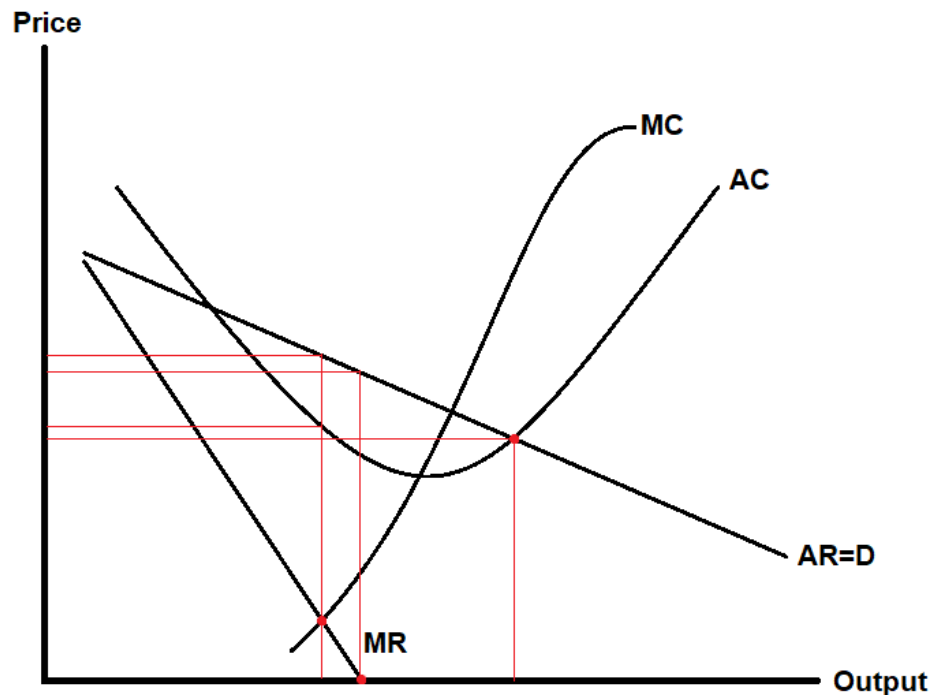


3.2.1 Business objectives

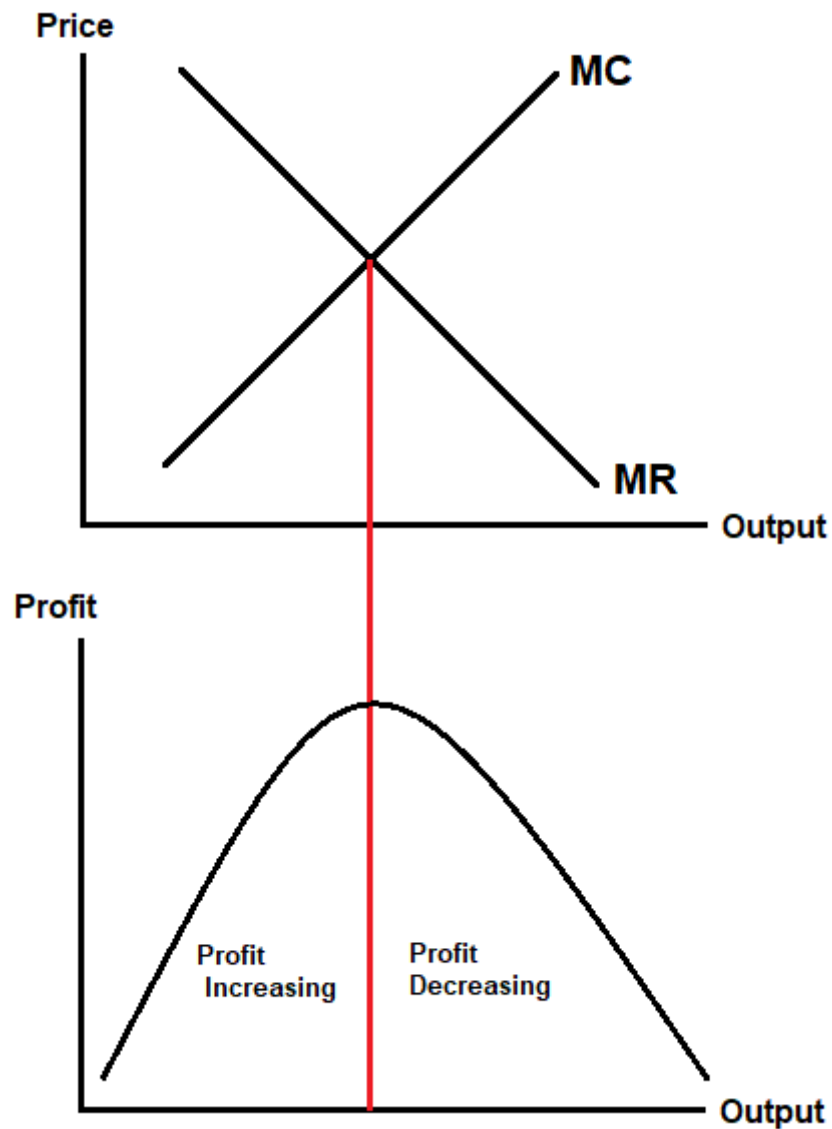
Construction Guide

- Draw Monopoly Diagram
- Mark the three points of objectives (MC=MR, AC=AR and MR=0)
- Draw lines up to the average revenue and average cost at these levels of output
- Show profit, selling price and output at these points



Profit Maximisation

- $MC=MR$
- $\pi = TR - TC$
- Despite all firms needing to profit to survive, not all firms aim to maximise profits
- Profit is the reward for risk taking therefore it is a rational assumption that the risk taker (entrepreneur) will aim to maximise reward
- Profit maximisation occurs when the difference between TR and TC is largest or when price minus cost per unit multiplied by quantity is greatest
- It occurs when the revenue gained from selling one extra unit is exactly equal to the cost of producing one more unit
- If a firm sells an extra unit and gains more money than the cost to produce it, marginal profit is positive
- If a firm sells an extra unit and gains less money than cost to produce it, marginal profit is negative and the firm should reduce output
- When $MC=MR$ firm is at equilibrium, neither increasing or reducing output would increase profitability. This can be proved with marginal analysis and a table if needed
- Based on assumption of rational behaviour, a neoclassical theory which should be critically analysed



Revenue Maximisation

- $MR=0$
- Occurs when TR is at a maximum
- Occurs when the revenue from selling one more unit is 0. This can be proved with marginal analysis and a table if needed
- Firm cuts prices down to the point where extra revenue from selling an extra unit is balanced by the reduced price on every item it is currently selling
- There are indeed rational reasons for this being a business objective
- One rational reason is to dispose of stock. In this scenario, costs are effectively not relevant. Supermarkets often sell sell-by-date products at a discount since they cannot sell them after.
- Another reason could occur as a result of the principal-agent problem. Owners may want maximum profit but managers may want maximum revenue due to their bonuses potentially being revenue linked.
- If a firm is about to be taken over, its valuation may be based on revenue. Max revenue = Max value in this case.

Sales Maximisation

- $AC=AR$
- The output at which total cost is equal to total revenue
- Occurs when the firm sells as much as possible subject to constraint that it makes AT LEAST normal profit (so it doesn't go bust in the long run)
- A firm may do this to increase market share and eliminate competitors through price reduction. Often a SR strategy
- To avoid attention of competition authorities/watchdogs. More likely to be investigated when making large amounts of profit or revenue
- To deter new firms from entering market, cutting prices and selling more scares off potential firms

Satisficing

- This objective abandons the idea of maximising
- Occurs when a business objective pursues several objectives
- Look at stakeholders, explain how maximising shareholder profit in the long run exploits workers, consumers and eventually leads to decreased business
- Can be followed when conflict of interest
- A policy of satisfying shareholders with sufficient profit and pursuing other objectives
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