**Objectives of Firms**

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**Introduction to Business Objectives**

* Standard theory assumes that businesses have sufficient information, market power and (importantly) motivation to set prices for their products that maximise [profits](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/profits/)
* This assumption is now heavily criticised by economists who have studied the organisation and objectives of modern-day corporations.
* Not only do most businesses frequently move away from pure profit-seeking behaviour, many are organised and operated in a way where profit is **not** the only objective.

Key Point: There will always be a range of business objectives:

1. Profit maximisation (where MR=MC)
2. Revenue maximisation (sales revenue) – where MR=zero
3. Increasing and protecting market share
4. Surviving an economic downturn / recession
5. Pursuing ethical business objectives (corporate social responsibility)
6. Providing a public service – see later sections on nationalised (state-owned) industries

**Why might a business depart from profit maximisation?**
Some explanations relate to the **lack of accurate information** required to set profit maximising prices. Others concentrate on the **alternative objectives of businesses**.

* **Imperfect information**:
	+ It might be hard for a business to pinpoint their profit maximising output, as they cannot accurately calculate marginal revenue & cost.
	+ Day-to-day [pricing](http://www.tutor2u.net/blog/index.php/business-studies/tagged/tag/pricing/) decisions are taken on the basis of “*estimated* demand” or “rules of thumb”.
	+ A business might look to add a profit margin on top of average cost – “**cost-plus pricing**”.
* **Multi-product businesses:**
	+ Most businesses are **multi-product firms** operating in a range of markets across countries and continents – the volume of information that they have to handle can be vast. And they must keep track of the **ever-changing preferences** of consumers.
	+ The idea that there is a neat, single profit maximising price is redundant.

**Behavioural Theories of the Firm**

[**Behavioural**](http://www.tutor2u.net/blog/index.php/economics/C11/) **economists** believe that large-scale businesses are **complex organizations** made up of various stakeholders – i.e. groups who have a vested interest in the activity of a business. Examples include:

* Managers employed by a business and other employees
* [Shareholders](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/shareholders/) – people who have an equity stake in a business
* Customers
* The government and it’s agencies including local government

Each group is likely to have **different objectives** or goals at points in time. The **dominant group** at any moment can give greater emphasis to their own objectives – for example price and output decisions may be taken at a local level by managers – with shareholders taking only a distant and imperfectly informed view of the company’s performance and strategy.
If firms are likely to move away from pure profit maximising behaviour, what are the alternatives?

1. [**Satisficing**](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/satisficing/) **behaviour** is a term first coined by economist **Hugo Simon** – when faced with a decision where the cost of identifying and pursuing the optimal choice is high.  For business owners this might mean moving away from pure profit maximisation and choosing instead to aim for **minimum acceptable levels of achievement** in terms of revenue and profit.
2. **Sales Revenue Maximisation**
* The objective of **maximising sales revenue** rather than profits was developed by [William Baumol](http://www.nyu.edu/econ/dept/vitae/baumol.htm) whose work focused on the behaviour of manager-controlled businesses.
* Baumol argued that **annual salaries** and **perks** are linked to total sales revenue rather than profits.
* Companies geared towards maximising revenue are likely to make extensive use of [price discrimination](http://www.tutor2u.net/blog/index.php/economics/C181/) to extract extra revenue and profit from consumers. A firm might also aim to maximise sales revenue rather than profits because it wishes to deter the entry of new firms.
* If a firm decides to aim to maximise sales revenue rather than profits, one of the consequences might be a reduction in the price of the firm’s shares
1. **Managerial Satisfaction model**

An alternative view was put forward by [Oliver Williamson](http://groups.haas.berkeley.edu/bpp/oew/) (1981), who developed the concept of **managerial satisfaction** (or managerial utility). This can be enhanced by raising sales revenue.

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* Assuming that the firm’s costs remain the same, a firm will choose a lower price and supply a higher output when sales revenue maximisation is the main objective.
* The **profit maximising** price is P1 at output Q1, the **revenue maximising** price is P2 at output Q2
* **Consumer surplus** is higher with sales revenue maximisation because output is higher and price is lower. Producer surplus is greater when profits are maximised.

**Social Entrepreneurs**

**Michael Porter - Shared Value and the Limitations of CSR**
*Narrow views about how to create profit has created disconnect between businesses and society and needs to change according to Harvard Business School Professor Michael Porter.*

*“A growing number of companies known for their hard-nosed approach to business—such as GE, Google, IBM, Intel, Johnson & Johnson, Nestlé, Unilever, and Wal-Mart—have already embarked on efforts to create shared value by looking again at  the intersection between society and corporate performance.”*
*Shared value is creating economic value by creating social value*

*In recent times, creating value has tended to focus on short-termist thinking - Businesses have been long on driving huge sales and output volumes, downsize and de-layering inefficient management and generally responding to pressure from financial markets to deliver immediate results through cost-cutting, dynamic pricing and increasingly tough marketing that can often persuade people to buy things that are not good for them.*

*This involves a recalibration and a rethinking about what a product really is and what needs a business is meeting, for example in the food industry, products that are nutritious and healthy rather than focus on volume, lower unit costs and higher profits. He notes to increasing prominence of social entrepreneurs with revenue generating business models.*

*Consumers looking at the world differently and expressing their preferences in strong ways - this is already having a direct effect on supermarket behaviour.*

* A **social enterprise** is a business that has **social objectives** whose profits are reinvested for that purpose in the business or the community, rather than being driven by the need to seek profit to satisfy investors.
* [Social entrepreneurs](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/social%2Bentrepreneur/) are looking to achieve social and [environmental](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/environmental/) aims

**Not for Profit Businesses**

These are charities, community organisations that are run on commercial lines e.g. Network Rail:

* [Network Rail](http://www.networkrail.co.uk/): Their stated purpose is to deliver a safe, reliable and efficient railway for Britain
* They employ over 35,000 people with annual staff costs in excess of £1.6bn
* It is a company limited by guarantee – whose debts are secured by the government
* [Network Rail](http://news.bbc.co.uk/1/hi/business/6686887.stm) operates as a commercial business and regulated by the [Office of Rail Regulation](http://www.rail-reg.gov.uk/)
* Network Rail is a "not-for-dividend" company - profits are invested in the railway network.
* Train operating companies (TOCs) pay Network Rail for use of the rail infrastructure
* They are given targets for punctuality and safety
* In 2011 Network Rail made profits of £750 million. It receives an annual subsidy from the UK government in excess of £5 billion.

**Businesses required to main a loss-making service**

A good example here is the [Royal Mail](http://www.royalmail.com/portal/rm) which is required to maintain a universal national postal delivery service throughout the UK for a uniform price.

Household mail makes a loss, **cross-subsidised** by business mail – although this market is shrinking for the Royal Mail because of the introduction of fresh competition from 2006. The **Post Office Ltd** is a subsidiary of the Royal Mail Group plc – it runs substantial losses on the network or rural post offices and has been under great pressure to close hundreds of offices to stem losses.