



Edexcel A - A Level Economics

Theme 3 – Business behaviour and the labour market

3.2 Business objectives Revision Notes

Contents

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- [3.2.1 Business objectives](#)

3.2.1 Business objectives

Profit maximisation

Most businesses have one big goal: **to make as much profit as possible** – this is called **profit maximisation**.

🧐 Why do they want profits so badly?

- More profit means more money to reinvest, grow the business, or just beat the competition.
- Profit can be paid to shareholders as **dividends** – which makes investing in the business more attractive.
- A rise in profits usually increases the company's **share price**, boosting the **wealth** of shareholders.

The Golden Rule: $MC = MR$

To maximise profit, firms use a simple rule:

👉 Produce at the point where Marginal Cost (MC) = Marginal Revenue (MR)

- **Marginal Cost (MC)** = the cost of making one extra unit
- **Marginal Revenue (MR)** = the money earned from selling one extra unit

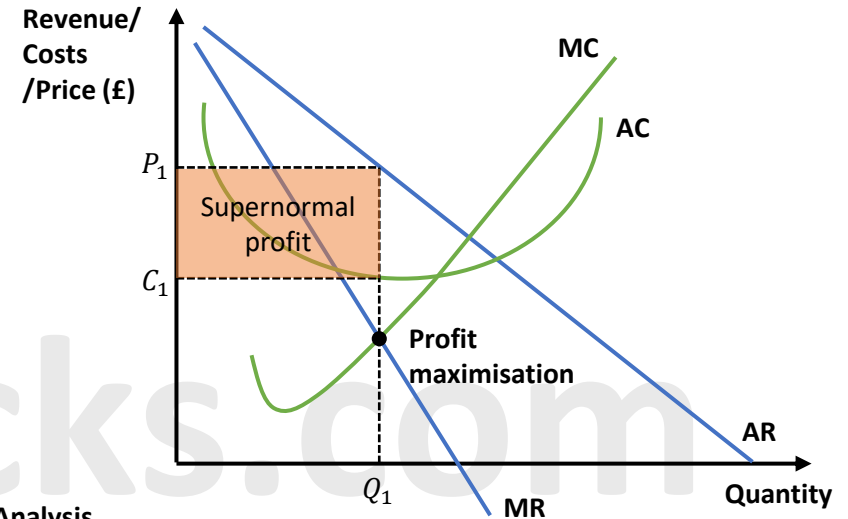
Here's what firms do:

- If $MC < MR$: keep producing – you're making profit on each extra unit.
- If $MC = MR$: stop here – you're at the perfect level (profit maximised!)
- If $MC > MR$: you've gone too far – every extra unit now loses money.

3.2.1 Business objectives

Profit maximisation

🧐 **Example:** Imagine a business that sells handmade candles. It costs £3 (MC) to make one candle, and they sell it for £6 (MR) – great! But if the cost rises to £6.50 while still selling at £6, they're losing money on every new candle. Time to stop.



Analysis

The diagram shows that the firm will produce at $P_1 Q_1$. At the profit maximisation point (where $MC = MR$), the firm is making as much money as it possibly can from selling its products. The price (P_1) at this output is determined by the AR (average revenue) curve. The average cost (C_1) per unit is determined by the AC (average total cost) curve.

If $P_1 > C_1$, the firm is making more on each unit than it costs to produce – that's called **supernormal profit** (or abnormal profit). It's the extra profit over and above normal expectations.

👉 Formula:
Supernormal profit = $(P_1 - C_1) \times Q_1$

🧁 **Example:**
Let's say a bakery sells cupcakes for £4 (P_1), and they cost £2 to make (C_1). If it sells 100 cupcakes (Q_1), then:
Supernormal profit = $(£4 - £2) \times 100 = £200$

3.2.1 Business objectives

Profit maximisation

Why Don't Firms Always Maximise Profit in Real Life?

Although the $MC = MR$ rule sounds simple, it's harder to apply in real life.

1. Hard to measure

Firms don't always know exactly what their marginal costs and revenues are – especially when prices or production change constantly.

2. Short-term challenges

Costs can change quickly, but businesses can't constantly change prices – that would confuse customers or reduce demand.

3. Long-term adjustments

Over time, firms can change prices or reduce costs to move closer to that ideal profit-maximising level.

4. Government intervention

Sometimes, if prices get too high (especially in essential services), the **Competition Commission** might step in to protect consumers. This can stop firms from pushing prices up, even if that's where profit is maximised.



3.2.1 Business objectives

Revenue maximisation

Sometimes, instead of aiming for maximum **profit**, firms go for **revenue maximisation** – that means making as much money from **sales** as possible, even if it doesn't lead to the highest profit. It focuses on increasing total revenue – which is calculated as:

Total Revenue = Price × Quantity Sold

Why Would a Firm Do This?

Not all firms are laser-focused on profit. Here's why:

1. Manager Bonuses

In some companies, sales managers earn bonuses based on revenue, not profit. This encourages them to sell as much as possible, even if costs rise.

2. Grow Fast and Beat Competitors

Start-ups or growing businesses (think: Spotify in its early days) might focus on grabbing customers quickly by keeping prices low and selling more – even if profits are tiny or non-existent.

3. Economies of Scale

Selling more units can help reduce **average costs** (e.g. bulk buying materials), making production more efficient in the long run.

3.2.1 Business objectives

Revenue maximisation

How Do Firms Know When They've Hit Revenue Max?

Firms will produce up to the point where **Marginal Revenue (MR) = 0**.

- 🧠 **Marginal Revenue** is the extra money a firm makes from selling one more unit.
- If **MR > 0**, selling more still increases revenue = 👍
- If **MR = 0**, they've reached the max – no extra revenue from extra sales.
- If **MR < 0**, they're actually losing revenue on each extra unit.
- 📌 So, revenue-maximising firms stop producing when **MR = 0**.

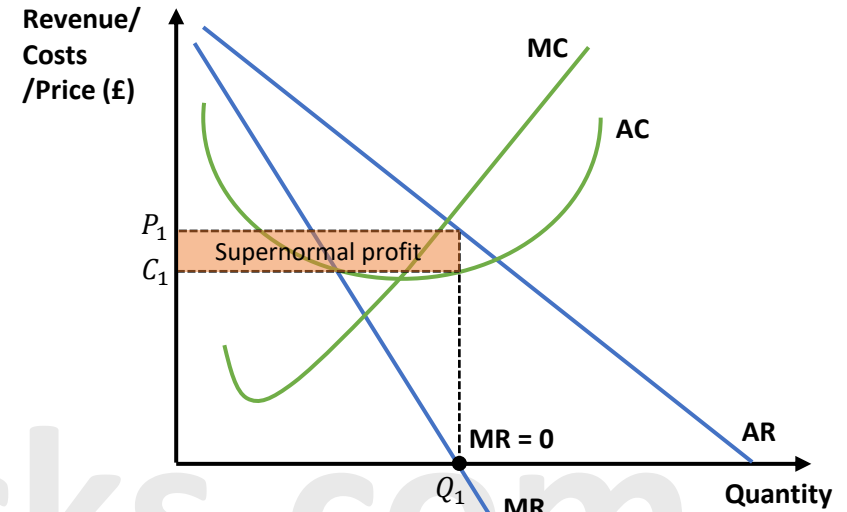
📖 Example:

Let's say a bakery sells cupcakes. As it lowers the price, it sells more. At some point, lowering the price further doesn't bring in more money overall – maybe because they've had to cut prices too much. That's the point where **MR = 0** – and where they'll stop if they're trying to maximise revenue.

Imagine a clothing brand selling t-shirts. If lowering the price helps them sell more and generate £10,000 in revenue (even if profit is only £1,000), they might go for it – especially if they want to dominate the market or hit bonus targets.

3.2.1 Business objectives

Revenue maximisation



Analysis

When a business is aiming to **maximise revenue**, it keeps increasing output until **MR = 0** – in other words, selling one more unit doesn't bring in any extra money.

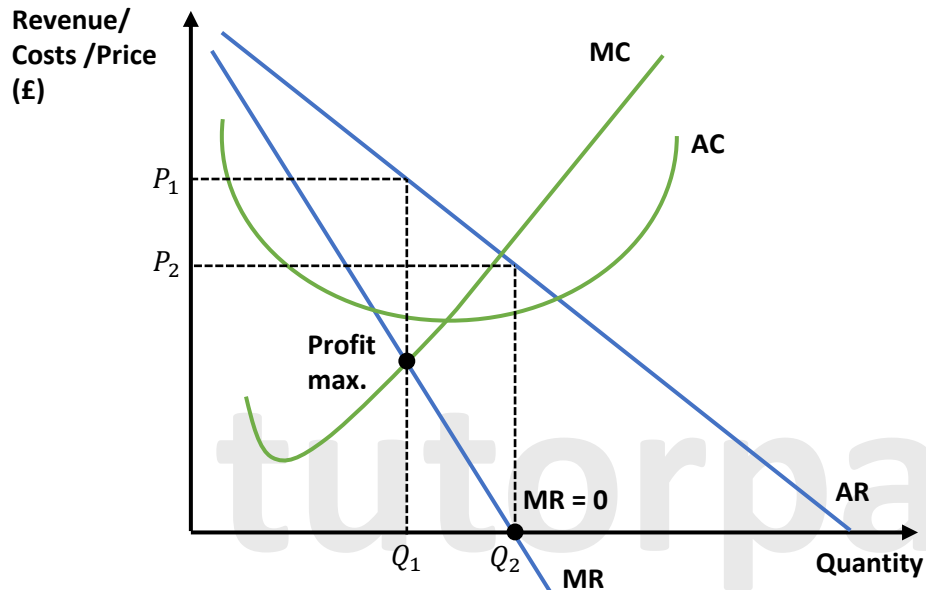
At this point:

- The **price charged** is P_1
- The **average cost** of production is C_1
- The firm still earns **supernormal profit**, calculated as:
👉 $(P_1 - C_1) \times Q_1$

🎯 But here's the catch:
While they do make supernormal profit, it's **less than** what they could have made if they followed the **profit maximisation rule** (where $MR = MC$). So, they're trading off some profit for more sales.

3.2.1 Business objectives

Profit v Revenue maximisation



To **revenue maximise**, a firm will produce at the point where **marginal revenue (MR) = 0**. This is because if MR is still positive, making and selling one more unit will still add to total revenue. So, the firm keeps producing until adding another unit brings in no extra money.

This means they produce a larger quantity, let's call it **Q2**, and sell at a lower price **P2**. In contrast, if they were **profit maximising**, they'd produce where **MR = MC**, which is at a smaller output (**Q1**) and a higher price (**P1**).

- In simple terms:
Revenue maximisation = more products sold, lower price.
Profit maximisation = fewer products sold, higher price per unit.

3.2.1 Business objectives

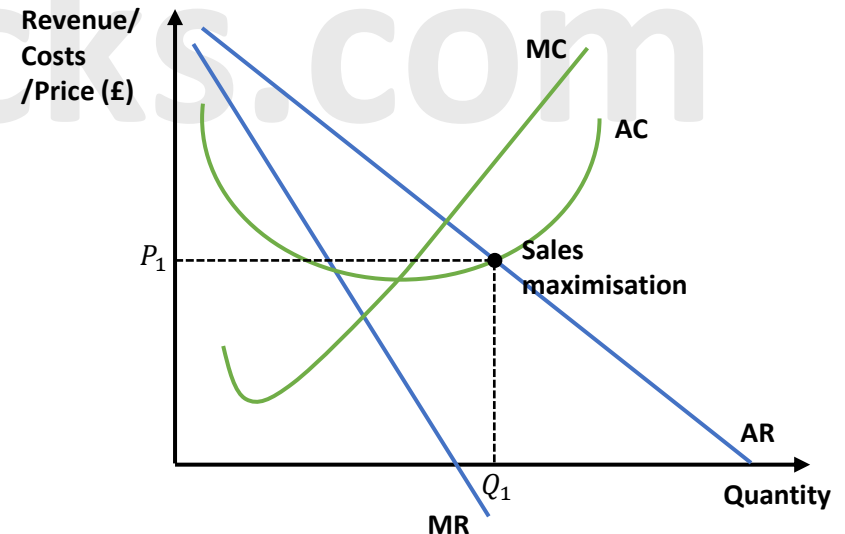
Sales maximisation

Some businesses aren't just chasing profit, instead, they aim to **sell as many units as possible**. This is known as **sales maximisation**.

This happens where average cost (AC) = average revenue (AR). This is also called the **breakeven point** – where the firm isn't making a loss, but it isn't making a super profit either (just covering all costs, including normal profit).

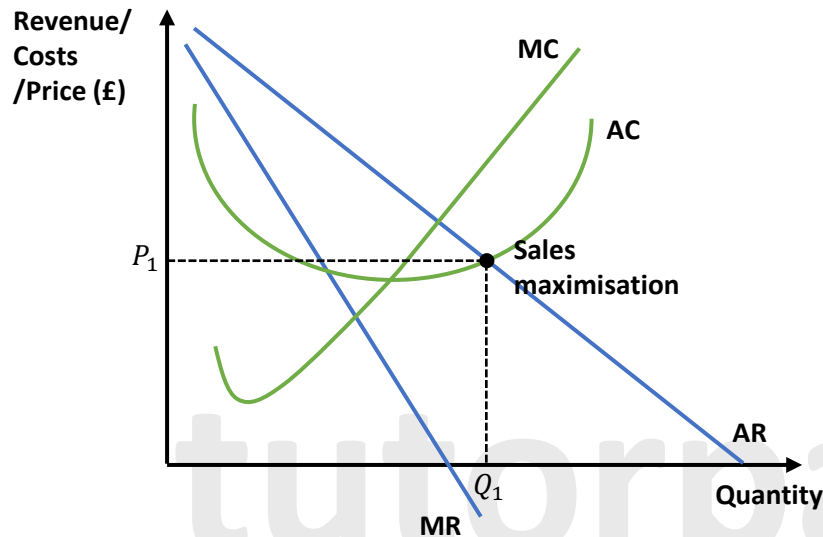
Why would a business want to do this?

Let's say a company is running a **big end-of-season sale**. Their goal? Get rid of as much stock as they can – even if they don't make much profit – as long as they're not losing money on each sale.



3.2.1 Business objectives

Sales maximisation



Analysis

At the **sales maximisation point**, output is at Q_1 and the selling price is P_1 .

Here:

- **AR = AC**, so the **firm breaks even** – no supernormal (extra) profit, but no losses either.
- The firm earns **normal profit**, which is just enough to cover all opportunity costs.



3.2.1 Business objectives

Satisficing

In the world of business, not everyone wants to squeeze out every last penny of profit. Sometimes, firms aim for a more relaxed objective called **satisficing** – basically making **just enough profit to keep the owners happy**, while also focusing on other goals.

Why does this happen?

It all comes down to something called the **principal-agent problem**. Here's what that means:

- **Principals** = the shareholders or owners of the business
- **Agents** = the managers or directors who run the business day to day

Now, these two groups don't always want the same thing. Owners want **maximum profit** to boost share prices and get big dividends 💰. But managers might have other things in mind – like keeping their jobs, enjoying big salaries, or getting bonuses and perks. So, managers will make sure the firm makes **enough** profit to avoid complaints from the owners... but they might not push for maximum profit if it gets in the way of their own goals.

So what do managers actually do?

They **satisfice** – they hit a profit target that's "good enough" rather than perfect. This lets them also:

- Spend more on fancy offices or extra staff
- Take less risky decisions
- Give themselves higher wages or bonuses

Of course, doing all this means profits are lower than they could be. But as long as shareholders aren't angry, managers get what they want too. It's a bit of a balancing act.

And how much profit is "good enough"?

That **changes every year**. For example:

- If the economy is down and other firms are making losses, then just breaking even (aka **normal profit**) might be fine.
- But if competitors are booming and raking in profits, shareholders will expect the same – so "good enough" suddenly means **a lot more**.

Please see the '3.2 Business Objectives Worked Examples' pack for exam style questions.

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