Business Objectives & Pricing

AQA A-Level Economics

Profit · Revenue · Sales · Satisficing · Principal–Agent · Growth · Pricing Strategies

Business Objectives

Traditional theory assumes firms maximise profit — but in reality firms may pursue a range of objectives:

Profit Maximisation

Making the largest possible profit — producing where MC = MR. The traditional assumption, serving shareholders' interests.

e.g. Most private-sector firms aim for high profits to reward shareholders and fund investment.

Revenue Maximisation

Making the largest possible total revenue — producing where MR = 0. Managers' pay and status are often linked to sales revenue.

e.g. Firms trying to grow market share may accept lower profit for higher revenue.

Sales (Volume) Maximisation

Selling as many units as possible without making a loss — producing where AR = AC (normal profit only).

e.g. Some start-ups price low to build a large customer base quickly.

Satisficing

Making enough profit to keep shareholders happy, while meeting the goals of other stakeholders — managers, workers and customers.

e.g. A family business may accept lower profit to protect jobs in its local community.

Survival

In a recession or a new market, simply staying in business may be the main objective — even at a loss in the short run.

e.g. During COVID-19, many hospitality firms focused only on survival.

Social & Environmental Goals

Some firms pursue corporate social responsibility (CSR) — ethical sourcing, low emissions and community projects.

e.g. Social enterprises and B-Corps such as Patagonia put social goals alongside profit.

Comparing Objectives: Output & Price

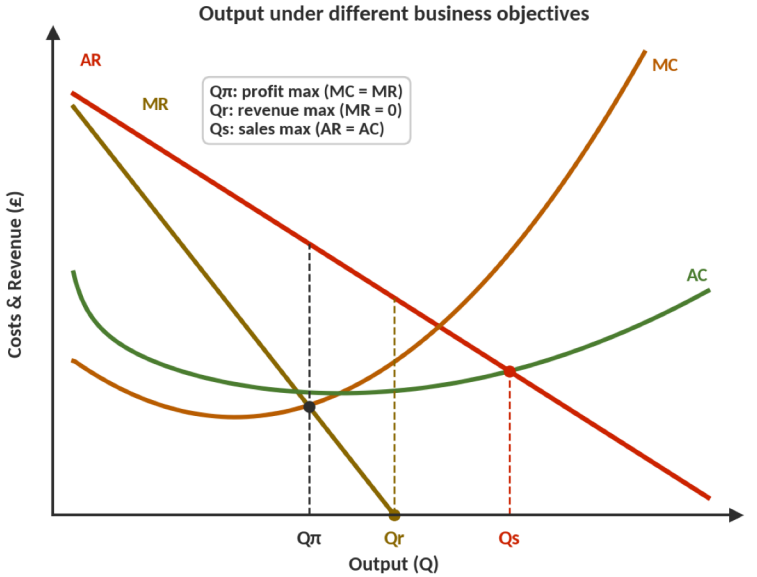
Different objectives, different outcomes:
Each objective leads the firm to a different level of output and price. The diagram shows the same firm's costs and revenues.

Profit maximisation (Qπ):
MC = MR. Lowest output and highest price of the three — but the largest profit.

Revenue maximisation (Qr):
MR = 0 — any extra unit sold would reduce total revenue. Higher output and lower price than profit maximisation.

Sales maximisation (Qs):
AR = AC — the highest output possible without making a loss. Lowest price, but only normal profit.

Key point: consumers may gain from lower prices and higher output when firms do not profit maximise.



Real-World Example

Amazon: for years prioritised revenue growth and market share over profit, reinvesting almost everything — before becoming hugely profitable once dominant.

Profit Maximisation: For and Against

Profit maximisation is the standard assumption in theory — but firms may have good reasons not to pursue it:

Why Firms Maximise Profit

Shareholders own the firm and want the highest possible returns (dividends and share price).

Profits are the main source of finance for investment — retained profit is cheap and flexible.

High profits reward risk-taking by entrepreneurs.

A profitable firm is less likely to be taken over — a low share price attracts bids.

Profits allow firms to survive downturns and fund R&D.

e.g. Private equity owners typically demand high short-term profits from the firms they buy.

Why Firms May Not

Divorce of ownership and control: managers may pursue their own goals, e.g. revenue or growth.

Lack of information: firms often don't know their exact MC and MR curves.

Fear of regulation: very high profits may attract the attention of the CMA or a windfall tax.

Limit pricing: firms may accept lower profit now to deter new entrants.

Stakeholder pressure: workers, customers and the local community also have interests.

e.g. Water and energy firms face public and political pressure if profits and dividends look excessive.

The Principal–Agent Problem

Divorce of ownership and control:
In large public limited companies, the owners (shareholders) are separate from the people who run the firm day-to-day (managers).

The principal–agent problem:
Shareholders (principals) employ managers (agents) to act in their interests. But managers may pursue their own objectives — higher pay, status, perks or empire-building.

Why it happens:
Asymmetric information — managers know far more about the firm than shareholders, who find it hard and costly to monitor them.

Consequences:
Firms may pursue revenue or sales maximisation, or growth, instead of profit maximisation. Managers may take excessive risks or focus on short-term results.

Solutions

Performance-related pay, share options (so managers become part-owners), independent non-executive directors, and shareholder votes on pay.

Limitations

Share options can encourage short-termism — boosting the share price before options are cashed in, rather than long-run growth.

Real-World Example

Carillion (2018): directors received bonuses and paid dividends while debts mounted. The firm collapsed with around £7bn of liabilities — a clear case of agents failing their principals.

Stakeholders & Conflicting Objectives

Definition:

A stakeholder is any individual or group with an interest in the activities of a business. Their objectives often conflict.

Satisficing: aiming for a satisfactory level of profit while meeting the needs of different stakeholders

Key stakeholder groups:

Shareholders (Owners)

Want high profits, dividends and a rising share price. Usually favour profit maximisation.

e.g. Activist investors may push firms to cut costs, sell divisions or return cash to shareholders.

Managers & Workers

Managers want pay, status and growth; workers want higher wages, job security and good conditions. Both may conflict with profit maximisation.

e.g. A pay rise for workers raises costs and reduces the profit available to shareholders.

Customers, Suppliers & Society

Customers want low prices and high quality; suppliers want fair prices and prompt payment; society wants low pollution and local jobs.

e.g. Cutting prices benefits customers but lowers profits — cutting emissions raises costs.

Pricing Strategies

Firms use a range of pricing strategies depending on their objectives, market power and the stage of a product's life:

Cost-Plus Pricing

Adding a fixed percentage mark-up to average cost. Simple, but ignores demand and competitors' prices.

e.g. Many small retailers and builders price this way.

Penetration Pricing

Setting a low price to enter a market and quickly win market share, raising the price later.

e.g. New streaming services often launch with cheap introductory offers.

Price Skimming

Setting a high price at launch to target early adopters with inelastic demand, then lowering it over time.

e.g. New smartphones and games consoles launch at premium prices.

Predatory Pricing

Pricing below average cost to drive rivals out of the market, then raising prices once they have gone.

e.g. Illegal under the Competition Act 1998 — an abuse of a dominant position.

Limit Pricing

Setting price just below the level that would allow a new entrant to make a profit — deterring entry.

e.g. Established airlines may cut fares on routes where a budget rival is about to enter.

Price Discrimination

Charging different prices to different groups for the same product, based on differences in PED.

e.g. Peak and off-peak rail fares; student discounts; cinema pricing by time of day.

Limit Pricing & Predatory Pricing

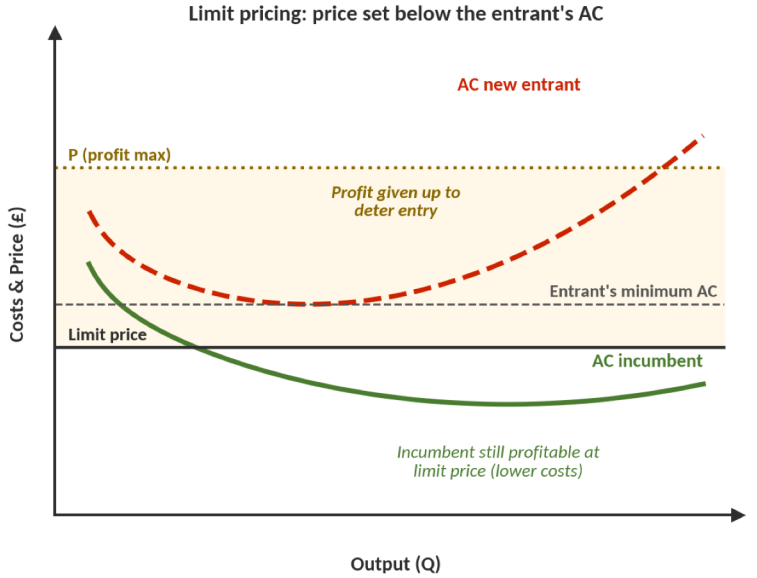
Limit pricing:
An incumbent firm sets its price below the new entrant's minimum average cost. The entrant would make a loss, so entry is deterred.

Why it works:
The incumbent usually has lower costs due to economies of scale and experience — so it can still make a profit at the limit price, while the entrant cannot.

Predatory pricing:
A dominant firm sets price below its own average cost for a period to force existing rivals out. Once they leave, it raises prices to recover its losses.

Evaluation:
Consumers gain from lower prices in the short run. ✗ Less competition and higher prices in the long run. ✗ Hard to prove — low prices may simply reflect efficiency.

Limit pricing is legal; predatory pricing is an illegal abuse of a dominant position.



Real-World Example

Napp Pharmaceuticals (2001): fined £3.2m by the OFT for selling morphine tablets to hospitals below cost to drive out rivals, while charging far more elsewhere.

The Growth of Firms

How firms grow:

Organic growth: investing in new capacity, products or markets. External growth: mergers and takeovers.

Why grow? Economies of scale, higher profits, market power, diversification, managers' objectives

Types of integration (external growth):

Horizontal Integration

Merging with a firm at the same stage of production in the same industry. Increases market share and economies of scale — but may reduce competition.

e.g. Vodafone and Three merged their UK operations in 2025, after CMA approval with conditions.

Vertical Integration

Merging with a firm at a different stage of the same supply chain.
Backward: towards suppliers.
Forward: towards customers.

e.g. Backward: a brewer buying a hop farm. Forward: a brewer buying pubs to control retail outlets.

Conglomerate Integration

Merging with a firm in an unrelated industry. Spreads risk through diversification, but managers may lack expertise in the new market.

e.g. Virgin Group operates in airlines, trains, finance, health and space travel.

★ Bonus: Behavioural & Dynamic Pricing

Behavioural pricing:
Firms use insights from behavioural economics — consumers are not always rational, so the way prices are presented affects what they buy.

Common techniques:
Psychological pricing (£9.99 not £10). Anchoring (showing a high 'was' price). Decoy pricing (a middle option that makes the premium look good value). Drip pricing (adding fees late in the buying process).

Dynamic pricing:
Prices change in real time based on demand — using algorithms. Common in airlines, hotels, ride-hailing and event tickets.

Evaluation:
Can allocate scarce capacity efficiently. ✗ Can exploit consumer biases and reduce trust — a growing focus for regulators.

Surge Pricing

Uber raises fares when demand is high — encouraging more drivers onto the roads but angering customers.

Regulation

The Digital Markets, Competition and Consumers Act 2024 gave the CMA new powers to fine firms directly for unfair practices.

Real-World Example

Oasis reunion tickets (2024): dynamic pricing pushed some standing tickets from around £150 to over £350 while fans queued. The outcry led the CMA to investigate Ticketmaster.

Summary: Key Terms & Relationships

Key Term	Meaning
Profit maximisation	Producing where MC = MR — the traditional objective of the firm.
Revenue maximisation	Producing where MR = 0 — the largest possible total revenue.
Sales maximisation	Producing the highest output without a loss — where AR = AC.
Satisficing	Making a satisfactory profit while meeting the goals of other stakeholders.
Divorce of ownership & control	Shareholders own the firm but managers control it day-to-day.
Principal–agent problem	Agents (managers) pursue their own goals rather than those of principals (shareholders).
Stakeholder	Any group with an interest in a firm — shareholders, workers, customers, suppliers, society.
Penetration pricing	Low launch price to gain market share quickly.
Price skimming	High launch price for early adopters, lowered over time.
Limit pricing	Setting price below a potential entrant's average cost to deter entry. Legal.
Predatory pricing	Pricing below cost to drive out rivals, then raising prices. Illegal.
Integration	Horizontal (same stage), vertical (different stage of supply chain) or conglomerate (unrelated).
Dynamic pricing	Prices change in real time with demand, set by algorithms.