

**Edexcel A-level Economics exam practice answers**

11: Growth of firms

- 1 (a) **Correct answer: B** The principal-agent problem [1]
(b) To focus on the core products of the business; to provide funds for investment [4]
- 2 (a) **Correct answer: D** Forward vertical integration [1]
(b) Ensures that there is a market for their product; managerial economies of scale [4]
- 3 **KAA (knowledge, application and analysis):** 16 marks
Evaluation: 9 marks
Indicative content:
- Meaning of the term rational, e.g. firms aim to maximise profit.
 - Advantage include economies of scale (falling long-run average costs) with explanation of various types, e.g. managerial, financial, technical, and marketing. But danger of diseconomies of scale if the firm grows too large.
 - Increase in revenue and profits but profit maximisation depends not only on costs but also on demand. Increasing output can lead to a fall in profits even if costs are falling, if price has to be cut.
 - Consideration of what firm growth means, e.g. increased sales, turnover, market share or size of market. A rational firm might seek different objectives in the short and long term.
 - Benefits of remaining small, e.g. niche market, family business, avoid diseconomies of scale. [25]