

Sample Exam Paper

Question 1

The recession phase of the trade cycle

- A. Is often caused by excessive consumer expenditure.
- B. Is normally characterised by accelerating inflation.
- C. Is most prolonged when the country has high levels of imports.
- D. Is usually caused by falling aggregate monetary demand.

Question 2

Supply side policy is designed to

- A. Raise the level of aggregate monetary demand in the economy.
- B. Manage the money supply in the economy.
- C. Improve the ability of the economy to produce goods and services.
- D. Reduce unemployment by limiting the supply of labour.

Question 3

The effects of low real interest rates include all of the following **EXCEPT which ONE?**

- A. Credit-based sales will tend to be high.
- B. Nominal costs of borrowing will always be low.
- C. Business activity will tend to increase.
- D. Investment will be encouraged.

Question 4

In the circular flow model of the economy, the level of national income will always reach equilibrium because:

- A. Injections and withdrawals are always equal.
- B. Withdrawals are a function of the level of income.
- C. Governments will change taxes and expenditure to ensure equilibrium.
- D. Expenditure equals income.

Question 5

All of the following government policies would tend to raise national income over time **EXCEPT which ONE?**

- A. Increased expenditure on the economic infrastructure.
- B. Tax cuts to encourage higher demand from consumers.
- C. Policies to encourage the training of labour.
- D. Financial incentives to encourage personal and corporate saving.

Question 6

Which **ONE** of the following would lead to a fall in the value of the multiplier?

- A. A decrease in the marginal propensity to consume.
- B. A fall in the level of public expenditure.
- C. Consumers saving a lower proportion of their income.
- D. A decrease in the marginal propensity to import.

Question 7

Which **ONE** of the following would lead a country's balance of payments current account to move towards a surplus?

- A. A rise in commodity imports.
- B. An inflow of foreign capital into the economy.
- C. An increase in foreign tourism into the country.
- D. An increase in government tax receipts.

Question 8

All of the following are benefits for a business from depreciation (reduction) in the rate of exchange for the country's currency **EXCEPT which ONE**?

- A. The business could charge lower prices for its exports.
- B. Imported raw materials used by the business would be cheaper.
- C. The business could raise profit margins on exports without losing sales.
- D. In its home market, the business would face reduced competition from imports.

Question 9

A slowdown in economic growth in the US would be transmitted to the rest of the world by all **EXCEPT which ONE** of the following processes?

- A. A fall in US interest rates.
- B. A fall in the US demand for imports.
- C. A decline in the level of US capital flows to the rest of the world.
- D. Falling US stock market prices leading to similar falls in other countries.

Question 10

The balance of payments accounts are defined as:

- A. The difference between the government's receipts and its expenditure over the period of a year.
- B. The difference between the exports of goods and services and imports of goods and services over the period of a year.
- C. The surplus or deficit on a country's international trade over a given period.
- D. A statement of the economic transactions between residents of a country and the rest of the world over a given period.

Question 11

All of the following are disadvantages of inflation **EXCEPT which ONE?**

- A. It redistributes wealth from debtors to creditors.
- B. It reduces international competitiveness.
- C. Market price signals are distorted.
- D. Fixed income earners experience a fall in real income.

Question 12

An expansionary fiscal policy would be most likely to reduce unemployment if the country had:

- A. A high marginal propensity to import
- B. A low marginal propensity to save.
- C. A high marginal tax rate.
- D. A low marginal propensity to consume.

Question 13

If a country were to join a free trade area, its business sector would gain because:

- A. It could get tariff-free raw materials from countries inside the free trade area.
- B. There would be exchange rate stability between the member countries.
- C. Prices of competitors from countries not in the free trade area would rise.
- D. There would be fewer barriers to establishing subsidiaries in other countries in the free trade area.

Question 14

All of the following are reasons for trans-national companies locating production of a good in more than one country except one. Which **ONE** is the EXCEPTION?

- A. The existence of trade barriers.
- B. Significant transport costs.
- C. Economies of scale in production.
- D. Differences in demand conditions between countries.

Question 15

All of the following are characteristics of a common market **EXCEPT which ONE?**

- A. Free trade in goods and services among member states.
- B. Common levels of direct taxation.
- C. Free movement of factors of production between member states.
- D. A common external tariff.

Question 16

All of the following are features of globalisation **EXCEPT which ONE?**

- A. Rising trade ratios for countries.
- B. Increased international capital flows.
- C. Improved terms of trade for all countries.
- D. Reduced barriers to international factor movements.

Question 17

The process of globalisation leads to all of the following **EXCEPT which ONE?**

- A. Increasing foreign competition in domestic markets.
- B. Decreasing interdependence of national economies.
- C. Greater international division of labour.
- D. Rising levels of international trade relative to national income.

Question 18

Multinational companies locate production in more than one country for all of the following reasons **EXCEPT which ONE?**

- A. The existence of trade barriers.
- B. High transport costs.
- C. Capital is internationally immobile.
- D. To increase market share.

Question 19

Which of the following is the most appropriate for indicating long term shareholder wealth?

- A. Net present value
- B. Rate of return on capital
- C. Earnings per share
- D. Profit

Question 20

Which of the following groups are stakeholders in a business organisation?

- (i) Employees
 - (ii) Shareholders
 - (iii) Management
 - (iv) Customer's
 - (v) Suppliers
- A. (i), (ii) and (iii) only
 - B. (i), (ii), (iii) and (iv) only
 - C. (ii) only
 - D. All of them

Question 21

Which of the following issues are true of objectives in non-for-profit organisations?

- (i) Conflict between the goals of different stakeholders
 - (ii) A complex set of objectives
 - (iii) Difficulty in setting measures for their performance
 - (iv) Those that benefit from the good or service offered may not pay for it
- A. (i), (ii) and (iii) only
B. (ii), (iii) and (iv) only
C. (i), (iii) and (iv) only
D. All of them

Question 22

Not-for-profit organisations have all the following features except one, which **ONE** is the EXCEPTION?

- A. They need to be efficiently run
B. They often have a range of organisation objectives
C. Their primary aim is to make financial surpluses
D. They have more than one group of stakeholders

Question 23

All but one of the following are characteristics of all organisations. Which **ONE** is the not a characteristic of all organisations?

- A. The pursuit of objectives
B. The need to measure performance
C. They need to compete with other organisations
D. They have a range of stakeholders

Question 24

X plc has 1 million shares issued. It has an EPS figure of \$0.10. X is planning a new investment project which is expected to raise profits after tax by \$50,000. This project will be financed by an issue of an additional 250,000 shares. After the project is completed, the new EPS will be:

- A. \$0.2
B. \$0.12
C. \$0.08
D. \$0.15

Question 25

Which of the following might lead to a rise in earnings per share for a company?

- A. A rise in corporate tax

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- B. An issue of new shares
- C. A fall in its rate of return on capital employed
- D. A fall interest rates

Question 26

Which of the following are reasons why future income is usually valued less than current income?

- (i) Inflation may reduce the value of future income
 - (ii) Future income flows are riskier than current flows
 - (iii) The lender must delay the pleasure from the consumption that the money could buy now
 - (iv) Higher interest rates
- A. (i) and (ii) only
 - B. (i) and (iii) only
 - C. (ii), (iii) and (iv) only
 - D. (i), (ii) and (iii) only

Question 27

If, in the long run, a business doubles all the inputs it uses, but total physical output less than doubles, the business is experiencing:

- A. Diminishing returns.
- B. Decreasing returns to scale.
- C. Price elasticity of demand of less than 1
- D. Market saturation

Question 28

The minimum condition for a business to continue to operate in the short run is that:

- A. Its revenue is sufficient to cover variable costs.
- B. Its revenue is at least equal to its total costs.
- C. Its marginal revenue is equal to its marginal cost.
- D. It is making normal profits.

Question 29

All of the following are internal economies of scale for a firm **EXCEPT** which **ONE**?

- A. The firm is able to reduce administration costs per unit of output when it opens a second production plant.
- B. The firm can buy raw materials from other firms at lower prices when it buys in bulk.
- C. TV advertising costs can be spread over a larger output.
- D. Training costs are reduced when the firm can draw on the development of pool of skilled labour in the region due to colleges setting up training courses for the industry.

Question 30

In order to remain in business in the short run, a firm's revenue must be sufficient to cover:

- A. Its fixed costs
- B. Its variable costs
- C. Its total costs
- D. Its total costs minus normal profit

Question 31

The initial fall for a business in the short run average cost per unit of its output is the result of:

- A. Diminishing returns to a fixed factor
- B. Diseconomies of scale
- C. The spreading of fixed cost over a larger output
- D. A fall in total variable costs

Question 32

The profit-maximising output will always be where:

- A. Average cost = marginal revenue.
- B. Marginal cost = marginal revenue.
- C. Average cost = average revenue.
- D. Marginal cost = average revenue.

Question 33

A business has the following costs:

Output	Fixed Cost	Total variable cost
10	\$100	\$150
11	\$100	\$164
12	\$100	\$176

The average cost of production for output 11 is \$_____

Question 34

The breakeven output for a firm will be where:

- A. Average cost is equal to average revenue
- B. Average cost is at a minimum
- C. Average revenue starts to fall
- D. Average cost starts to rise

Question 35

The profit maximising level of output for a business is where:

- A. Average costs are lowest
- B. The difference between total cost and total revenue is greatest
- C. Where average revenue is highest
- D. Where average revenue is equal to average cost

Question 36

The optimum level of output for a business is where:

- A. Profits are maximised
- B. Revenue is maximised
- C. Marginal cost is minimised
- D. Average cost is minimised

Question 37

All of the following are example of the sources of internal economies of scale for a business except one. Which **ONE** is the EXCEPTION?

- A. Lower external financing costs for a larger firm
- B. Greater specialisation of tasks in its labour force
- C. Lower supply costs resulting from its bulk buying
- D. Lower production costs resulting from long run technical change in the economy

Question 38

Which **ONE** of the following will tend to make the demand for a company's product LESS price elastic?

- A. A fall in consumer incomes.
- B. A rise in the price of complementary goods.
- C. A fall in the number of substitute goods.
- D. A lower price for the good.

Question 39

In a market economy, prices perform all of the following functions **EXCEPT which ONE?**

- A. A means of allocating resources between competing uses.
- B. A means of ensuring a fair distribution of incomes.
- C. A signal to consumers.
- D. A signal to producers.

Question 40

Which **ONE** of the following will produce the largest fluctuations in a market price?

- A. Large shifts in supply with price elastic demand.

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- B. Large shifts in supply with price inelastic demand.
- C. Large shifts in supply with perfectly price elastic demand.
- D. Small shifts in supply with price elastic demand.

Question 41

If the demand curves for Good A shifts to the left when the price of Good B rises, we may conclude that:

- A. The goods are substitutes.
- B. Good A is an inferior good.
- C. The goods are complements.
- D. The demand for Good A is price elastic.

Question 42

Which **ONE** of the following would lead the demand curve for a good to shift to the right?

- A. A rise in consumer income where the good is a normal good.
- B. A decrease in the supply of a complementary good.
- C. An increase in the supply of a substitute good.
- D. A fall in the price of the good.

Question 43

If a business currently sells 10,000 units of its product each month at \$10 each unit and the demand for its product has a price elasticity of -2.5, a rise in the price of the product to \$11 will?

- A. Raise total revenue by \$7,250.
- B. Reduce total revenue by \$17,500.
- C. Reduce total revenue by \$25,000.
- D. Raise total revenue by \$37,500.

Question 44

If the government imposed a price for a good that was above the equilibrium price, the consequence would be:

- A. A contraction of demand, an increase in supply and a market surplus
- B. A decrease in demand, an extension of supply and a market surplus
- C. A contraction in demand, an extension in supply and a market surplus
- D. A rise in supply, a fall in demand and a market shortage

Question 45

If the government imposes a maximum price for a good that is below the equilibrium price, the resulting market shortage will be greatest when:

- A. The demand is price elastic and the supply is price inelastic
- B. The demand is price elastic and the supply is price elastic
- C. The demand is price inelastic and the supply is price elastic
- D. The demand is price inelastic and the supply is price inelastic

Question 46

All of the following would shift the supply curve for a product to the right except one. Which **ONE** is the EXCEPTION?

- A. A government subsidy
- B. An improvement in production techniques
- C. Lower input prices
- D. An indirect tax on the product

Question 47

If the production of a good involves an external social cost, the appropriate policy for the government is to:

- A. Take the industry into state ownership
- B. Impose an indirect tax on the good
- C. Impose a higher rate tax on the profits of the producers
- D. Provide a subsidy for the consumers of the product

Question 48

A government may prevent horizontal mergers in an industry because:

- A. By controlling sources of supply, the merged firms can prevent the entry of new firms into the industry
- B. There will be a lack of synergy between the merging companies
- C. The merged firms will be unable to reduce costs
- D. Consumers may suffer if the merged firm achieve market dominance

Question 49

Which **ONE** of the following statements is true?

- A. A legal maximum price for a good always results in a shortage of the good.
- B. A price fall for a good will lead to an increase in demand for that good.
- C. A price fall for a good will always lead to a contraction in supply of the good.
- D. An excess supply of a good arises when a legal minimum price is set below equilibrium price.

Question 50

Which **ONE** of the following does **NOT** restrict the number of firms in an industry?

- A. Low levels of product differentiation.
- B. Significant economies of scale.
- C. Barriers to entry.
- D. The use of capital-intensive technology in the industry.

Question 51

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Which **ONE** of the following is an example of an external social cost?

- A. Bad weather reducing the output of the farm sector.
- B. Possible illness caused to owners of mobile phones as a result of excessive use.
- C. Smoke emissions by a factory causing health problems for nearby residents.
- D. Cost increases caused by rising prices of imported raw materials.

Question 52

Which **ONE** of the following is **NOT** a potential source of market failure?

- A. External costs.
- B. External benefits.
- C. An unequal income distribution.
- D. The existence of monopolies.

Question 53

All of the following factors will lead to an imperfect allocation of resources EXCEPT which **ONE**?

- A. There are some production costs that are not borne by the producer.
- B. Consumers only wish to buy a limited amount of the product.
- C. There are spill over benefits in consumption.
- D. Consumers have limited knowledge of market prices.

Question 54

Whenever government intervention prevents prices from reaching their equilibrium level, the result will always include ALL of the following EXCEPT which **ONE**?

- A. Shortages or surpluses.
- B. Demand and supply not equal.
- C. Reduced profits for producers.
- D. Resources not allocated by price.

Question 55

The economic welfare case for governments increasing taxes on petrol to raise its real price is that:

- A. Oil is a scarce resource.
- B. It would reduce the imports of oil.
- C. There is a large demand for petrol.
- D. Petrol consumption involves external social costs.

Question 56

Which **ONE** of the following would tend to increase the degree of monopoly power of a company?

- A. The ending of one of its patents.

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- B. An increase in excess profits.
- C. A fall in the cross price elasticity of demand for its product.
- D. Diversification into a wider range of products.

Question 57

The main function of the money market is to:

- A. Enable businesses and government to obtain liquidity.
- B. Encourage saving.
- C. Permit the efficient buying and selling of shares.
- D. Deal in credit instruments of more than one year maturity.

Question 58

Which ONE of the following does NOT normally form part of the equity capital market?

- A. Central bank.
- B. Pension funds.
- C. Retail banks.
- D. Venture capitalists.

Question 59

All of the following statements about the monetary system are true EXCEPT which ONE?

- A. Financial intermediation links net savers and net debtors.
- B. In developed economies cash and notes form only a very small part of the money supply.
- C. The capital market deals in long term financial assets.
- D. The more liquid a financial asset is, the higher is the expected rate of return.

Question 60

In order to finance an excess of expenditure over taxation receipts, a government could:

- A. Reduce its current consumption expenditure
- B. Issue government bonds
- C. Raise direct taxes
- D. Run an overdraft on its account at the World Bank

Question 61

All the following are sources of a short run lack of financial synchronisation for a business except one. Which ONE is the EXCEPTION?

- A. The need for working capital
- B. Early receipt of payment of goods sold
- C. The financing of the purchase of new capital equipment
- D. A requirement to pay an element of end of year tax early

Question 62

Which one of the following is not usually a source of long-term finance?

- A. Bank overdrafts
- B. Debentures
- C. Preference shares
- D. Mortgages

Question 63

Equity finance in high risk enterprises is known as:

- A. Venture Capital
- B. Working Capital
- C. Debentures
- D. Gearing

Question 64

In their role as financial intermediaries, banks fulfil all of the following functions except one. Which **ONE** is the EXCEPTION?

- A. Provide a transactions mechanism
- B. Aggregation
- C. Financial synchronisation
- D. Maturity transformation

Question 65

A central bank has all of the following functions except one. Which **ONE** is the EXCEPTION?

- A. Acting as banker to the banks
- B. Providing very long term finance for investment
- C. Acting as banker to the government
- D. Lender of the last resort

Question 66

A bond has the following features:

Nominal Value \$1000
Coupon rate 4%
Current Market Value \$1250

The running yield on this bond is _____%

Question 67

The following data refer to X plc:

Issued shared 1m

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Current share price \$1.20
Dividend payment \$0.15 per share

The net dividend yield for X plc is _____%

Question 68

The main determinant of the cost of borrowing is:

- A. Maturity
- B. Base rate
- C. Size of loan
- D. Risk

Question 69

A commercial bank has the following data:

Required reserve assets ratio 12.5%
Additional cash deposit \$1000

Total bank deposits will ultimately rise by \$_____

Question 70

Which of the following is not provided by stock markets? A market for:

- A. Large transactions in foreign currencies
- B. Shares in publicly quoted companies
- C. Long term government bonds
- D. New share issues

Question 71

All the following contributed to the bank crisis of 2008/09 except one. Which **ONE** is the EXCEPTION?

- A. Problem in the US mortgage market
- B. The over use of credit default swaps
- C. Under regulation of the banking system by authorities
- D. Banks holding too much capital relative to their liabilities

Question 72

The forward exchange market is an example of:

- A. A perfect market
- B. Reinsurance
- C. A future market
- D. Underwriting

Question 73

All of the following would tend to raise the exchange rate (appreciate) for a country's currency except one. Which **ONE** is the EXCEPTION?

- A. A fall in the volume of imports
- B. A risen in foreign investment in the country
- C. A fall in domestic interest rates
- D. A rise in the country's invisible earnings

Question 74

Which one of the following is an advantage for a country adopting a flexible exchange rate system regime?

- A. It provides certainty for organisations engaged in international trade
- B. It eliminates transaction costs
- C. Monetary policy can be used to manage to exchange rate
- D. It reduces the need for central banks to keep reserves of foreign exchange

Question 75

Which one of the following is not a benefit to a country from joining a single currency area?

- A. Reduced transaction costs
- B. Lower interest rate
- C. Reduced exchange rate uncertainty
- D. Increased price transparency

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C04 – Answers

Question	Answer		Question	Answer
1	D		44	C
2	C		45	B
3	B		46	D
4	B		47	B
5	D		48	D
6	A		49	C
7	C		50	A
8	B		51	C
9	A		52	C
10	D		53	B
11	A		54	D
12	A		55	C
13	A		56	C
14	C		57	A
15	B		58	D
16	C		59	D
17	B		60	B
18	D		61	C
19	C		62	A
20	D		63	A
21	D		64	A
22	C		65	B
23	C		66	3.2%
24	B		67	12.5%
25	D		68	D
26	D		69	\$8,000
27	B		70	A
28	A		71	D
29	D		72	C
30	B		73	C
31	C		74	D
32	B		75	B
33	\$24			
34	A			
35	B			
36	A			
37	D			
38	C			
39	B			
40	B			
41	C			
42	A			
43	B			

C04 – Explanations

1. (answer: D) A general slowdown in economic activity is termed an economic recession. This is caused by fall in aggregate monetary demand $[C+I+G+ (X-M)]$. An economic recession indicated by:

 - low or negative growth of GDP
 - low business confidence, investment spending and reduced business profits
 - low household income and widespread drop in consumer spending (A cannot be correct)
 - falling inflation rate (option B cannot be correct)
 - increased bankruptcies and unemployment rates.
2. (answer: C) Supply side policy aimed at increasing the long term productive capacity of an economy. This is based on the macroeconomic argument that economic growth can be most effectively created by lowering barriers for people to produce (supply) goods and services, such as lowering income tax and capital gains tax rates, and by allowing greater flexibility by reducing regulation. As a result, consumers will benefit from a greater supply of goods and services at lower prices.
3. (answer: B) Real interest rate = Nominal interest rate – Rate of Inflation
Therefore, real interest rate will be low when nominal interest rate is high with high rate of inflation.
In times of low real interest rates, credit-based sales (option A) and the level investment (option D) tend to be higher due to low cost of borrowing. This in turn will enhance the general business activity in an economy (option C).
4. (answer: B) The circular flow of income and expenditure model describes the reciprocal circulation of income between inter-dependant entities of firms (producers) and households (consumers) in an economy. With government and international trade (four-sector model), injections into an economy are government spending (G), investments (I) and exports (X), whereas the withdrawals from economy are taxation (T), savings (S) and imports (M). National income will reach an equilibrium when $G + I + X = T + S + M$.
5. (answer: D) National income is the total value a country's final output of all new goods and services produced in one year. National income can be increased by enhancing the productive capacity (increase in long run aggregate supply - LRAS) and / or by increasing aggregate monetary demand (AMD). Better infrastructure such as transport, information technology etc (option A) and trained workforce (option C) will enhance the productive capacity of an economy, shifting the long run aggregate

supply curve outwards. Increased consumer expenditure (option B) will increase the level of AMD. With more savings (option D) there will be less consumption, thus the level of AMD will fall. $[AMD = C+I+G+ (X-M)]$.

6. (answer: A) According to Keynesian economic theory, any injection into the economy via investment capital (I), government spending (G) or exports (X) will result in a proportional increase in overall national income. Decrease in MPC (marginal propensity to consume) as in option A means, increase in the MPS (marginal propensity to save). According to the below formula, decrease in MPS will lead to a fall in the value of multiplier.

$$\text{Multiplier} = 1 / \text{MPS} + 1 / \text{MRT} + 1 / \text{MPM}$$

7. (answer: C) Balance of payments (BoP) current account records inflows and outflows of funds into / out of a given economy due to international trade of goods and services. If inflows exceed outflows, it will be in surplus. It will be in deficit if there is a net outflow. Increase in foreign tourism into the country (option C) will result in inflows of funds. Capital transactions between a given country and the rest of the world (option B) are recorded in the BoP capital account, hence no impact on the BoP current account. Government tax receipts (option D) is flow of funds within an economy, and hence no impact on BOP.
8. (answer B) Depreciation of a country's currency makes imports expensive in terms of domestic currency (options B and D). On the other hand, depreciation makes exports cheaper in foreign currency, thus businesses could raise price (increased profit margins) in domestic currencies but the price of the exports in foreign currency will remain unchanged (options A and C).
9. (answer A) slowdown in economic growth in US means that the US economy has entered into an economic recession, caused by fall in aggregate demand. Reduction in household income and consumer expenditure means demand for imports into the US falls (option B). Low level of business confidence during recession will reduce amount of US investments in other parts of the world (option C), and which in turn will reflect in the stock market prices in other countries (option D). Interest rates may be reduced (option A) in the US as a measure to help recovery.
10. (answer D) Refer explanation to Question 7.
11. (answer A) Inflation occurs when the general price level increase in an economy, and as a result the buying power of money declines. This means, borrowers / debtors

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benefit at the expense of lenders / creditors which is technically interpreted as 'redistribution of wealth from creditors to debtors (and not from debtors to creditors, as in option A).

12. (answer A) an expansionary fiscal policy involves reducing tax and / or increasing government expenses, in order to boost the level of aggregate demand. This will result in higher consumer expenditure and increased demand for goods and services. Demand for labour is derived from the demand for goods and services, but if the consumers tend to spend their increased income on imported goods and services, it will not create employment opportunities within the economy.
13. (answer A) A free-trade area is a trade bloc whose member countries have signed a free-trade agreement, which eliminates tariffs, import quotas and preferences on most (if not all) goods and services traded between them. Therefore, firms in a free-trade area will be able to import raw materials without paying tariff from the member countries (option A). Exchange rate stability occurs when two or more countries share a common currency or decides to peg their exchange rates (option B).
14. (answer C) Trans-national companies register in more than one country or have their operations in more than one country (e.g. design in Italy, produce in Sri Lanka, finance / IT in Philippines). The operations are spread in different countries for variety of reasons including options A, B and D. To obtain economies of scale in production (in order to reduce the long run average cost), firms need to expand the output, and need not necessarily operate from different countries.
15. (answer B) Free-trade area (refer Question 13) is also referred to as common market. The individual countries can decide on taxation independently.
16. (answer C) Terms of trade ToT) is the ratio of quantities of domestic goods that a country must give up to obtain a unit of imported goods. A rise in the prices of exports with the prices of imports unchanged indicates a rise in the terms of trade because it will now take fewer exports to purchase the same quantity of imports. However, globalisation will not lead to improvement in ToT for all trading partners.
17. (answer B) is the process of international integration arising from the interchange of products, ideas, world views and other aspects of national cultures. Therefore, globalisation will increase interdependence of national economies.

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18. (answer D) a company may continue to produce in the same country, but sell in more than country to increase its market share.
19. (answer C) An important aspect of EPS is that it ignores the capital required to generate the earnings (net income). Two companies could generate the same EPS, but one could do so with less equity (investment) - that company would be more efficient at using its capital to generate income and, all other things being equal would be a "better" company. Therefore, EPS is the most appropriate for assessing the long term wealth of shareholders.
20. (answer D) a stakeholder is a person or an organisation that has interest or concern in an organisation. Stakeholders can affect or be affected by the [organization's actions](#), [objectives](#) and [policies](#). Therefore, all of the listed parties are stakeholders of a typical business organisation.
21. (answer D) An organisation that exists for any reason (e.g. educational or charitable reasons) other than for profit where its owners or trustees do not benefit financially. Surplus revenues (if any) will be retained to achieve its goals.
22. (answer C) Refer Question 21.
23. (answer C) An organisation is a social entity that has a collective goal and is linked to the external environment. There are a variety of legal types of organizations, including public corporations, governments, non-government organisations, armed forces, charities, partnerships, limited and unlimited liability companies, cooperatives, universities etc, some of which need not / do not compete with other organisations (e.g. armed forces).
24. (answer B) $EPS = \text{Profit after tax and preference dividends} / \text{No. of equity share in issue}$.
 $0.01 \times 1,000,000 = \text{Original profit after tax} = 100,000$
 $\text{New EPS} = (100,000 + 50,000) / (1,000,000 + 250,000) = 0.12$
25. (answer D) $EPS = \text{Profit} / \text{Number of shares}$ (very basic formula). Therefore, reduced profit due to increase in corporation tax (option A) and issue of new shares (option B) will reduce the EPS. A fall in interest rate (option D) will increase the profit, increasing EPS.
26. (answer D) Future income isn't affected by the change of interest rate, although lower interest rate may lead to inflation as more people are able to borrow money and spend more. Higher interest rate, in contrast, is likely to reduce inflation and will not cause future income to worthless.

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27. (answer B) concept of returns to scale identifies a relationship between change in output as a response of change in input. Decreasing returns to scale occurs when output changes by a less proportion compared with change of input.
28. (answer A) in the short term, the price needs to cover at least average variable cost.
29. (answer D) Internal economies of scale occur when a firm expands its output and as a result the long run average cost falls, due to various reasons such as:
- fixed costs being shared amongst more output (option A and C);
 - bulk purchasing enables trade discounts (Option B).

External economies of scale occur when an industry expands so that all firms in the industry are benefitted with reduced long run average cost (option D).

30. (answer B) Refer Question 28.
31. (answer C) Short run is a time period that is long enough to change only variable inputs, and not fixed inputs. Therefore, in the short run, fixed costs remain unchanged. A larger output in the short term means that the fixed cost can be spread amongst larger output, hence short run average cost falls (despite, average variable cost is assumed remain intact)
32. (answer B) Profit maximising output (where $MR = MC$) of a firm is called the equilibrium of the firm. Up to equilibrium, $MR > MC$ and therefore with each additional output produced / sold, total profit increases. Beyond equilibrium, $MC > MR$ and as a result total profit will start falling with each additional output produced / sold. Therefore, for a firm to record the highest profit, it needs to produce an out where $MR = MC$.
33. (answer \$24)
- | | | |
|--|---|-------|
| Total cost of producing 11 units ($\$100 + \164) | = | \$264 |
| Average cost of producing 11 units ($\$264 \div 11$) | = | \$24 |
34. (answer A) For a firm to break even its total cost (TC) must equal to total revenue (TCR). Assuming that a firm sells all output it produces, its $TR = TC$, when average cost is same as average revenue (price).
35. (answer B) Profit = $TR - TC$ and therefore, highest profit will be recorded when the gap between TR and TC is the greatest.

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36. (answer A) All typical business organisations aim for highest possible profit. The optimal level of output is therefore the output that generates maximum profit.
37. (answer D) Refer Question 29.
38. (answer C) Price elasticity of demand refers to the level of responsiveness of quantity demanded to change in price of the same commodity. A product is said to be less price elastic (inelastic demand) when the demand change by a small proportion to a given change in price. When a product has less substitutes, consumers tend to buy almost the same quantity despite high prices (e.g. petrol)
39. (answer B) In a market economy, resources are allocated amongst competing uses based via market mechanism (interaction of demand and supply). The economic behaviour of both consumers and producers are influenced by price in a market economy (e.g. at high prices, consumers tend to demand less). One main weakness of market mechanism is that it leads to unfair allocation of income. For instance, only those who have marketable resources may produce and earn an income.
40. (answer B) Obviously, large shift in supply or demand create the largest price change, hence option D can be opted out. When demand is perfectly price elastic, any quantity is demanded at a given price, so option C can be opted out. For a given change in quantity demanded the largest price change can be expected when the demand is inelastic, hence option A can be opted out.
41. (answer C) leftward shift of demand curve for Good A corresponds to reduction in demand due any factor other than price of Good A (in this case, due to rise in price of Good B). An inverse relationship between price and quantity demanded can be seen for complementary goods (which are usually bought / used together)
42. (answer A) Rightward shift of the demand curve corresponds to increase in demand, due to any factor other than price of the same commodity. When consumer income rises, demand for normal goods increase, shown by rightward shift of demand curve.
43. (answer B) $PED = \frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}}$
 $- 2.5 = \frac{\% \text{ change in quantity demanded}}{+10\%}$

Therefore, % change in quantity demanded is $(-2.5 \times 10\%) -25\%$

New quantity demanded at \$11 is $(10,000 - 25\% \text{ of } 10,000)$ is 7,500 units

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Total revenue at the price of \$11	= \$82,500 (7,500 units @ \$11)
Total revenue at the price of \$10	= \$100,000 (10,000 units @ \$10)
Change in total revenue	= reduction of \$17,500 (from \$100,000 to \$82,500)

44. (answer C) At the equilibrium price quantity demanded = quantity supplied. Increase in price will contract demand and expand supply, leading to market surplus.
45. (answer B) Market shortage occurs when demand exceeds supply. For a given reduction in price, a greater proportionate expansion in demand and contraction of supply can be expected when the demand and supply is price elastic.
46. (answer D) Rightward shift of the supply curve corresponds to increase in supply, due to any factor other than price of the same commodity. An indirect tax on the product is shown by leftward shift of the supply curve due to increase in costs.
47. (answer B) An externality is a cost or benefit which results from an activity or transaction and which affects an otherwise uninvolved party who did not choose to incur that cost or benefit. An example for an external cost is air pollution caused by manufacturing activities, that impose health and clean-up costs on the whole society. An indirect tax imposed by the government will add to the costs of the producer, thereby reduction in activity is theoretically expected.
48. (answer D) Horizontal merger occurs when two (or more) firms in the same industry and at the same stage of production integrate (e.g. two car manufacturers). The merged firm will be able to exploit consumers due the size, so governments tend to discourage horizontal mergers.
49. (answer C) When the demand is perfectly elastic (horizontal demand curve), at a legal maximum price (lower than equilibrium price), demand = supply (option A, watch the word 'always'!). A fall in price will expand (not increase) the quantity demanded (option B). At a price below equilibrium price, there will be excess demand due to expansion of demand and contraction of supply (option D).
50. (answer A) Options B, C, D high level of product differentiation are examples of entry barriers which makes firms difficult to enter into a given market. #
51. (answer C) Refer Question 47.

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52. (answer C) Market failure is a concept within economic theory describing when the allocation of resources by market mechanism (demand and supply) is inefficient or imperfect. An unequal income distribution is a consequence (not a source) of market failure.
53. (answer B) Refer Question 52.
54. (answer D) Government interference sometimes enables producers to earn more profit. E.g. when the demand is inelastic, producers will earn a higher revenue / profit when a legal minimum price is introduced.
55. (answer C) Refer Question 47.
56. (answer C) Fall in cross price elasticity of demand means the low level of substitutability of the products, which gives a firm monopoly power. Ending of patents (option A) and diversification into wider product range (option D) will reduce monopoly power. Increase in excess profits (option B) is a consequence of monopoly power, and not a cause.
57. (answer A) Money market assists businesses and governments to raise short term capital in order to maintain the required level of liquidity.
58. (answer D) Central Bank is the banker to commercial banks, and banker to the government, and hence is not part of the equity capital market.
59. (answer D) Liquidity is the ability to convert assets into means of exchange without delay and loss of face value. Illiquid assets earn higher rate of return as compensation for the loss of liquidity. Therefore, there is an inverse relationship between level of liquidity and the rate of return.
60. (answer B) The key word to note in the question is 'finance' – an immediate measure to bridge the gap between tax receipts and government expenditure. Options A, C and D suggest medium or long term measures to address the problem.
61. (answer C) Financing capital equipment belongs to long term (not short term) financial management.
62. (answer A) Bank overdrafts are usually a tool to support short term lack of financial synchronisation.

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63. (answer A) Venture capitalist specialise in funding high risk business projects / enterprises, usually for a higher rate of return (e.g. high-tech business start ups)
64. (answer A) Financial intermediaries link surplus units (lenders / creditors) and deficit units (borrowers / debtors). Banks offer cheque books for current account holders as a safer / reliable means to engage in financial transactions. Aggregation (option B) is where banks accept deposits of varied amounts and lend in lump-sum. Financial synchronisation (option B) takes place when banks lend short term using depositors' money. Maturity transformation (option D) refers to banks accepting deposits for varied time periods and lends money for varied time periods.
65. (answer B) Central bank is the banker to the government (not the banker to commercial organisation).
66. (answer 3.2%) Running yield = annual interest/ current market value
Annual interest = nominal value x coupon rate = 1000 x 4% = 40
Running yield = 40/ 1250 = 3.2%
67. (answer 12.5%) Dividend yield = dividend per share / price per share = 0.15/ 1.20 = 12.5%
68. (answer D) Creditors lend money to those who have a likelihood of returning it at the end of agreed maturity period. However, debtors may face financial difficulties and may not repay. Further, inflation reduces the value of money (what money could buy) – all adds up to risk. Interest is charged to compensate this risk.
69. (answer \$8,000) The credit multiplier of the bank is $(1/ \text{cash retention ratio}) = 1/ 0.125$ 8 times. Therefore, the additional cash deposit of \$\$1,000 will finally rise by 8 times. This is called 'credit-creation' by banks that practice 'fractional reserve banking system where a fraction of the deposit (in this case 12.5%) is retained and the rest is advanced to borrowers with each new deposit it receives.
70. (answer A) Foreign Exchange markets deal with foreign currencies.
71. (answer D) If banks hold more capital than its liabilities, banks will be more financially stable. The 2008/09 banks crisis was in fact caused by banks not having enough capital relative to their liabilities.

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72. (answer C) In forward exchange markets, lenders (banks) and borrowers (businesses) contract to buy / sell foreign currency at a future date, at a pre-determined exchange rate.
73. (answer C) Exchange rate is determined by the market forces – demand for (by foreigners) and supply of (by residents) a given currency. Fall in domestic interest rate is expected to reduce the demand for the domestic currency due to low returns. Reduction in demand for the currency will reduce the exchange rate (depreciation).
74. (answer D) In a flexible exchange rate system, the exchange rate is determined by the free play of demand for and supply of a given currency, without government intervention.
75. (answer B) In a single currency area, the member countries collectively decide the interest rate for all member countries, but there is no assurance that the interest rate will always be low.