

Economics of business case questions

Chapter 2

P22 Mission and objectives

- **What do you think the mission of Amazon might be?**
To be the most customer centric business in the world.

- **Why do you think Amazon has set an objective of growth?**
 - a. to benefit from more market power
 - b. to establish itself as a global business in many markets
 - c. to enable it to benefit from economies of scale.

- **How might this objective affect its decisions within the business?**
 - it may affect investment decisions
 - it may affect how much is paid as dividends v how much is retained
 - it may affect the time horizon when making decisions – it may be happy with long term returns.

P23 Question

Do you think Google should take more responsibility for content on the internet?

Increasing pressure for it to do so; however, there may be difficulties agreeing who decides what is and what is not allowed. Google wants to avoid making those decisions and wants to be careful how much it is filtering what we see.

P24 Doing the business maths

1. **At which output is revenue maximized?**
50 units
2. **At which output are costs the lowest?**
10 units
3. **At which output is profit maximized?**
50 units; £500

2.1 Quick check

P25 For each of the following statements, say whether it is true or false.

A business objective should be:

- Specific. TRUE
- Measurable. TRUE
- Ambiguous. FALSE
- Reductionist. FALSE
- tentative FALSE

P27 Analysing the business data: Tesco plc

The table shows Tesco's return on capital employed over an eight-year period.

Comment on Tesco's ROCE.

Source: FAME; www.tescopl.com/investors/

Year Return on capital employed

2017	0.55%
2016	0.67%
2015	-26.13%
2014	7.85%
2013	6.29%
2012	12.05%
2011	11.99%

- Low returns are being generated. In 2015 there are negative returns which means a loss was being made. Overall profitability is much lower than it used to be in 2011 and 2012. This may suggest more competitive conditions and/or less successful strategy.

P27 Business insight

Questions

1. What do you think managers need to consider when deciding how much to pay as dividends?

Answers may include:

- Long term plans
- Cost of external funds v cost of using internal funds
- Returns from share price changes
- Returns available elsewhere
- Expectations of investors.

2. Why would managers borrow money to pay dividends?

Answers may include:

- Because of need to reward owners and maintain share price

P29 Doing the business maths

Questions

1. What is the overall effect on profits of allocating over 2 or 5 years?

- Total costs of the equipment is $£50000 - £10000 = £40,000$
- The overall effect on profits is the same; overall costs will be £40,000 and profits will be reduced by this.

2. What is the impact on profits in (a) Year 1 and (b) Year 5 of the two different methods?

- Over two years this costs £20,000 a year, so profit would be reduced by this much in year 1 and 2. There would be 0 costs in year 3, 4 and 5.
- Over five years this costs £10,000 a year, so profit would be reduced by this much in year 1, 2, 3, 4 and 5.

P31 Quick check Question

How many units should be produced? Why?

- Up to 3 units the marginal revenue is greater than the marginal costs and so they should be produced.
- At 3 units marginal revenue equals marginal costs so there is not extra profit on this unit; profits are maximised here.
- After 3 units the marginal revenue is less than the marginal costs and so they should not be produced.

P34

Quick check questions

For each of the following statements, say whether it is true or false.

- a. If revenue increases, profits must increase. FALSE (depends on costs)
- b. Maximum profit occurs when revenue is maximized. FALSE (depends on costs)
- c. Higher profits mean higher returns on investment. FALSE (not necessarily; it depends on how much has been invested)
- d. Profits are maximized when there is the biggest difference between marginal revenue and marginal cost. FALSE (it is the biggest positive difference between total revenue and total cost and occurs when marginal revenue equals marginal cost)
- e. Maximum revenue occurs when total revenue is zero. FALSE

P36 Business Insight

Question

John Lewis is owned by its employees. How might this affect the objectives it sets and the decisions taken by its managers?

May be more employed focused e.g. better terms and conditions, more involvement in decision making, more focus on training and development

P37 Business Insight

Question

How might the fact that Nationwide is a mutual (?) lead to different decisions compared to decisions made by a bank (owned by shareholders)?

May be better returns for savers; may be greater regard to benefits for savers rather than looking to reward “outside” investors; may be better information and greater transparency for (whom?)

P38 Business Insight

Question

Do you think all businesses should produce an environmental profit and loss statement?

May depend on

- Ease of doing this
- Costs of doing it

- How information is used
- Pressure from employees, investors, customers.

P38 Quick check

For each of the following statements, say whether it is true or false.

- Satisficing occurs when different stakeholder groups are satisfied. TRUE
- CSR acknowledges that business may have social objectives. TRUE
- Achieving growth does not necessarily mean achieving maximum profits. TRUE
- Profits are measured by total revenue minus total costs. TRUE

P39 Business Insight

Questions

- 1. Do you think companies should be responsible for how their customers use their products?**

It depends on your view of the responsibilities of business, the role of the law and the extent to which businesses should do more than the law requires.

- 2. If you were running Apple would you try and limit the amount of time young people use your smartphone?**

Business case

May do for moral reasons; may do it for public relations reasons; may do it to prevent legislation coming in that might be very restrictive.

P40 Quick end of chapter questions

- 1. What is the difference between a mission and an objective?**

A mission is the overall purpose of the business; the objectives is a specific target

- 2. What is the value to a business of setting objectives?**

Helps coordinate actions; helps motivate; helps prioritise

- 3. How is profit measured?**

Profit = total revenue – total costs

- 4. Why is profit a common objective of a business?**

Profits are a financial measure of success; it shows the value of output in financial terms is greater than the value of inputs used up to generate the revenue.

- 5. What is meant by corporate social responsibility?**

Occurs when managers accept responsibilities to society over and above their legal responsibilities.

- 6. Why is maximizing revenue different from maximizing profit?**

It does not take account of costs.

- 7. Why might achieving growth be different from maximizing profit?**

It generally measures sales growth not revenue minus costs

- 8. What is meant by satisficing?**

Meeting the different demands of various groups within the organization. It means managers may not maximise anything (e.g profits or sales) but will aim to satisfy these different groups

- 9. What is the difference between marginal revenue and total revenue?**

Marginal revenue is the extra revenue from selling an extra unit; total revenue is the total value of the sales.

10. What is meant by a return on investment?

This measures profits relative to the investment made.