# Value maximization and Profit maximization of a Firm

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**Abstracts**

*The primary objective or goal of the firm is to maximize value of the firm, that is, shareholders wealth. Since in a corporate form of business it is the shareholders who are the owner of the firm, value of a firm represent shareholders wealth. Thus value maximization of a firm implies maximization of shareholders wealth.*

*Actually value maximization is not a vision or a strategy or even a purpose, it is the scorecard of the organization.*

***Key words: Profit Maximization, Value Maximization, Profit Margin, Shareholders Wealth, Market Demand***

## INTRODUCTION

As the primary objective of the firm is to maximize the profit maximization and it is a short term objective. Maximization of profit leads the long term objective of the firm and that is value maximization. Actually profit maximization is a traditional approach and value maximization is almost universally accepted and appropriate goal of the firm. Value maximization ensures fair return to the shareholders, reserve fund for growth and expansion, promoting financial discipline in the management.

## Objectives of the study

- To know how to maximize the shareholders equity.
- To know how to maximize the value of shares.
- To know how to maximize value of the firms.
- To know how to minimize the operating cost of the business.

## Research objectives and methodology

The research methodology used in studying the various reports and data. The research involves studying secondary data through internet, books and magazines.

## Profit maximization- a case study

Starbucks raised the price of beverage by an average 1% across the U.S. As per Starbucks the price increase was due to increase of labor cost and non Coffee commodity expenses, but with the significantly lower coffee cost already improved their profit margins.

In addition, the price hike was applied to less than a third of their breverages and only targets certain region. As a result Starbucks achieved by average 11% operating profit increase due to 1% rise of beverage prices.

Starbucks used the theory of-

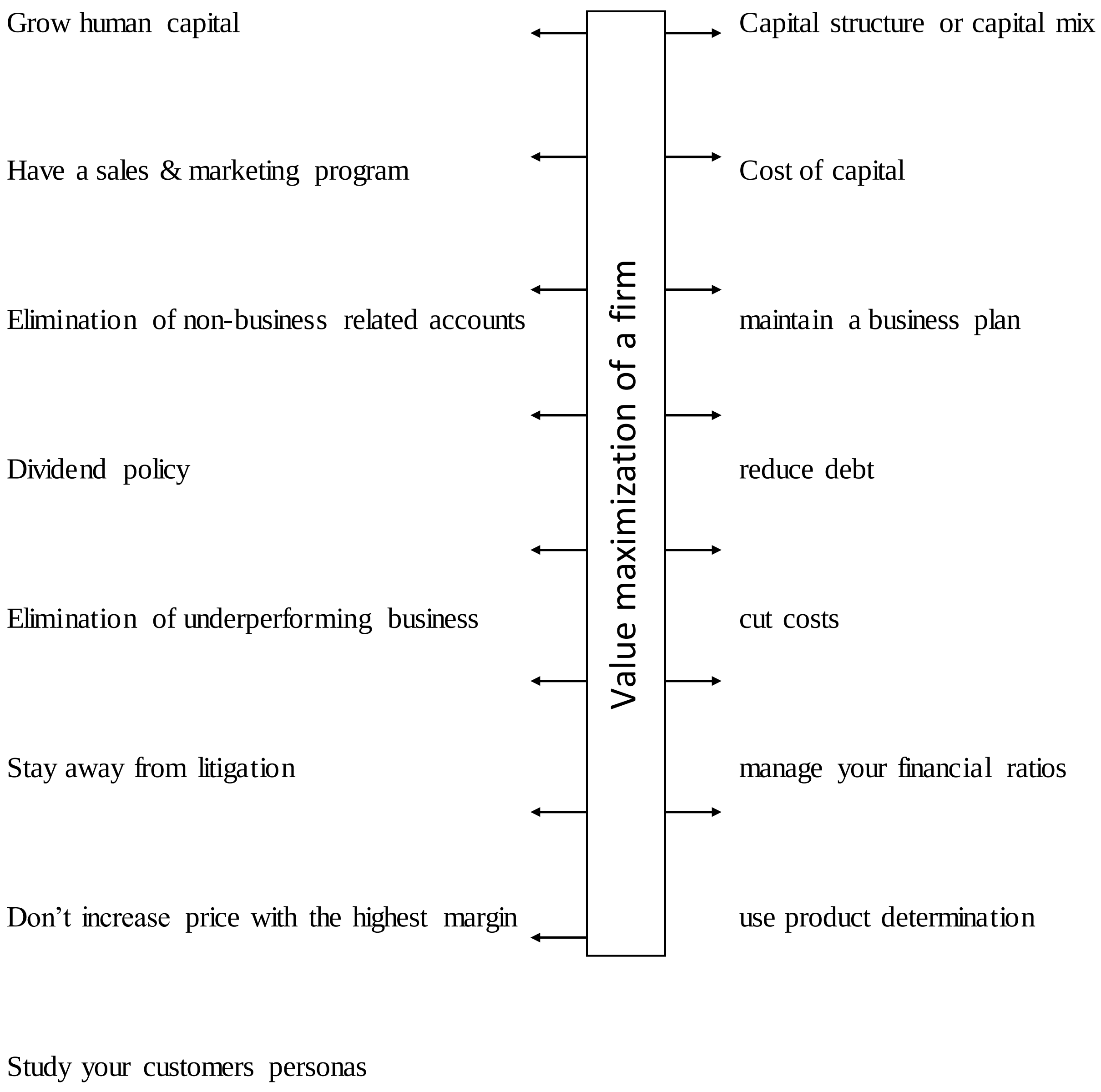
1. The right customers and the right market and
2. Product versioning and price communication.

In Statbucks case price increase have already deterred the most price sensitive customers, leaving a loyal, higher income consumer base that perceives these coffee beverages as an affordable luxury.

Starbucks used price hikes to separate itself from the back and reinforce the premium image of their brand and products. As their loyal customers are not are not especially price sensitive, Starbucks coffee maintains a inelastic demand curve and a small price increase can have a huge change positive impact on their margins without decrease demand of product.

Starbucks also strategically communicated their price increases to manipulate consumer's perception. The price hike might be based on analysis of the customers willingness tom pay.

**Value Maximization tools**


Value maximization of a firm
Grow human capital
Have a sales & marketing program
Elimination of non-business related accounts
Dividend policy
Elimination of underperforming business
Stay away from litigation
Don’t increase price with the highest margin
Study your customers personas
Capital structure or capital mix
Cost of capital
maintain a business plan
reduce debt
cut costs
manage your financial ratios
use product determination

**How to maximize the Profit and value of the firms**

- At the time of capital structure planning, the interest of the ordinary shareholders is given due weightage. This is done keeping in mind the objective to maximize the market price of equity shares. The finance manager should plan the capital structure in such a way which maximizes the value of the firm.

- Bringing skilled labour or to retain skilled labour or to train them is important. Good working environment, salary structure etc. are the important factors to retain skilled labor. Elimination of key person dependencies risky. Strategic plan is required and it will take time. But key person dependency maximizes risk, which minimizes value of the firm.

- The cost of capital obtained from different sources refers to the payment that has to make to the suppliers of capital. This payment includes dividend payment to the equity shareholders, interest payment for debt capital etc.

  K0=KeW1+Krw2+KpW3+KdW4

  K0=Overall cost of capital

  Ke=Cost of equity capital.

  Kr=Cost of retained earnings.

  Kp=Cost of preference shares.

  Kd=After cost of debt.

  W=Proportion of each capital on total capital.

  So, K0 is to be minimized to maximize the value of the firm or to maximize the equity shareholders interest.

- Have a plan to develop branding and recognition, name recognition is very important in the industry to maximize profit. Making new plans to make new business should be a continuous process with the existing business. New marketing a sales plan may open new opportunity. With the rapid changes new product, design is to be taken into consideration to maximize organization goal.

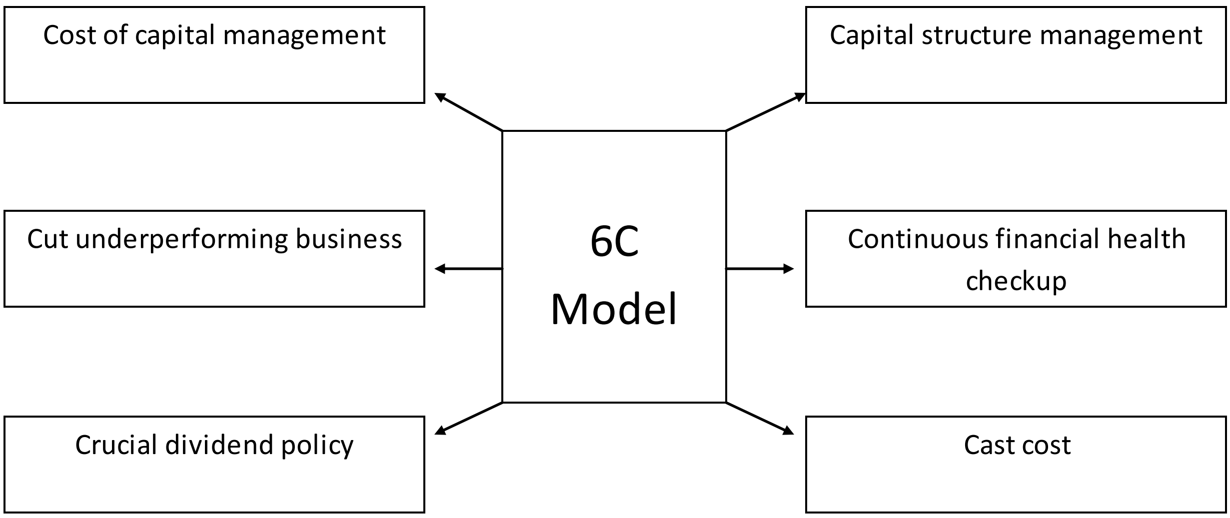
- Dividend is the share of profit which goes to the credit of shareholders after paying others obligations. A firm has to choose between distributing profit to the shareholders and ploughing them back in to the business. Main objective of dividend policy is to distribute dividend in such a way which will maximize value of the firm or value of the equity shares.

- Having strategic plan with skilled and experienced employees is important to identify the areas where cost can be minimized, it has been seen that in case of many business unused warehouse cost, unproductive machine cost are responsible to minimize the value of the firm. These areas are to b identified and examined by such experienced team.

- Reduction of debt is another important factor to maximize value of the firm. Debt has to eventually be repaid, however, and maturity could hit during an economic downturn when sales are down and the ability to issue new debt to replace the old issues becomes nearly impossible. Less debt allows a firm the opportunity to better control its destiny and this can really increase in value during downturn.

- Financial health check up should be a continuous process of the business. Time to time checking various ratios, like, current ratio, working capital ratio; stock turnover ratio, Net profit ratio etc are to be evaluated. Analyses of cash flow statement, inventory system are also important for consideration for health check up.

**The above discussion may be summarized in a model, called C6 model:-**




**Conclusion**

It is to be kept in mind that profit maximization is a short term objective whereas value maximization is long term objective. Profit maximization assures the growth of capital, but it neglects risk and uncertainty of the organization can pass-through in the future. Other hand market value of the firm is based on many factors, like sales, quality of products; profit .Value maximization considers both risk and uncertainty. These mean that long-term goal recognize time value of money, accelerating the growth rate of the enterprise and aiming to attain maximum market share of the economy.

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