Types of Business Objectives

GCE A-LEVEL & IB ECONOMICS

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Business Owner Role Play

Imagine you are the owner of one of the businesses below. What would your most important business objective be? Why? Discuss with your neighbors.

An company based on an app that has just been coded without any users

A niche accountancy business that has been operating for 10 years

A charity which aims to save pets

Types of Business Objectives

- Profit maximisation
  - This is when a business aims to maximise profit. It is the default objective for firms in Economics, and we will assume this in most cases.
  - As Total Profits = Total Revenue (TR) – Total Costs (TC), you may think it is done by maximising firm revenue and minimising costs…
  - In theory, the state where the greatest difference occurs between the total revenue (TR) and total costs (TC), is when the firm produces at the point where marginal costs are equal to marginal revenue (MC = MR). This will be discussed in our Profit Maximisation Notes later on.

Types of Business Objectives

- Revenue maximisation
  - This is when a business aims to maximise revenues (total sales value). This happens when the firm produces at the point where marginal revenue (MR) = 0 (later explained in our Total/Average/Marginal Revenue Notes)
  - Both revenue and sales maximisation may be an objective if the firm is focused on achieving business growth, to gain market share
- Sales maximisation
  - This is when a business aims to sell as much quantity as possible without incurring a loss. They maximise sales volume by producing at the point where average revenue (AR) = average cost (AC)
  - Producing at the lowest price possible without making any profits (limit pricing), is a strategy to prevent new competitors from coming into the market, and to protect market share

Types of Business Objectives

- Satisficing
  - This is when a business aims to meet the requirements of its stakeholders including shareholders, employees and consumers by producing an acceptable amount of profits rather than maximizing it.
  - The reason for this is perhaps the organisation is not aimed to make profit, but a non-profit objective – e.g. World Health Organisation, Chelsea Football Club

A Tale of 3 Businesses

To your right, you can see stores/offices of 3 companies. Can you guess what type of business objectives they may be pursuing?

Profit Maximization

Profit maximisation is a key business objective because shareholders (owners) of the firm need a financial return for the money used to fund the business. They want to generate a monetary reward from what they paid. Hence, this is an important factor for banks and publicly traded companies to consider.

For example, if you own shares of Goldman Sachs, you would want them to generate more profit, as then you will be rewarded when they distribute those profits to shareholders (dividends).

If a firm keeps making losses, it may fail to survive.

The Cost of Profit Maximization?

“To put the problem in the simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money.”

“What are three quick ways to become a leader? a) Execute on the firm’s “axes,” which is Goldman-speak for persuading your clients to invest in the stocks or other products that we are trying to get rid of because they are not seen as having a lot of potential profit. b) “Hunt Elephants.” In English: get your clients — some of whom are sophisticated, and some of whom aren’t — to trade whatever will bring the biggest profit to Goldman. Call me old-fashioned, but I don’t like selling my clients a product that is wrong for them. c) Find yourself sitting in a seat where your job is to trade any illiquid, opaque product with a three-letter acronym.”

Greg Smith is resigning today as a Goldman Sachs executive director and head of the firm’s United States equity derivatives business in Europe, the Middle East and Africa. https://www.nytimes.com/2012/03/14/opinion/why-i-am-leaving-goldman-sachs.html

The Cost of Profit Maximization?

Can you think of some reasons why a firm would maximise profits?

What are some benefits or costs of doing so?

In what circumstances wouldn't a company maximise profits?

The Cost of Profit Maximization?

Can you think of some reasons why a firm would maximise profits?

- Firm Survival

- Return on Investment for Shareholders

What are some benefits or costs of doing so?

- Effect on other stakeholders (e.g. employees' wellbeing)

- Business sustainability

- Potential damage to corporate image

- Less Research & Development if profits aren't reinvested

The Cost of Profit Maximization?

In what circumstances wouldn't a company maximise profits?

- Separation of ownership from control

In bigger companies, company managers who controls the firm may not be shareholders (owners). Depending on how the staff are incentivised, they may receive more commission or bonuses by focusing on sales maximisation.   As a result, the firm may end up focusing on other objectives due to management, rather than what the shareholders (owners) set out to do.

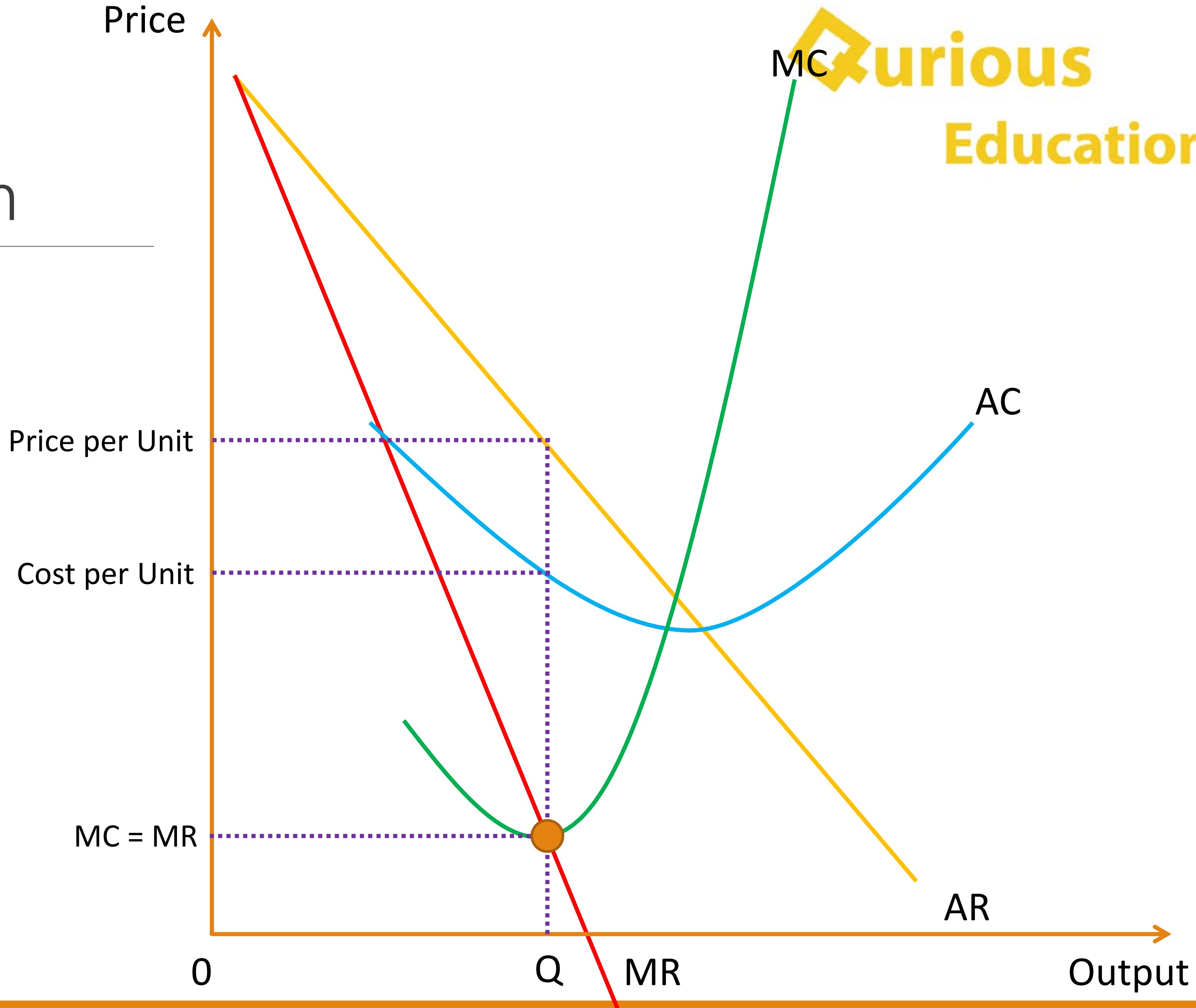
- Business type and shareholder (owner) objectives

If the organisation/owners have other business objectives (e.g. non-profits/charities), they may not aim to maximise profits.

Profit Maximization

Profits are maximized when the firm produces at quantity Q, where Marginal Cost (MC) equals Marginal Revenue (MR). It ensures the difference between total revenue (TR) and total costs (TC) is the highest.

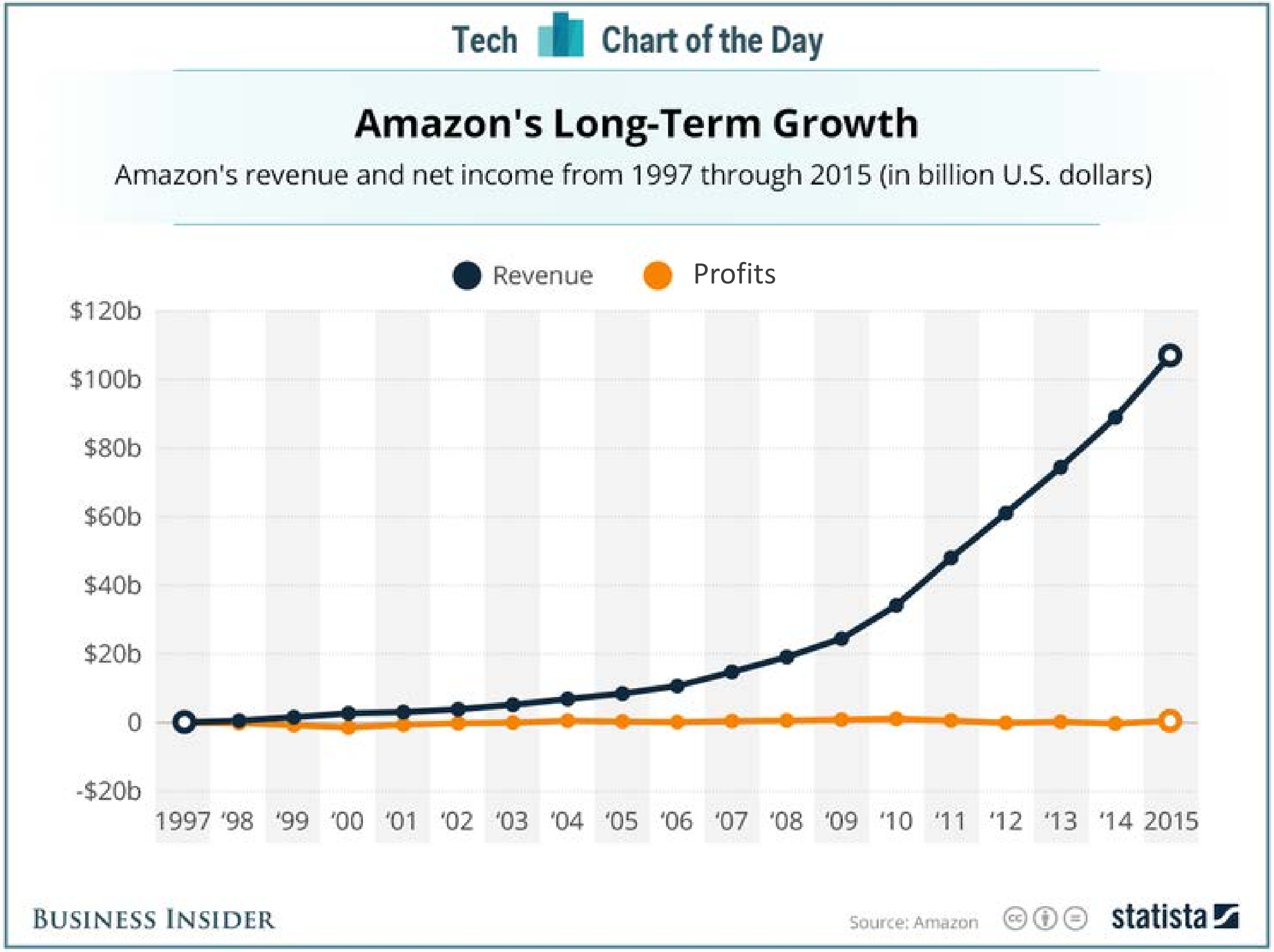
The theoretical reason for this is discussed in our [Profit Maximisation Notes](), using diagrams for various market structures.



Where Are My Profits?

https://www.businessinsider.com/amazon-revenue-vs-profit-2016-1?r=US&IR=T

Video on Amazon's aggressive growth strategy: https://www.youtube.com/watch?v=pBffKzWECUQ



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Revenue/Sales Maximization

Tech companies tend to need a large user base on say an app or website before they are able to generate a profit. Hence, they may initially focus on revenue maximisation and sales maximisation to grow their company.

Amazon used to earn no profit on Kindles in order to gain e-reader market share and now come to dominate the platform as a monopoly.

Revenue/Sales Maximization

Can you think of some reasons why a firm would maximise sales or revenue?

What are some benefits or costs of doing so?

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Revenue/Sales Maximization

Can you think of some reasons why a firm would maximise sales or revenue?

- Business Growth

- Competition for Market Power/Market Share

- Managerial interests

What are some benefits or costs of doing so?

- Long term strategy for profit maximization

- Economies of scale

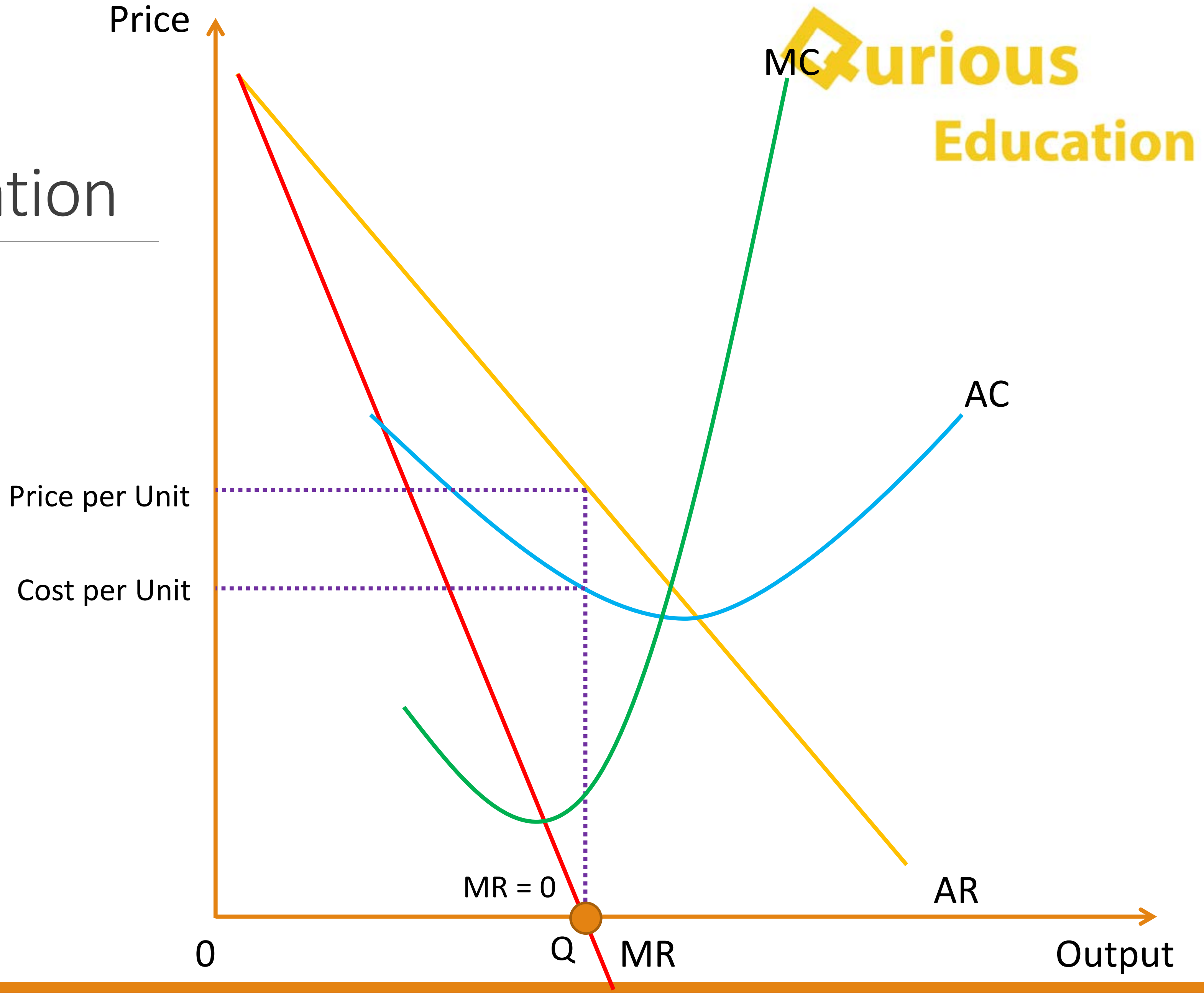
- Additional risk on investment returns

Revenue Maximization

To maximise total revenues, the firm will produce at the point where MR = 0.

Total revenue (TR) is output (Q) x price per unit, and is the area of the biggest purple rectangle on the right. The rectangular area is the greatest when MR = 0. This is explained further in our [Total/Average/Marginal Revenue Notes]

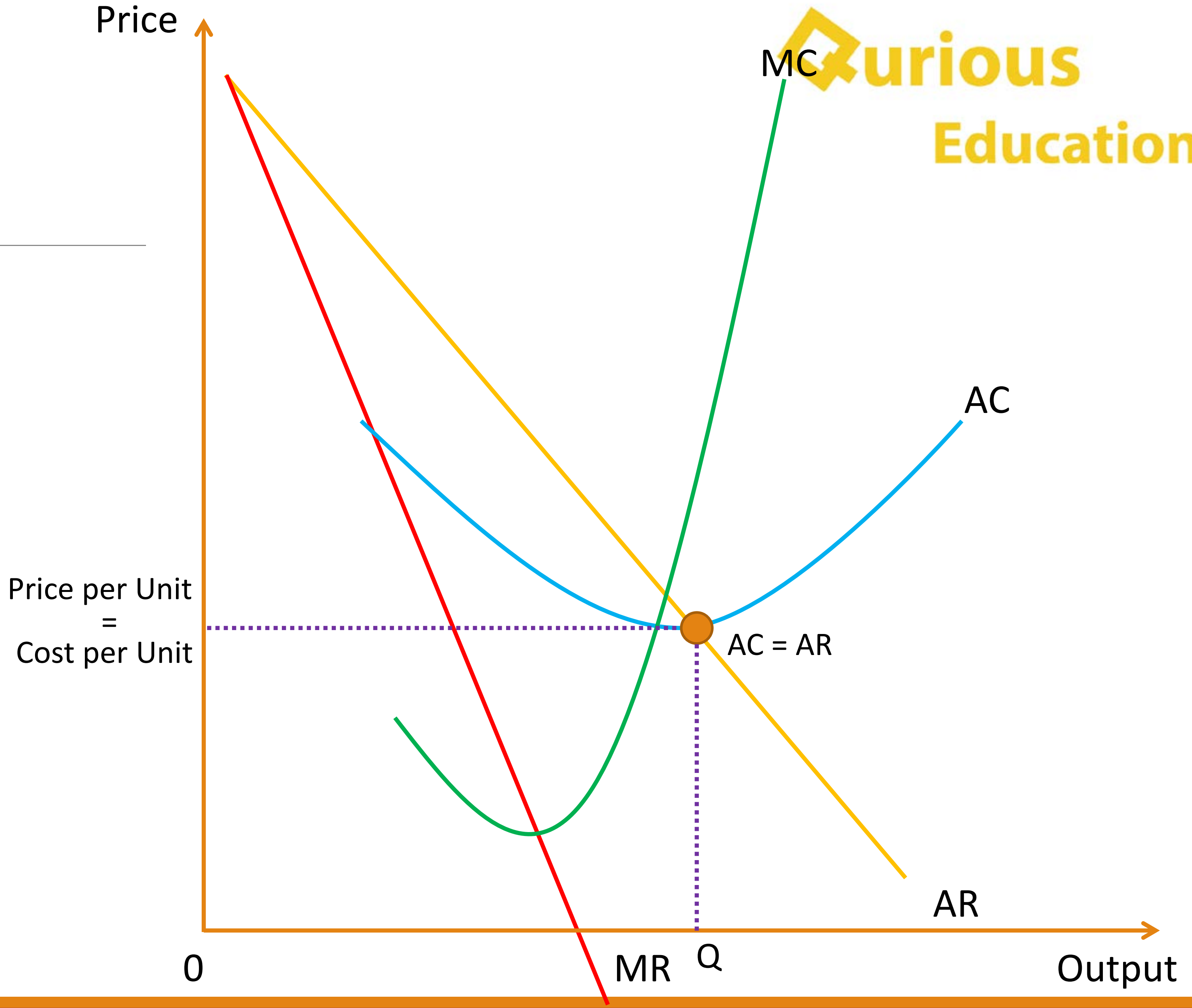
The firm is still earning less profits than profit maximisation, but is producing more with higher market share.



Sales Maximization

Maximising output produced without making a loss means minimising the firm's profits to sell as much goods/services as possible.

This occurs when the firm produces at the quantity where average cost (AC) equal to average revenue (AR), and the firm is making normal profits. The price which the firm sells its product is equal to its production cost. Compared with the diagrams on other objectives, we can confirm the output (Q) is the highest when a firm maximises its sales volume.



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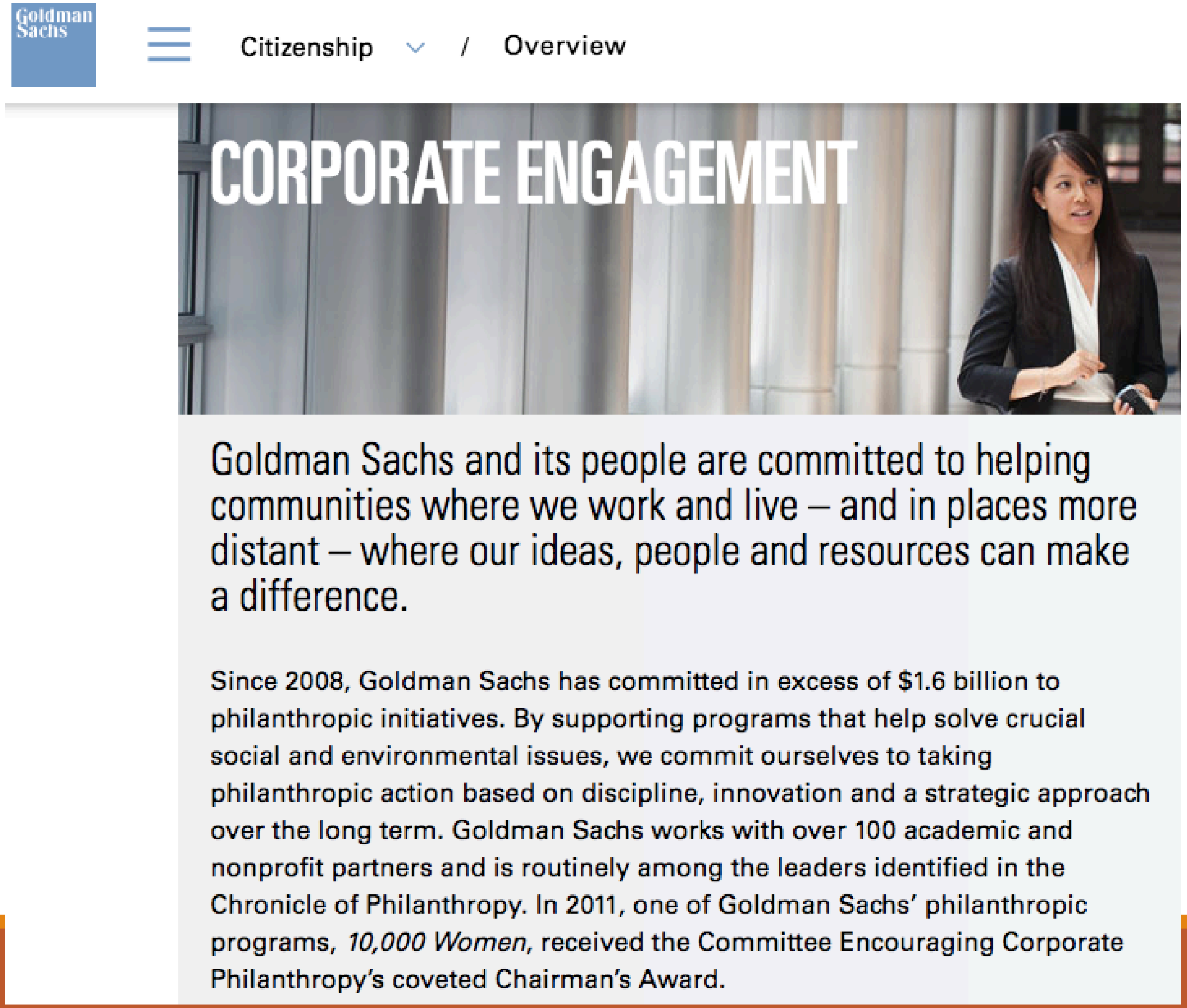
Satisficing

The firm might set a level of profit that meets the requirements of **stakeholders** such as shareholders, employees and consumers. For example, the firm might ensure a high level of **corporate social responsibility (CSR)** that will improve its ethical and environmental practices but increase costs, leading to lower profits.



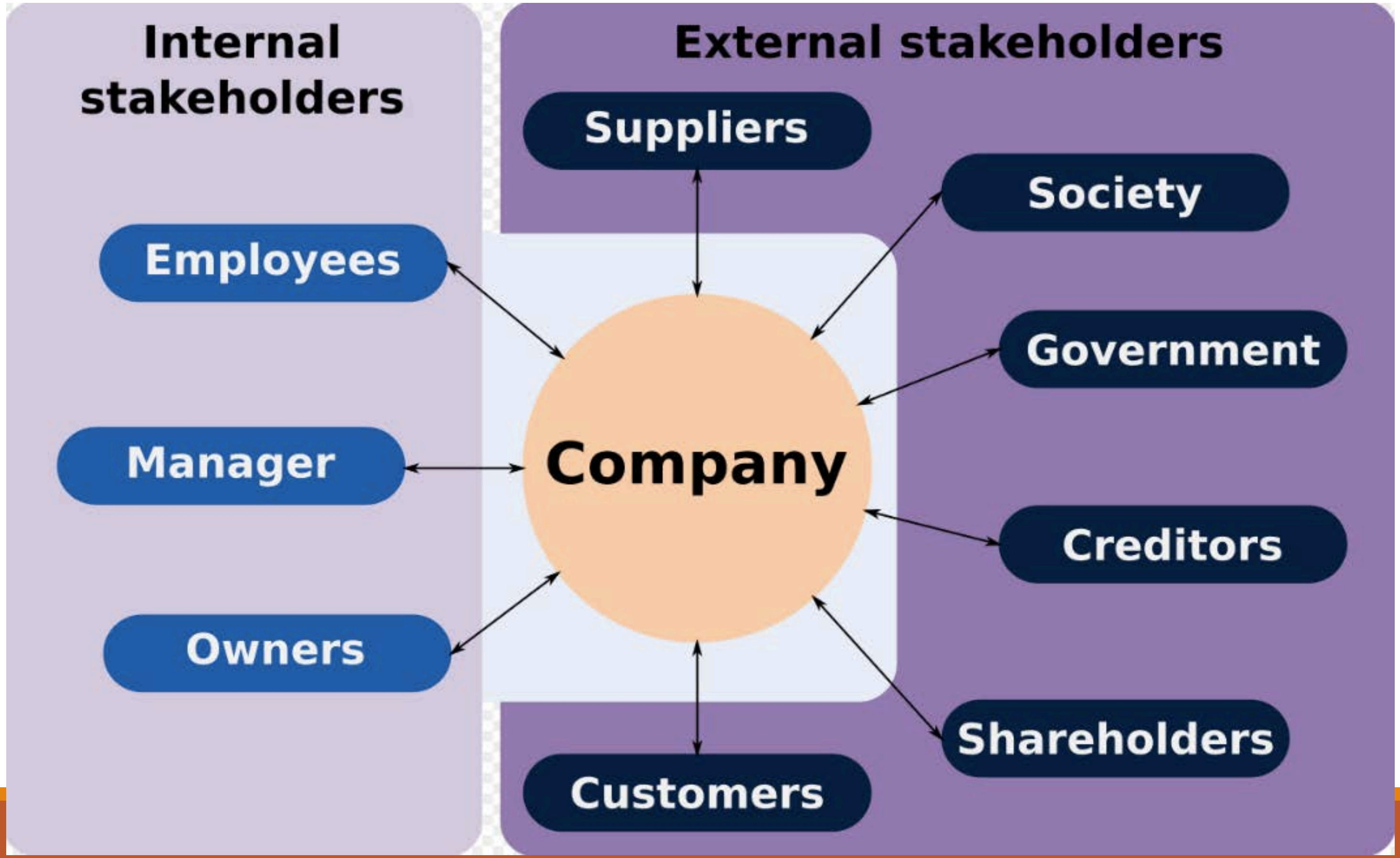
Satisficing

Firms with key objectives other than profits also tend to satisfice. They generate enough profits to sustain their operations/cost, then they focus on their organisational objective (e.g. saving pets). But earning less profits does not mean less salaries for managers are paid out!

As companies start to come under more scrutiny for corporate social responsibility in recent years, more firms are embracing satisficing and increasing business sustainability (ie to produce less pollution, use less sweatshops)… although the underlying reason for this may be to make them look good, and to earn more profits!

Satisficing

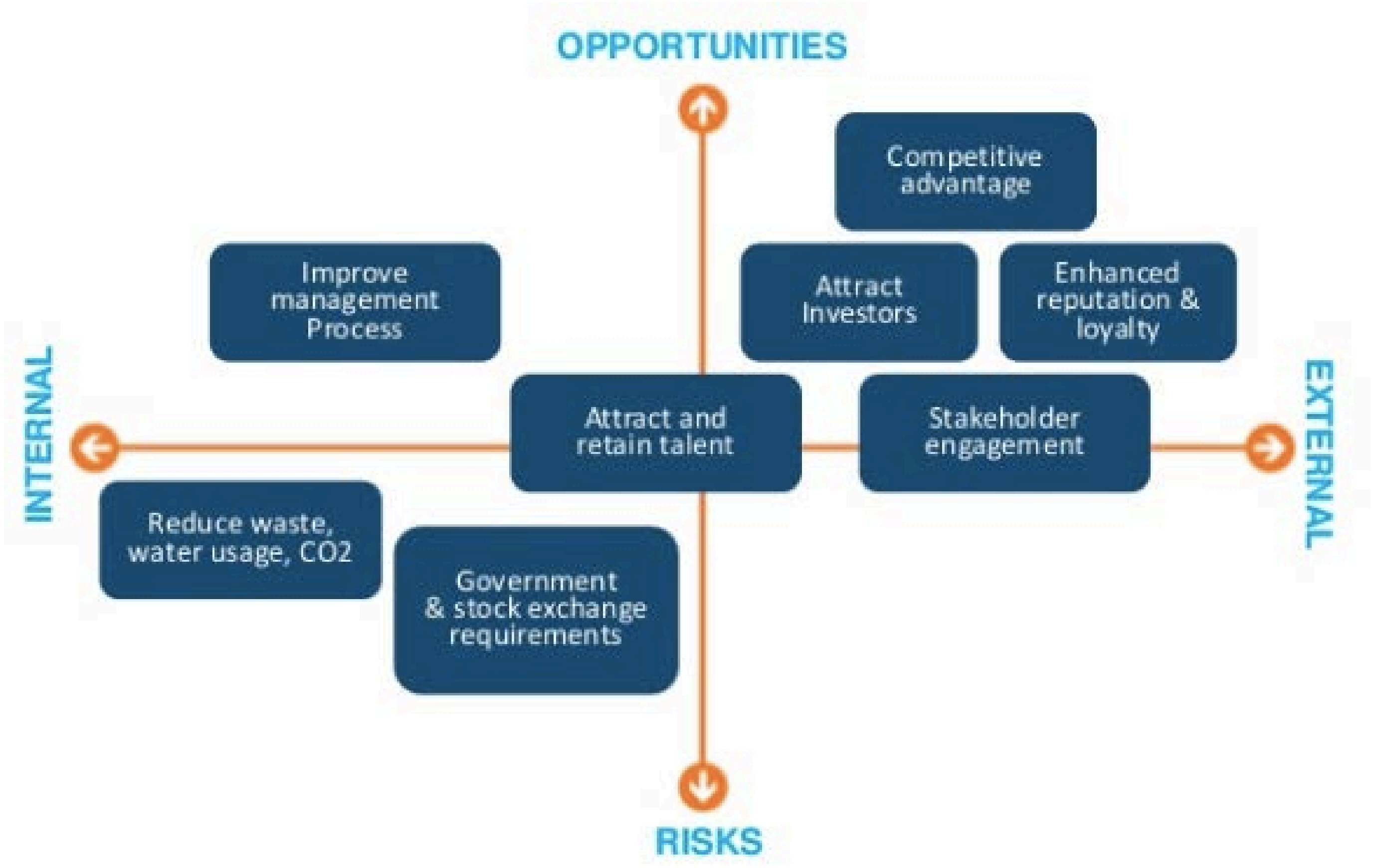
Some stakeholders to satisfy... who may these be if you are IKEA?



"IKEA's invested in sustainability throughout its entire business operations, including things customers can readily see and things they can't. It starts with their supply chain, where the Swedish furniture-maker has sourced close to 50 per cent of its wood from sustainable foresters and [100 per cent of its cotton] from farms that meet the Better Cotton standards, which mandate reduced user of water, energy and chemical fertilisers and pesticides. You can also see their commitment to sustainability at the store. IKEA has more than [700,000] solar panels powering its stores, and plans to start [selling them to customers] in the UK. In 2012, IKEA announced its goal to be powered by 100 per cent renewables by 2020 – but just four years later, it upped the ante aiming to be a [net energy exporter] in the same time."

https://www.virgin.com/virgin-unite/10-global-companies-are-environmentally-friendly

Reasons for Being a Sustainable Enterprise



But what do you think some challenges firms may face when trying to be sustainable?

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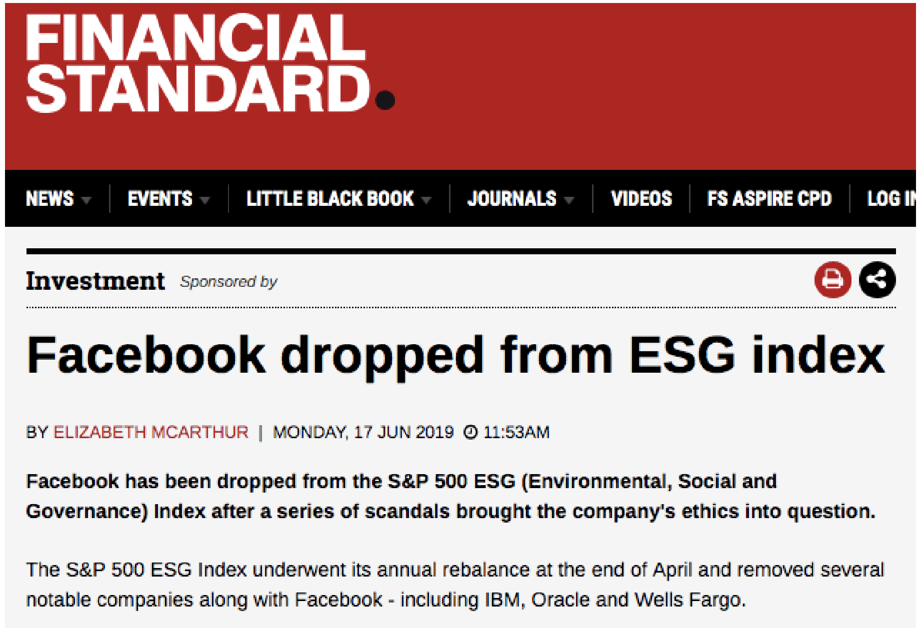
ESG Case Study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Facebook dropped from ESG index

BY ELIZABETH MCARTHUR | MONDAY, 17 JUN 2019 11:53AM

Facebook has been dropped from the S&P 500 ESG (Environmental, Social and Governance) Index after a series of scandals brought the company's ethics into question.

The S&P 500 ESG Index underwent its annual rebalance at the end of April and removed several notable companies along with Facebook - including IBM, Oracle and Wells Fargo.

"S&P scores this ESG performance out of 100. Facebook had an overall score of 21 despite having an environmental score of 82.

It was scored 22 for social and just six for governance. Environmental impact was deemed by S&P to carry less weight in Facebook's work and so its high score for environmental friendliness could not outweigh the social and governance issues.

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It was scored 22 for social and just six for governance. Environmental impact was deemed by S&P to carry less weight in Facebook's work and so its high score for environmental friendliness could not outweigh the social and governance issues."

ESG Investing... What?

Socially responsible investing

From Wikipedia, the free encyclopedia

Socially responsible investing (*SRI*), or *social investment*, also known as *sustainable*, *socially conscious*, "*green*" or *ethical investing*, is any investment strategy which seeks to consider both financial return and social/environmental good to bring about social change regarded as positive by proponents.

Recently, it has also become known as "sustainable investing" or "responsible investing". There is also a subset of SRI known as "impact investing", devoted to the conscious creation of social impact through investment.

In general, socially responsible investors encourage corporate practices that they believe promote environmental stewardship, consumer protection, human rights, and racial or gender diversity. Some SRIs avoid businesses perceived to have negative social effects such as alcohol, tobacco, fast food, gambling, pornography, weapons, contraception/abortifacients/abortion, fossil fuel production or the military.[1] The areas of concern recognized by the SRI practitioners are sometimes summarized under the heading of ESG issues: environment, social justice, and corporate governance.

Socially responsible investing is one of several related concepts and approaches that influence and, in some cases, govern how asset managers invest portfolios.[2] The term "socially responsible investing" sometimes narrowly refers to practices that seek to avoid harm by screening companies included in an investment portfolio.[3] However, the term is also used more broadly to include more proactive practices such as impact investing, shareholder advocacy and community investing.[4] According to investor Amy Domini, shareholder advocacy and community investing are pillars of socially responsible investing, while doing only negative screening is inadequate.[5]

https://www.fidelity.co.uk/funds/esg-investing/

https://www.youtube.com/watch?v=XbcaSBq9UK8

Lesson Summary

Profit maximisation occurs where:

- MC __ MR, when the difference between TR and TC is __________

Revenue maximisation occurs where:

- MR = __, and total sales value (price x ________) is maximised

Sales maximisation occurs where:

- AR = __, where the firm will be earning _________ profits, but output is _________

Lesson Summary

Profit maximisation occurs where:

- MC = MR, when the difference between TR and TC is highest

Revenue maximisation occurs where:

- MR = 0, and total sales value (price x quantity/output) is maximised

Sales maximisation occurs where:

- AR = AC, where the firm will be earning normal profits, but output is highest