BUSINESS ECONOMICS

Slides by CAO Thi Hong Vinh

Chapter 2:

BUSINESS OBJECTIVES & THEORIES OF FIRMS

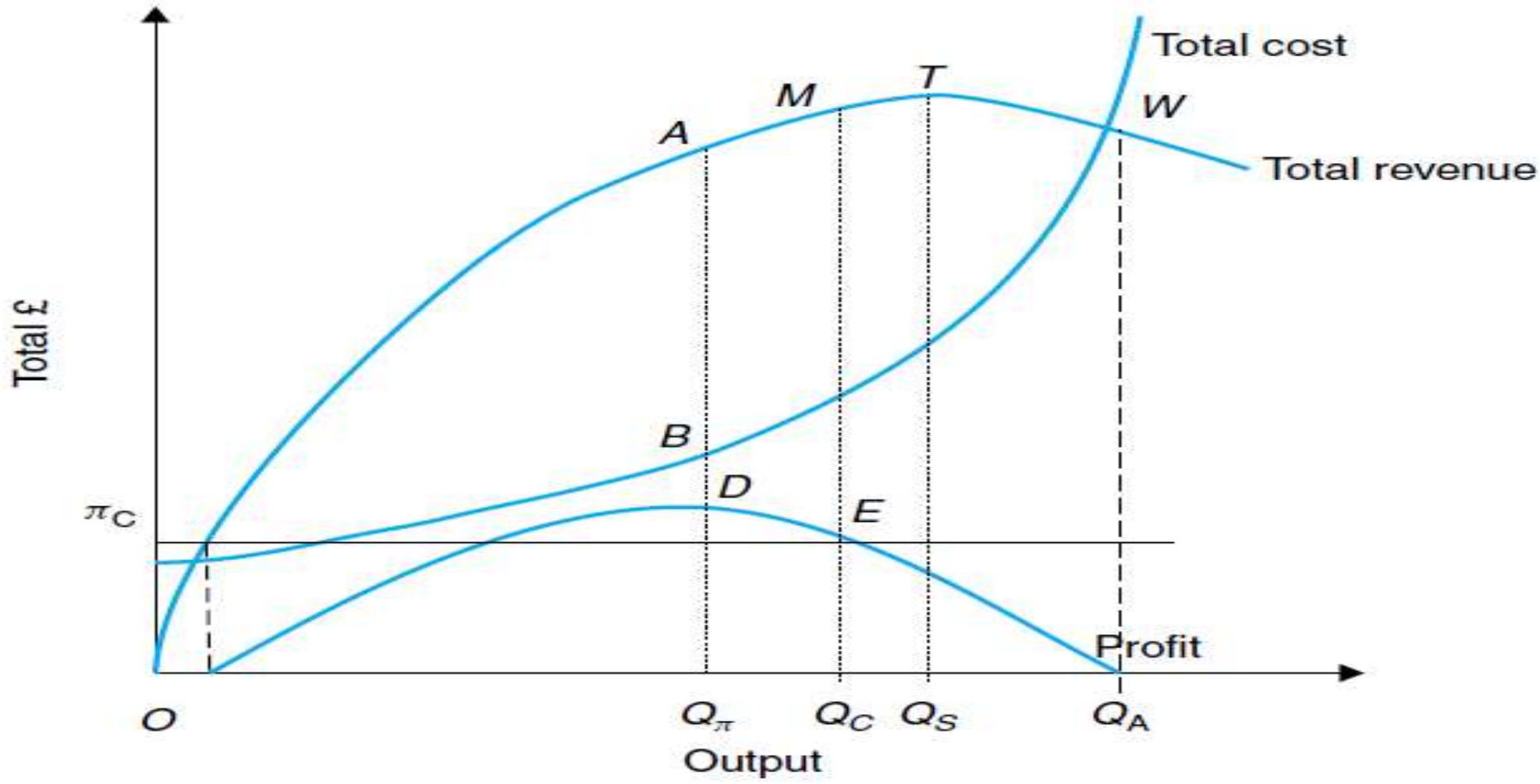
- Required: ***Business Economics and Managerial Decision Making***, C. 2
- Recommend: ***Economics for Business and Management***, C. 4

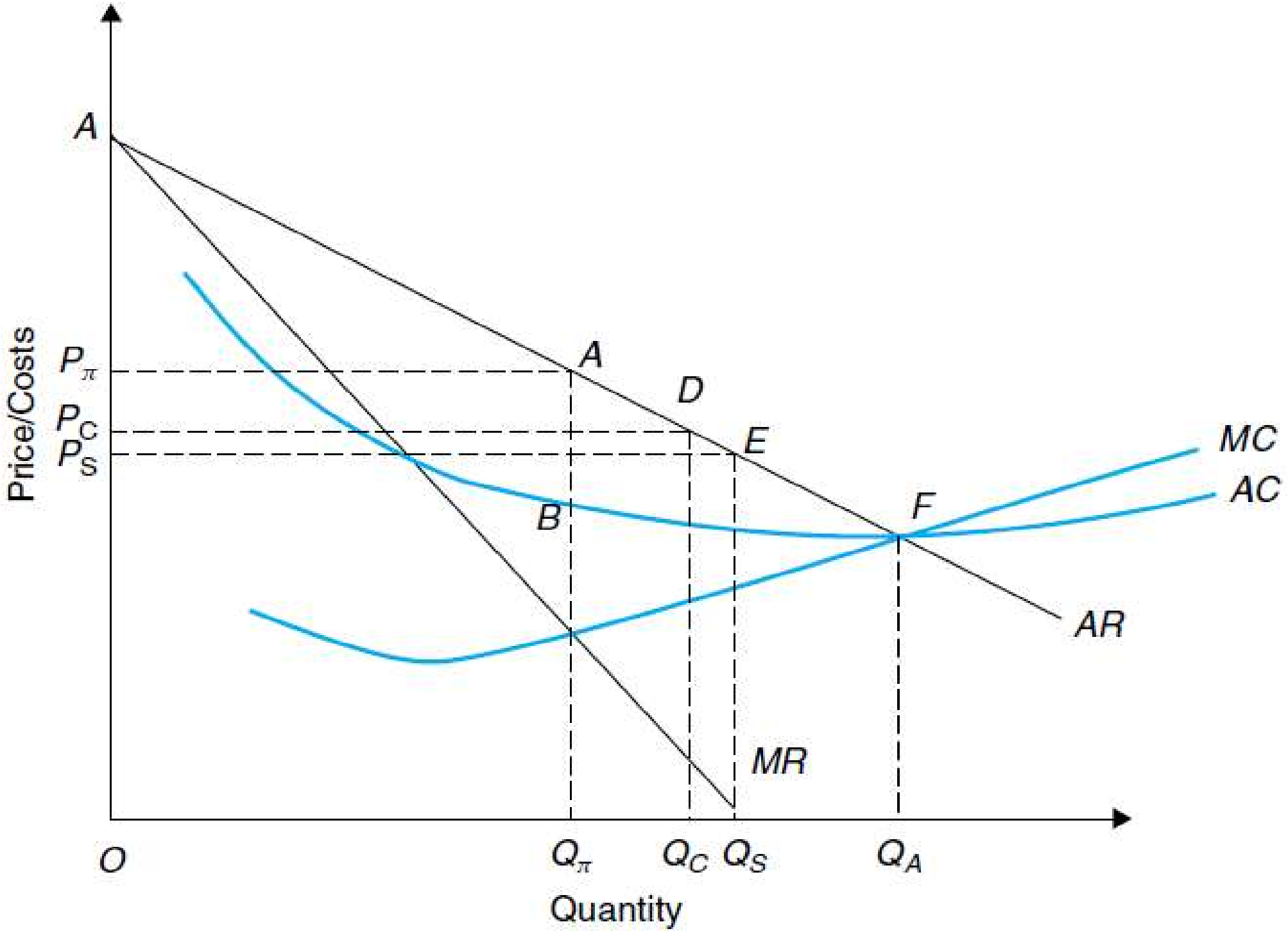
STRUCTURE

1. Profit maximization
2. Sales revenue maximization
3. Managerial utility model
4. Behavioral models
5. Corporate social responsibility

1. Profit maximization

1.1 Rules Max (TR - TC)

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MC
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Q_S
Q_A
Price/Costs
Quantity

1. Profit maximization

1.2 Criticisms

- *Theoretical perspectives:*

  + Imperfect and uncertain information → calculation of MR & MC?

  + Profit is related to time → trade-off SR for LR?

  + A set of objectives for modern organizations

1.2 Criticisms (cont)

- *Main empirical perspectives:*

  + Maximal profit? Shipley (1981) & Hornby (1995) → just satisfactory

  + Other objectives: Shipley (1981): 15% are true profit maximizers

***But*….important**

→ for survival and presence

(for maintaining and raising capital)

2. Sales revenue max

Baumol (1959):

Role of managers → rewards and sales revenue??

2. Sales revenue max

2.1 The static single-period max

a. Assumption

- A single product, non-linear functions of TR and TC
- No consideration of other firms
- Objective of maximizing TR (i) w/o constraints (ii) subject to π_C

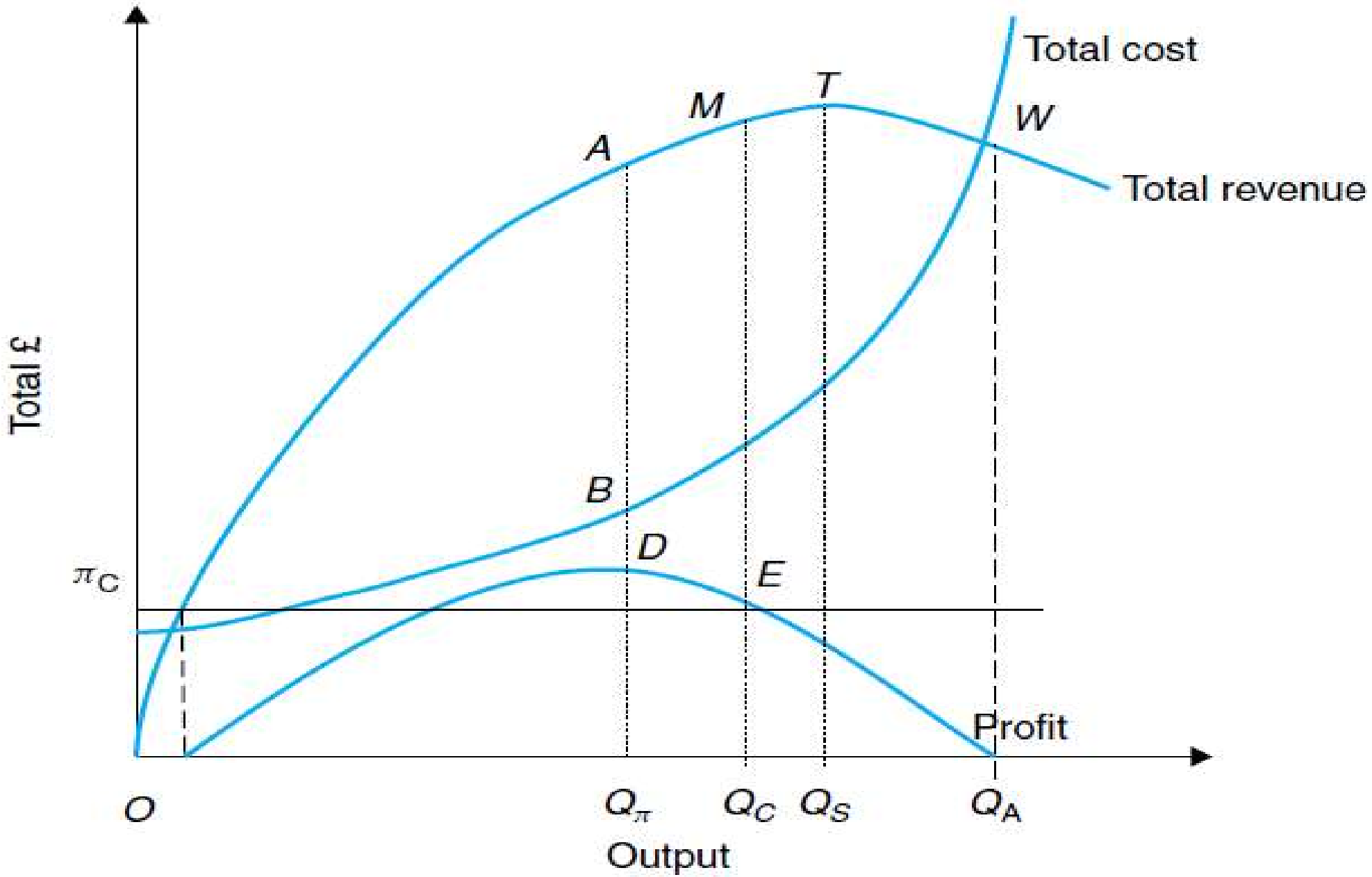
2. Sales revenue max

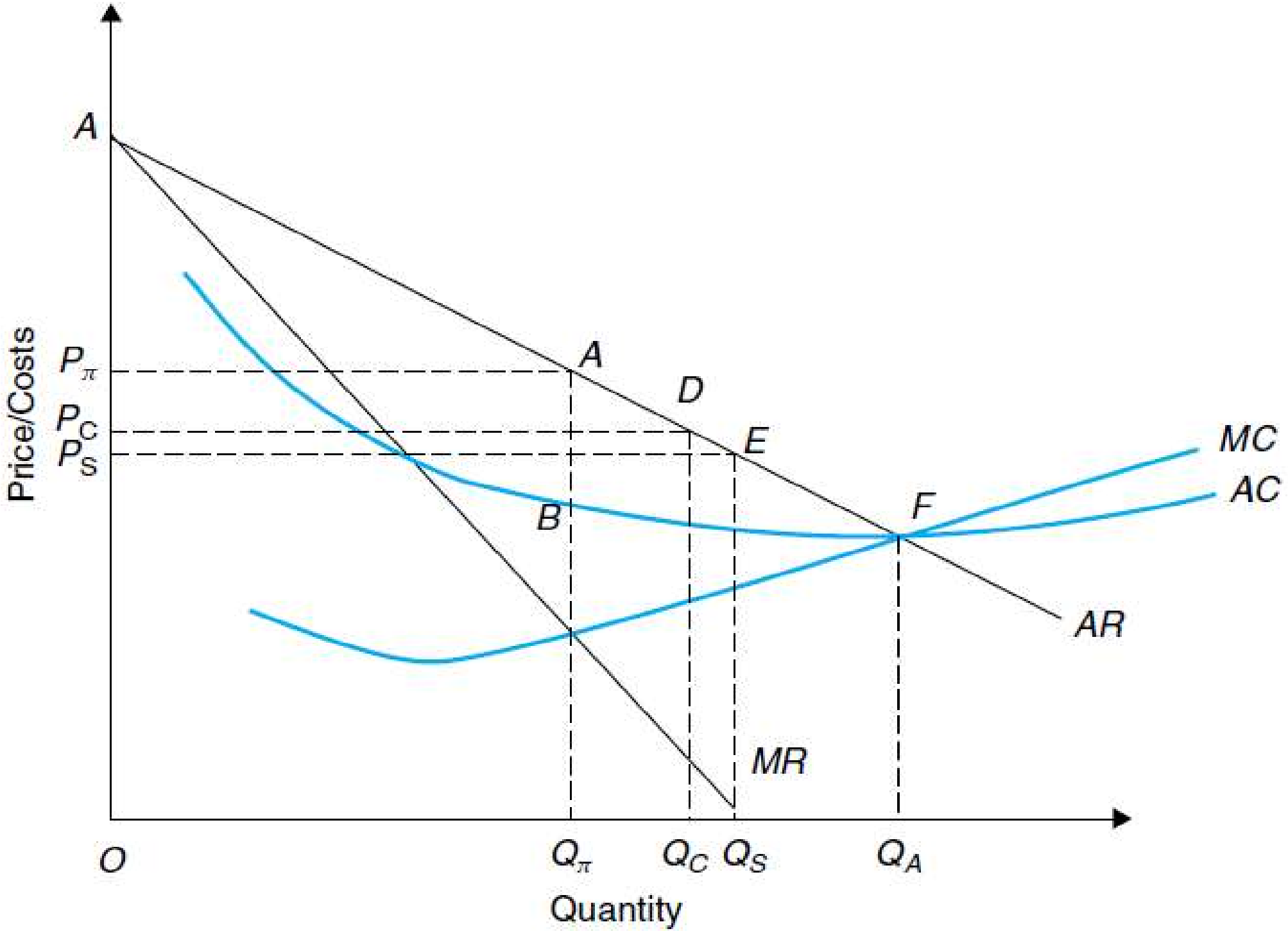
2.1 The static single-period max

(i) Max TR

(ii) Max TR s.t. π_C

2. Sales revenue max

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Quantity

2. Sales revenue max

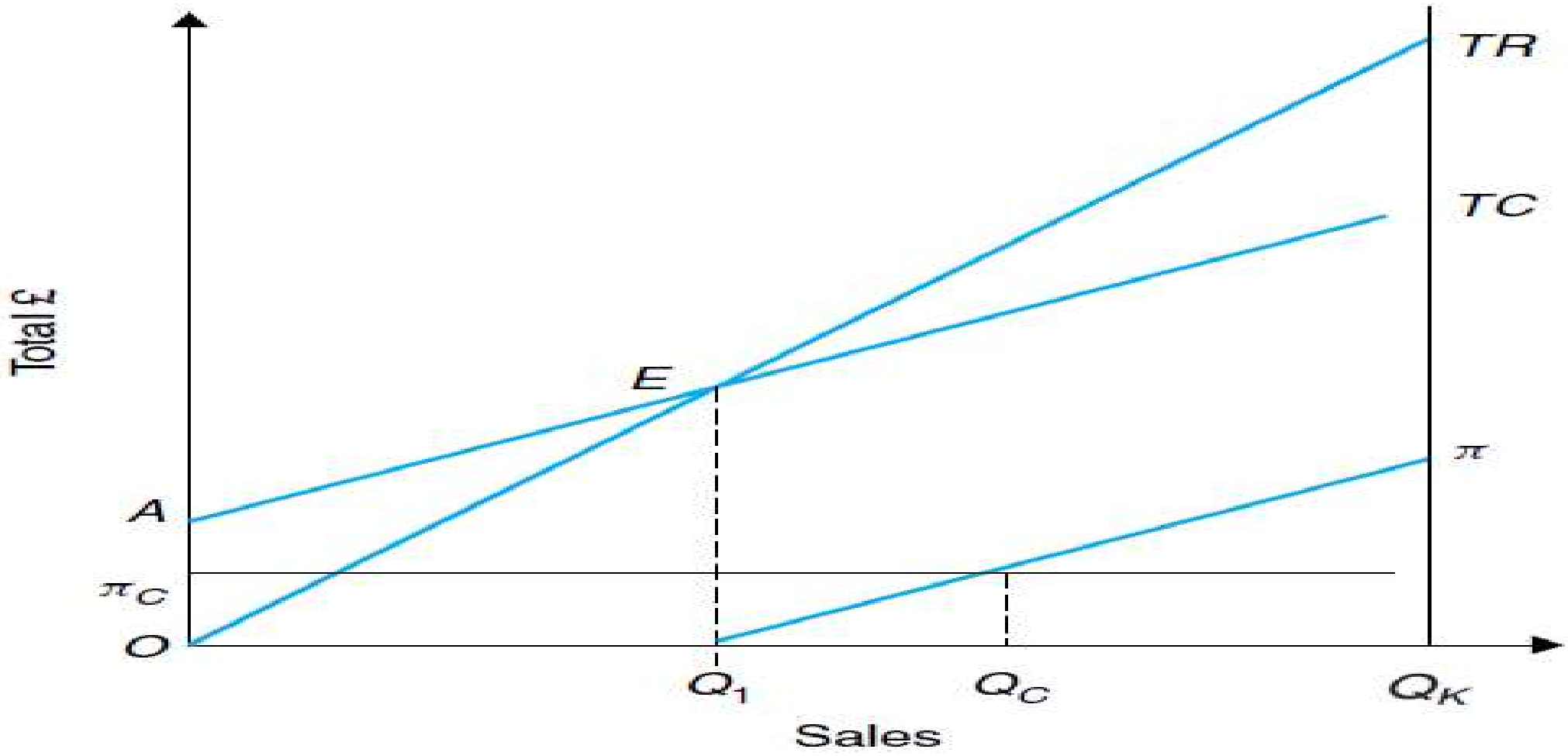
Determinations of π_C

- The normal rate of returns in the sector
- Satisfactory levels for shareholders
- Levels discouraging hostile takeover and takeover bids

2. Sales revenue max

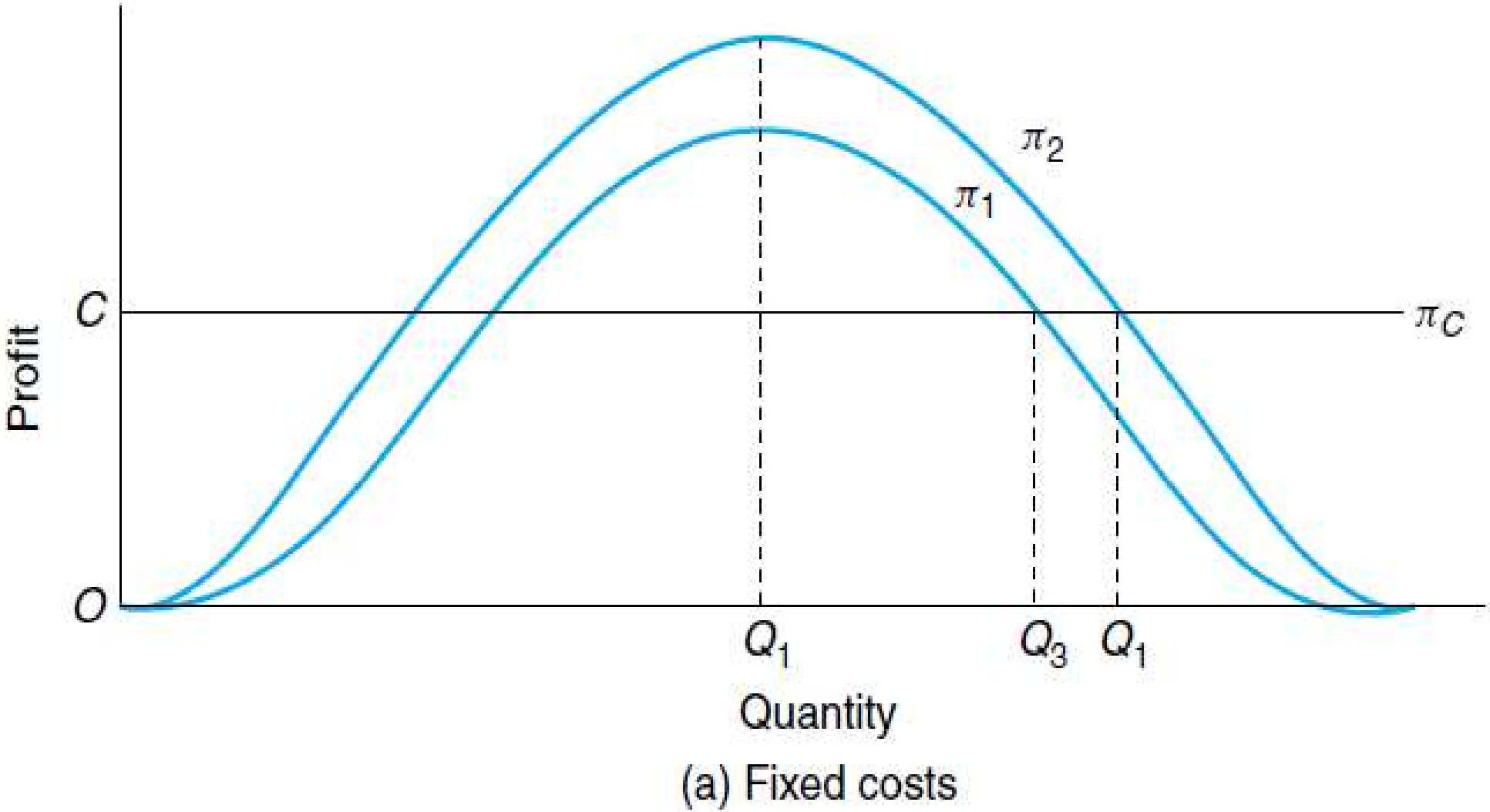
2.1 Profit & SR maximizations

2.2.1 Linear TR and TC



2.2.2 Non-linear TR and TC

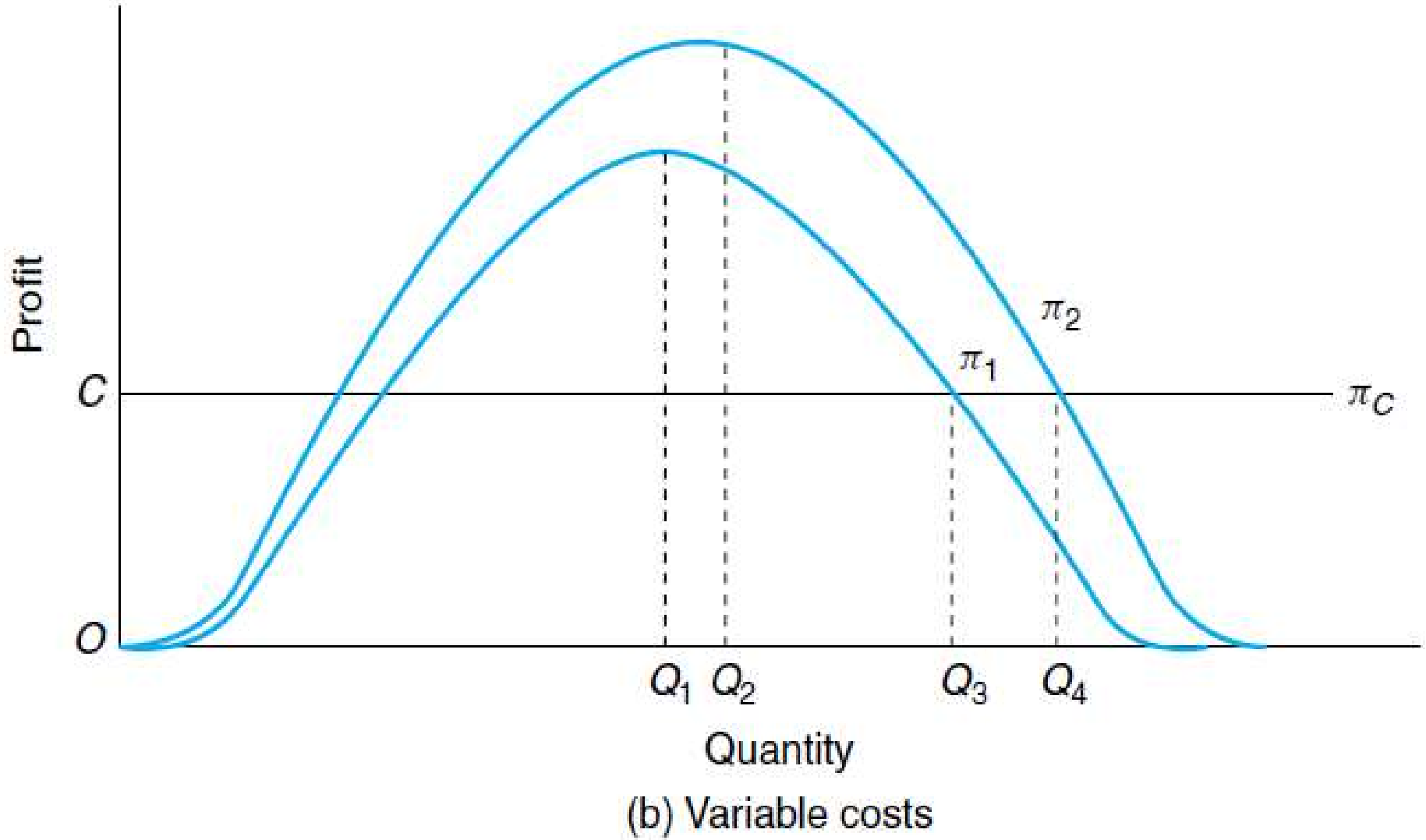
a. Change in FC:



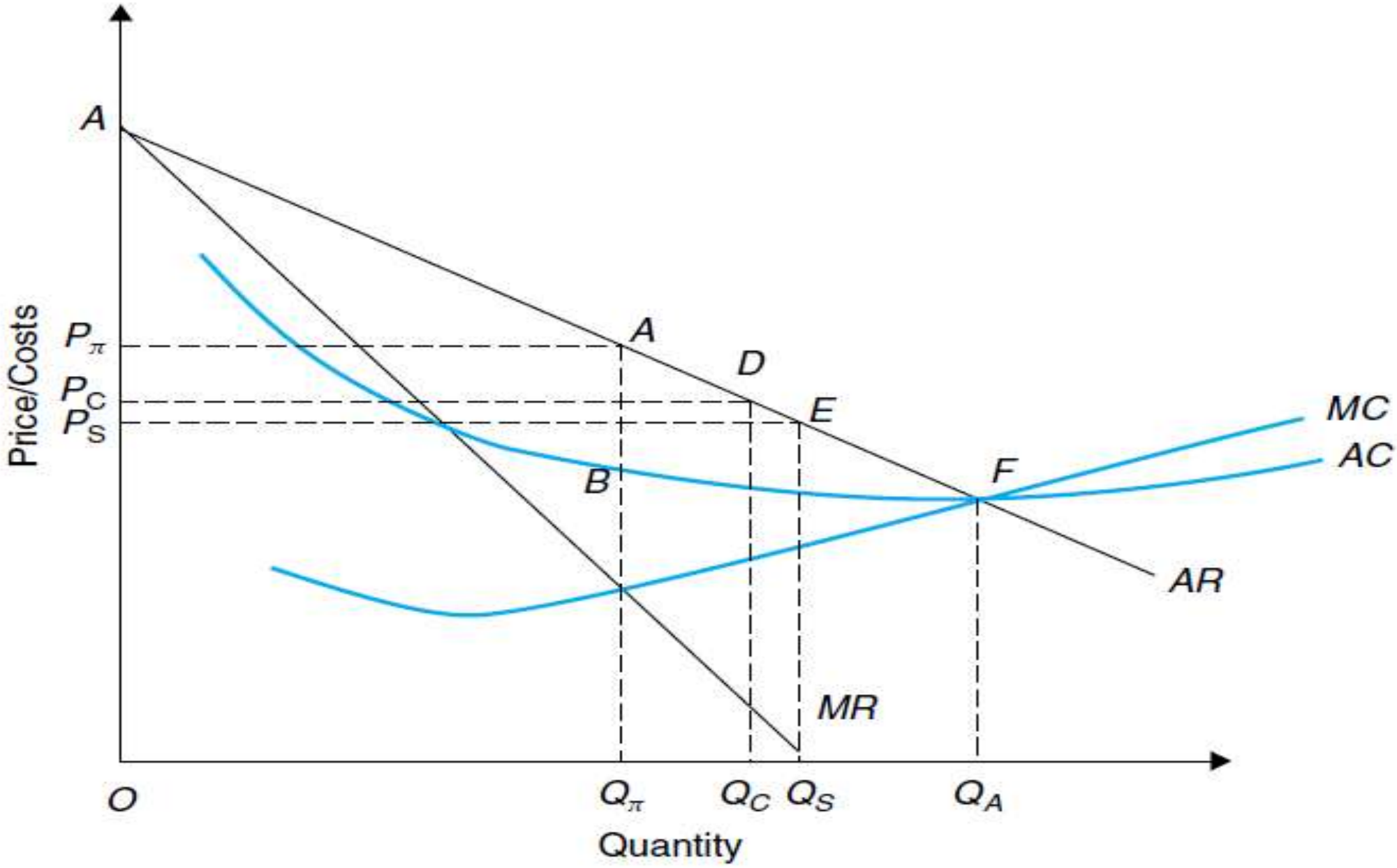
(a) Fixed costs

2.2.2 Non-linear TR and TC

b. Change in VC:



b. Change in VC:



3. Managerial utility model

Williamson (1963):

a) B = Salary + Non-pecuniary B

Non-pecuniary B = S+M+Id

(*Discretionary ex./*Managerial slack)

+ Staff (S)

+ Fringe benefits (M)

+ Discretionary investments (Id)

3. Managerial utility model

→ ***Discretionary ex.*** = ***S***+***M***+***Id***

b) Profits of firms:

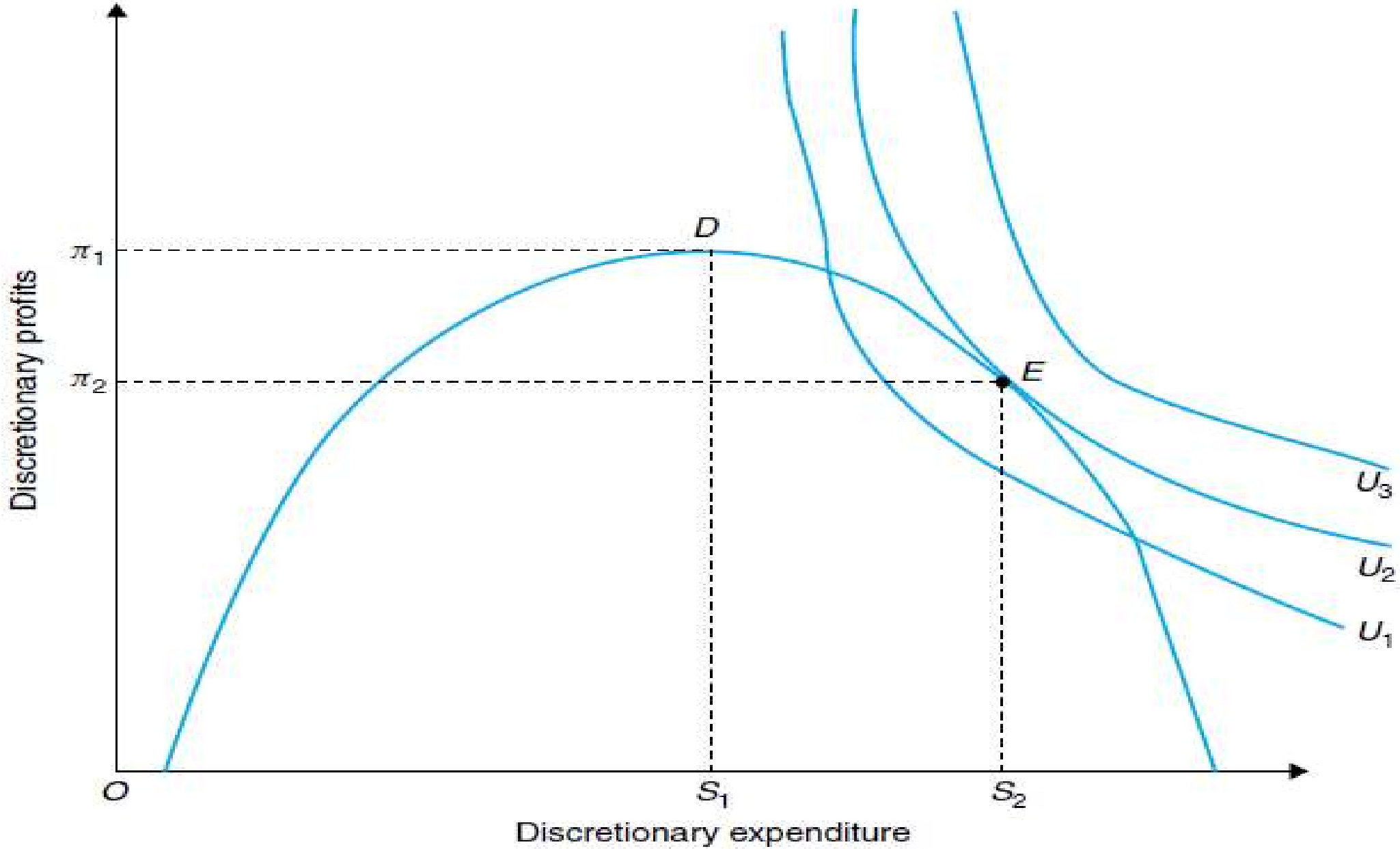
+ Actual profit: π_A

+ Minimum profit: π_M

→ ***Discretionary profit:***

$$\pi_D = \pi_A - \pi_M$$

3. Managerial utility model



3. Managerial utility model

- ***Profit-max***: no dis. ex.
- ***Managerial utility-max***: change dis. ex.

Firms were able to make cost reductions in times of declining profit opportunities without hindering the operations of the firm (Williamson, 1964)

4. Behavioral models

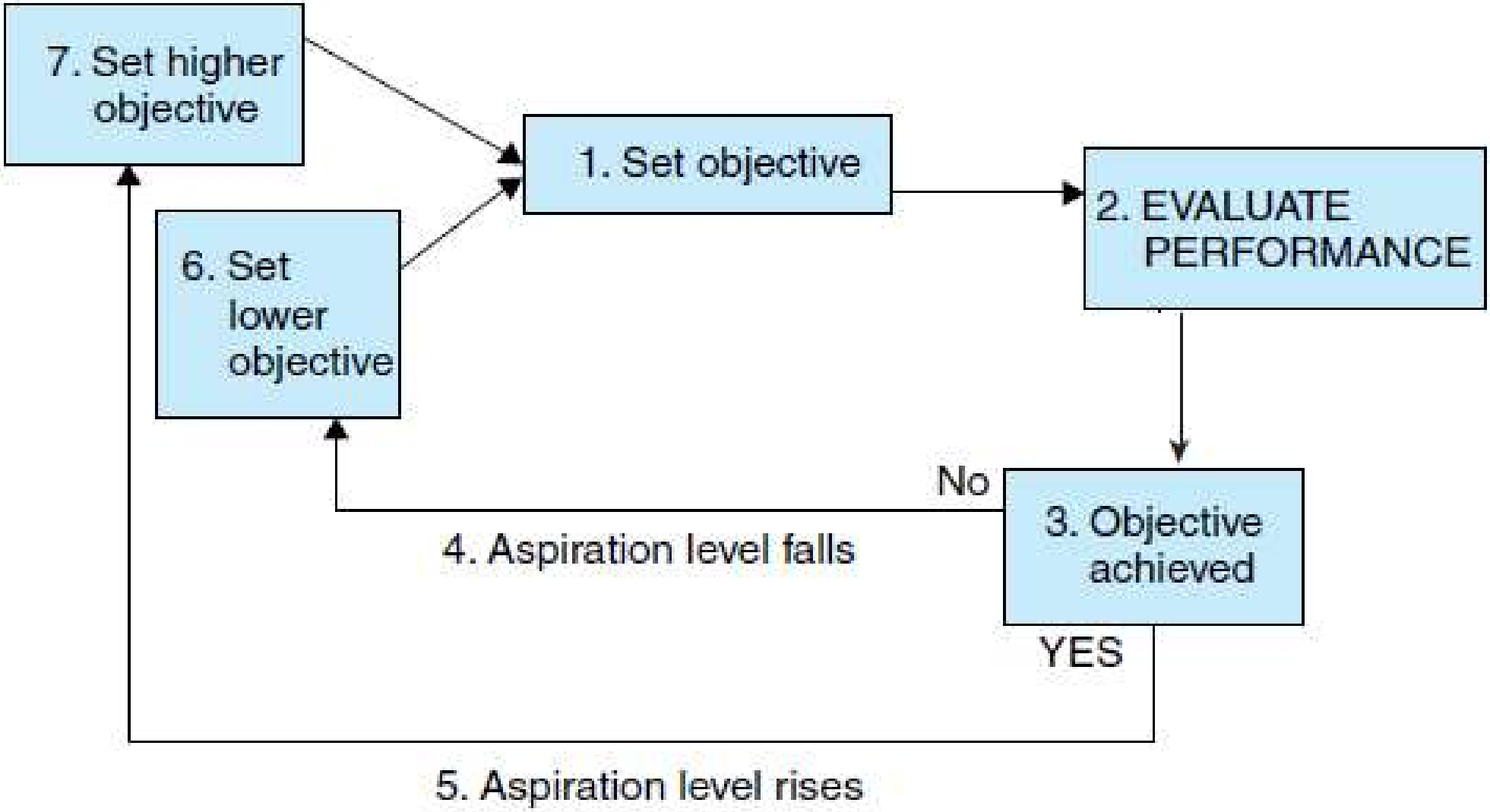
Multiplicity of objectives

4.1 Simon (1959): Satisficing

- Satisfactory rate of profit and survival
- Iterative process of setting ob.
- In LR → profit-max

4. Behavioral models

4.1 Simon (1959): Satisficing



4. Behavioral models

4.2 Cyert and March (1963):

- Firms as a collection of interest groups
- ***Different goals***: production, stock, sales, market share, profit
- ***How to resolve the dif?*** *Payment of money / policy commitments*

4. Comments about B.M.

- ***Advantages:***
  - Realistic decision-making
  - Firm as an actual organization
- ***Disadvantages:***
  - No consideration of reaction to external environment (& other firms)

5. Corporate social responsibility

5.1 Definition

Moir (2001): CSR can be defined as the extent to which individual firms serve **social needs** other than those of the owners and managers, even if this conflicts with the maximization of profits

5. Corporate social responsibility

Why to be needed?

+ LR self-interest of the firms: socially responsible & additional revenue and profits (em. studies)?

+ Stakeholders → minimize the risks to reputation and profitability

+ Regulation