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A Gateway to All Post Grad

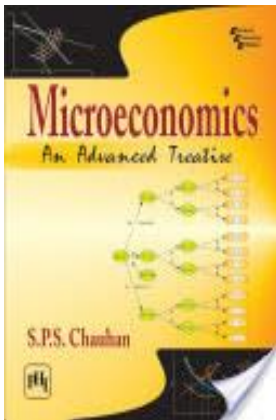
ECONOMICS
Paper 3: Fundamentals of Microeconomic Theory
Module 30: Baumol Sales Maximization Model

Weblinks

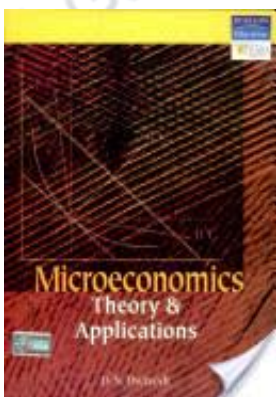
- ❑ <http://www.yourarticlelibrary.com/oligopoly-market/sales-maximisation-model-of-oligopoly-explained/37346/>
- ❑ <http://www.slideshare.net/jkpayal/theory-of-firm-33138648>
- ❑ http://mpra.ub.uni-muenchen.de/9877/1/MPRA_paper_9877.pdf
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Suggested Readings

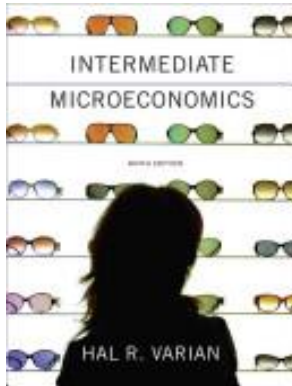
- ❑ Chauhan S.P.S, “Microeconomics: An Advanced Treatise (2009)”, Eastern Economy edition, PHI Learning Pvt. Ltd



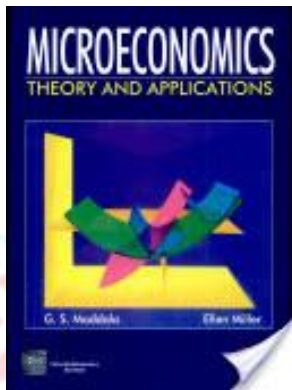
- ❑ Dwivedi .D.N, “Microeconomics: Theory And Applications (2002)”, Pearson Education India



- ❑ Varian. R. Hal, “Intermediate Microeconomics: A Modern Approach (Ninth Edition), 2014”, W. W. Norton



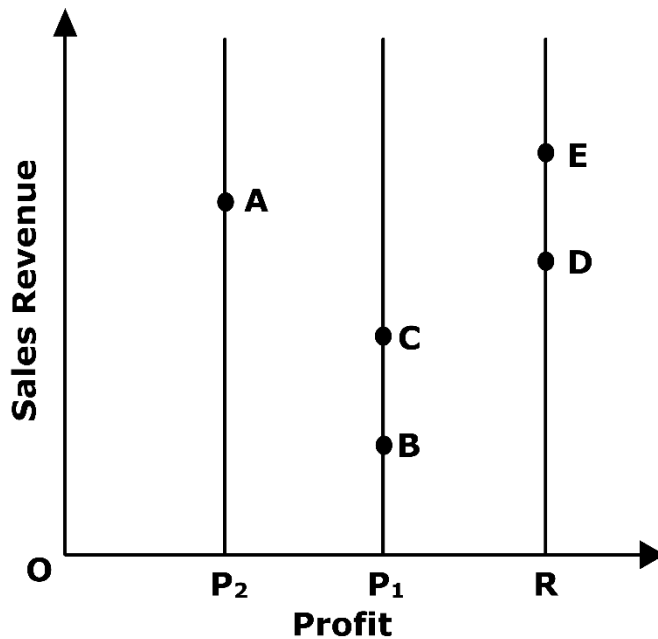
- ❑ Maddala, “Microeconomics: Theory And Applications (2004)”, Tata McGraw-Hill Education,



Baumol's Sales Maximisation Model
Criticisms:

Baumol's sales maximisation model is not free from certain weaknesses.

1. Rosenberg has criticised the use of the profit constant for sales maximisation by Baumol. Rosenberg has shown that it is difficult to specify exactly the relevant profit constraint for a firm. This is explained in Figure. Sales revenue of the firm is measured along the vertical axis and profit on the horizontal axis. R refers to the profit constraint.



For any two combinations with profits below the constraint, the one with the larger profit will be preferred. For instance, B on the profit level P_1 is preferred to A at the profit level P_2 since the line P_1 represents a higher level of profit. Again, of the two combinations B and C lying on the same profit line P_1 , the one with higher sales will be preferred, i.e., C will be preferred to B. Similar is the case with points D and E on the constraint line R where E with higher sales will be preferred to D. Thus it is very difficult to choose the sales maximisation and minimum profit constraint in Baumol's model. Further, so long as profits exceed the constraint, they will always be converted into advertising to increase sales.

2. According to Shepherd, under oligopoly a firm faces a kinked demand curve and if the kink is large enough, total revenue and profits would be the maximum at the same level of output. So both the sales maximiser and the profit maximiser would not be producing different levels of output.

But Hawkins has shown that if the firm is engaged in any form of non-price competition such as good packaging, free service, advertising, etc.. Shepherd's conclusions become invalid. When the sales maximiser spends more on advertising, his output will be more than that of the profit maximiser. This is because the kink of the former's demand curve

will occur to the right of the kink of the profit maximiser.

3. Hawkins has also shown that Baumol's conclusion that a sales-maximiser will in general produce and advertise more than a profit-maximiser, is invalid. According to Hawkins, a sales-maximiser "may choose a higher, lower or identical output—and a higher, lower or identical advertising budget. It depends on the responsiveness of demand to advertising rather than price cuts. This conclusion holds for firms producing only one product, or one group of products."

4. In the case of multiproducts, Baumol has argued that revenue and profit maximisation yield the same results. But Williamson has shown that sales maximisation yields different results from profit maximisation.

5. Another weakness of this model is that it ignores the interdependence of the prices of oligopolistic firms.

6. The model fails to explain "observed market situations in which price are kept for considerable time periods in the range of inelastic demand."

7. The model ignores not only actual competition, but also the threat of potential competition from rival oligopolistic firms.


8. The model does not show how equilibrium in an industry, in which all firms are sales maximisers, will be attained. Baumol does not establish the relationship between the firm and industry.

9. Prof. Hall in his analysis of 500 firms came to the conclusion that firms do not operate in accordance with the objective of sales maximisation.

Despite these criticisms, there is no denying the fact that sales maximisation forms an important goal of firms in the present day business world.

Source: <http://www.yourarticlelibrary.com/economics/baumols-sales-or-revenue-maximisation-theory-assumptions-explanation-and-criticisms/28983/>

Biographic Sketch

Description	Image
<p>William Jack Baumol (born February 26, 1922) is an American economist. He is a professor of economics at New York University, Academic Director of the Berkley Center for Entrepreneurship and Innovation, and Professor Emeritus at Princeton University. A prolific author of more than eighty books and several hundred journal articles, Baumol has written extensively about labor market and other economic factors that affect the economy. He also made significant contributions to the theory of entrepreneurship and the history of economic thought. He is among the most influential economists in the world according to IDEAS/RePEc. He was elected a Fellow of the American Academy of Arts and Sciences in 1971. He was considered a candidate for the Nobel Prize in Economics for 2003, and Thompson Reuters predicted that he would win in 2014.</p>	
<p>Source: https://en.wikipedia.org/wiki/William_Baumol</p>	