Exercise walk-through

Differing objectives and policies of firms ▪ 7.8

eXercise

You must be able to

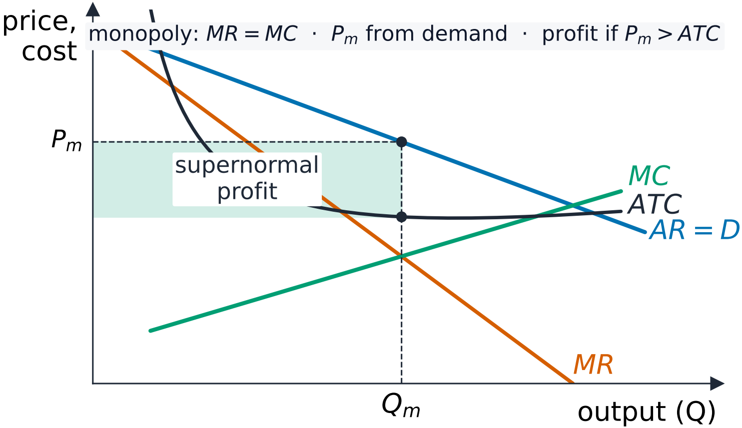
- describe the alternative objectives of firms
- explain the divorce of ownership from control
- analyse why firms may not maximise profit

Method — What firms aim for

- **Profit maximisation 利润最大化**: produce where **MR = MC**. **Revenue maximisation 收益最大化**: where MR = 0.
- **Sales maximisation 销售最大化**: largest output while still making normal profit. **Satisficing 满意化**: "good enough" for all stakeholders.
- **Divorce of ownership from control 所有权与控制权分离**: managers $\neq$ owners $\rightarrow$ the **principal-agent problem 委托代理问题** (managers pursue their own aims).

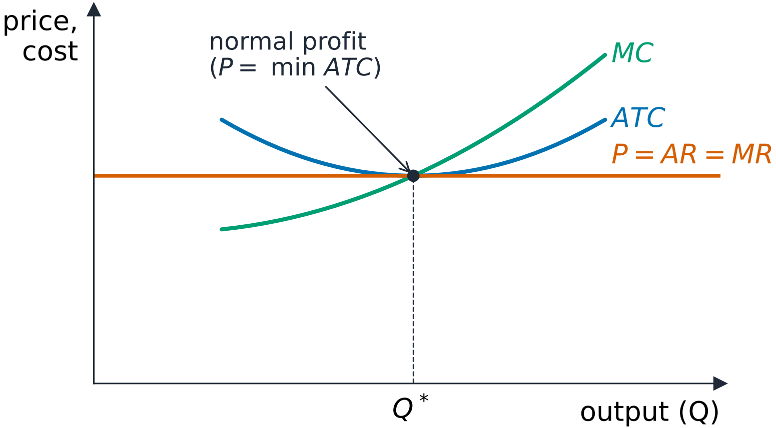
Answer shapes: AO1 + AO2 + AO3 (analysis) + AO4 (a supported judgement *in context*).

Method — What firms aim for



A profit-maximising firm produces where $MR = MC$

Method — What firms aim for



A perfectly competitive firm makes only normal profit in the long run

Practice 2.1 ▪ 1 mark

State the output condition for *profit maximisation*.

Solution 2.1

Method: What firms aim for

Worked steps

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

Practice 2.2 ▪ 2 marks

Define the term *satisficing*.

Solution 2.2

Worked steps

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).

Practice 2.3 ▪ 2 marks

Define the term *divorce of ownership from control*.

Solution 2.3

Method: What firms aim for

Worked steps

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).

Exam-style 3.1 ▪ 1 mark

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

A marginal revenue equals marginal cost

B marginal revenue equals zero

C price equals average cost

D average cost is at its minimum

Solution 3.1

Method: What firms aim for

A marginal revenue equals marginal cost

B marginal revenue equals zero ✓

C price equals average cost

D average cost is at its minimum

Worked steps

B. Revenue is maximised where marginal revenue equals zero.

Exam-style 3.2 ▪ 6 marks

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

Solution 3.2

Method: What firms aim for

Worked steps

[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) $\rightarrow$ because owners cannot fully monitor managers, managers may pursue their own goals instead of profit $\rightarrow$ the firm does not maximise profit.

Exam-style 3.3 ▪ 12 marks

Discuss whether firms always aim to maximise profit.

Solution 3.3

Method: What firms aim for

Worked steps

[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.