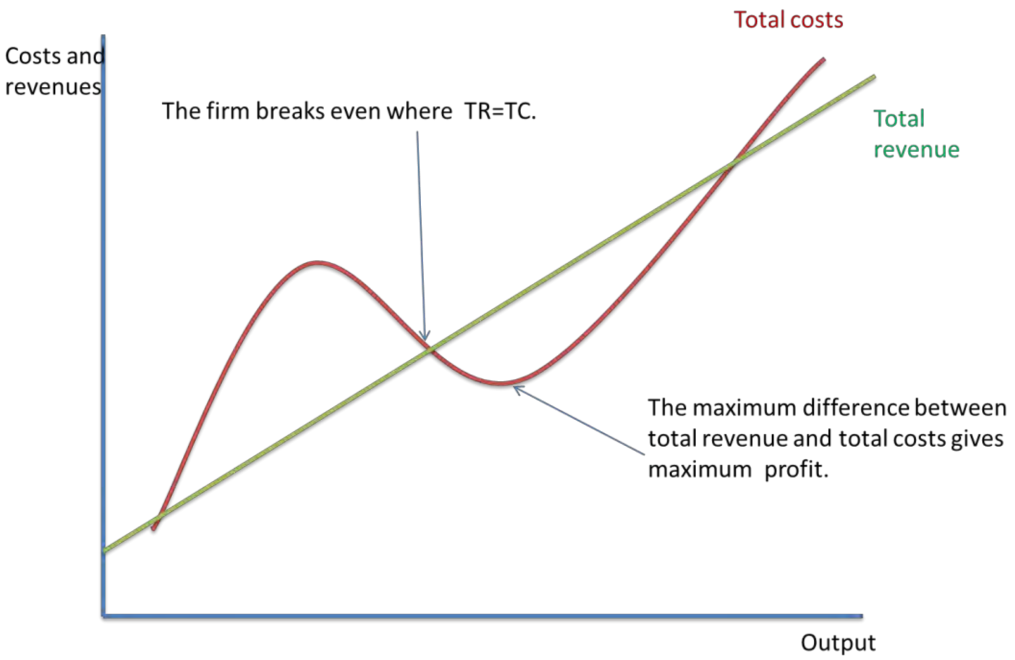
Notes

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.
- However, firms can have other objectives which affect how they 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.

- 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.



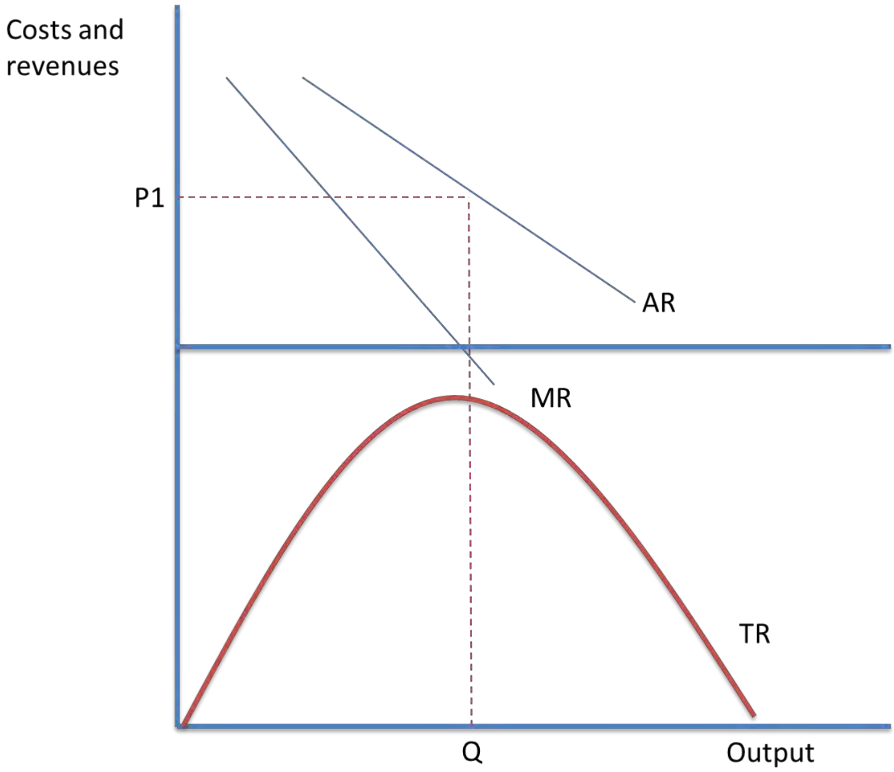
- Profits increase when MR > MC. Profits decrease when MC > MR.
- Some firms choose to profit maximise because:
    - It provides greater wages and dividends for entrepreneurs
    - Retained profits are a cheap source of finance, which saves paying high interest rates on loans
    - In the short run, 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.

- 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.

Revenue maximisation

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



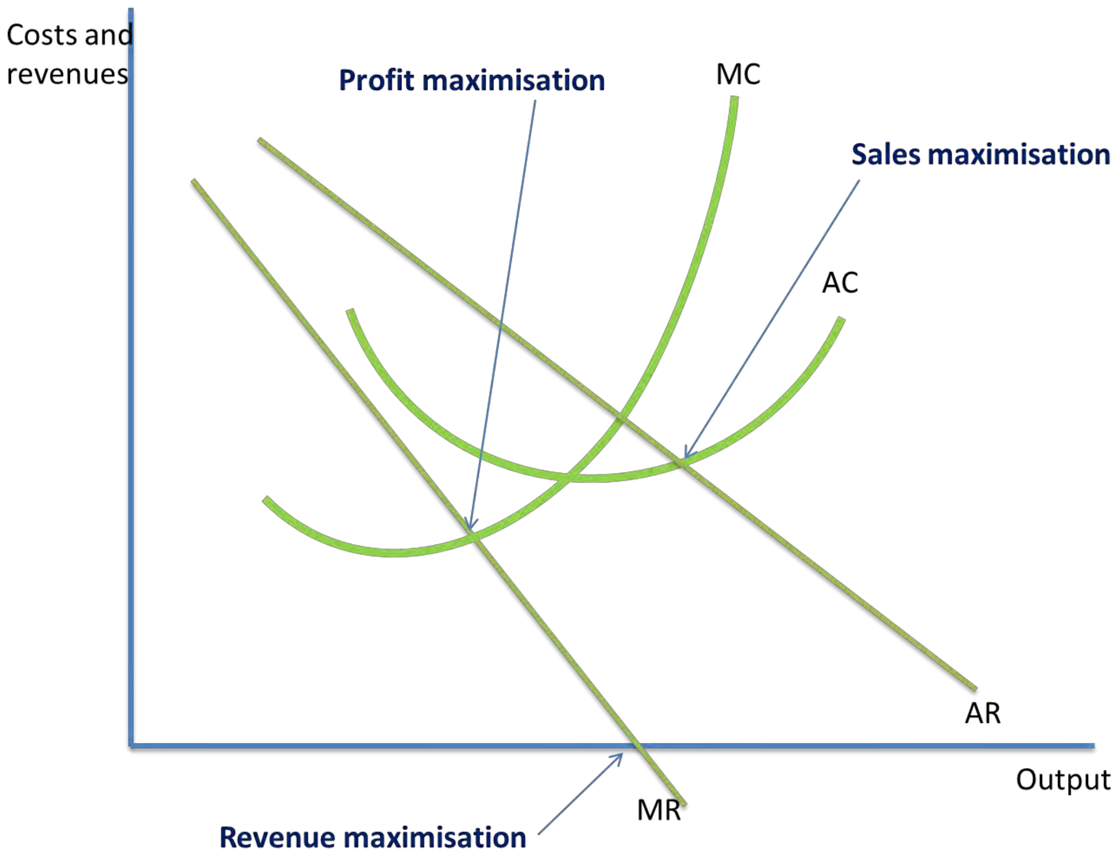
At the point Q P1, the firm is operating at MR=0, where revenue maximises. The curve shows how the point of maximum total revenue is MR =0.

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.

The diagram below summarises each objective.



Growth maximisation

- **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.

Utility maximisation

Maximisation for consumers is when consumers aim to generate the greatest utility possible from an economic decision. Firms aim to generate the highest profits possible. A consumer's utility is the total satisfaction received from consuming a good or service. It is assumed that economic agents only act in their own interests.

Some firms might have philanthropic owners who seek to maximise the utility of others.

Profit 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.

Social welfare and Corporate Social Responsibility (CSR)

Some firms 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.

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