

Exercise walk-through

7.8

Differing objectives and policies of firms

A-Level Economics

Different prices need an explanation

Four pricing rules for comparison

A seller charges each unit at the buyer's maximum willingness to pay. Another offers a lower unit price for a larger quantity. A cinema checks student IDs for a cheaper ticket. A shop charges more to deliver to a distant address because delivery costs more. Which rules use price discrimination? What evidence would you need for the quantity discount?

Different prices need an explanation

Four pricing rules for comparison

A seller charges each unit at the buyer's maximum willingness to pay. Another offers a lower unit price for a larger quantity. A cinema checks student IDs for a cheaper ticket. A shop charges more to deliver to a distant address because delivery costs more. Which rules use price discrimination? What evidence would you need for the quantity discount?

Price discrimination means different prices for the same product where the difference is not explained by different supply costs.

Individual values, quantity menus and identifiable groups

First-degree price discrimination : each unit is priced at that buyer's maximum willingness to pay. Detailed information is needed.

Second-degree price discrimination : unit prices vary with quantity or a menu; buyers select an option. A quantity discount explained entirely by lower costs is not enough to establish it.

Third-degree price discrimination : identifiable groups pay different prices, such as verified students and adults. Group separation must work.

The distant delivery charge may just reflect its higher cost. A ticket price rising near departure can sort buyers by willingness to pay, but timing alone does not establish its precise degree.

Compare uniform and individual-unit prices

An illustrative buyer and constant marginal cost

One buyer's maximum prices for successive units are £12, £9 and £6. Later units have no value. Supply costs £4/unit, with no fixed or administration cost. The buyer purchases when value equals price. Compare uniform prices £12, £9 and £6, then pricing the three units at £12, £9 and £6 respectively. Find quantity, revenue, cost and profit.

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Compare total profit across the feasible quantities. Do not confuse different unit values with three different customers in this example.

Exercises 2.1-2.3

2.1 State the output condition for *profit maximisation*.

[1]

2.2 Define the term *satisficing*.

[2]

2.3 Define the term *divorce of ownership from control*.

[2]

Exercises 2.1-2.3

2.1 State the output condition for *profit maximisation*. [1]

2.1

- produce where marginal revenue equals marginal cost ($MR = MC$) (1)
-

2.2 Define the term *satisficing*. [2]

2.2

- aiming for results that are “good enough” to keep owners, workers and customers reasonably satisfied, rather than maximising any one thing (2 for a clear definition; 1 for a partial idea)
-

2.3 Define the term *divorce of ownership from control*. [2]

2.3

- when the owners (shareholders) of a firm are different people from the managers who control its day-to-day decisions (2 for a clear definition; 1 for a partial idea)

Exercises 3.1-3.2

3.1 A firm that aims for **revenue maximisation** produces where:

[1]

☐

A marginal revenue equals marginal cost

B marginal revenue equals zero

C price equals average cost

D average cost is at its minimum

3.2 Explain how the divorce of ownership from control can lead to the principal-agent problem.

[6]

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3.1 B

- Revenue is maximised where marginal revenue equals zero

3.2 Explain how the divorce of ownership from control can lead to the principal-agent problem.

[6]

3.2

- [6] AO1 1 + AO3 up to 5 – owners (principals) want maximum profit, but managers (agents) control decisions and have their own aims (higher salaries, an easier life, bigger firms)
- because owners cannot fully monitor managers, managers may pursue their own goals instead of profit
- the firm does not maximise profit

Exercise 3.3

3.3 Discuss whether firms always aim to maximise profit.

[12]

Exercise 3.3

3.3 Discuss whether firms always aim to maximise profit. [12]

3.3

- [12] AO1/AO2/AO3 up to 8 + AO4 up to 4. **For profit max:** profit funds survival and rewards owners, and competition forces firms towards it. **Against:** the divorce of ownership and control lets managers satisfice or pursue sales/revenue growth, and firms may pursue ethical or market-share aims. Judgement: profit maximisation is a useful baseline, but in large firms with separated ownership, other objectives often dominate – it depends on the firm's ownership and the strength of competition