CFA
LEVEL I
(2027)

Question Bank

February, May, August & November
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Economics

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Question & Answers

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Economics

LM1 Firms and Market Structures

Questions

Question 1

An analyst makes the following statements:

Statement 1: Profit maximization can be identified with two methods. When MR = MC or when the difference of TR and TC is maximum.

Statement 2: Profit maximization can be identified with only one method. Profit is maximized when difference of TR and TC is maximized.

Which statement is *least likely* correct?

A) Both.

B) Statement 1.

C) Statement 2.

Question 2

The output of Abel Inc. increases by a larger percentage than the increase in inputs. Abel is *most likely* experiencing:

A) economies of scale.

B) diseconomies of scale.

C) constant returns to scale.

Question 3

Under perfect competition, what will a firm *least likely* earn in the long run?

A) Normal profits.

B) Zero economic profit.

C) Positive economic profit.

Question 4

Profit maximization *most likely* occurs when:

A) Average total cost is minimum.

B) Marginal revenue is greater than marginal cost.

C) The difference between total revenue and total costs is the most.

Question 5

Ali Enterprises is operating in a perfectly competitive environment. Which of the following actions is best for Ali Enterprises to take in order to stay in the market in the long run?

A) Operate at any point beyond the minimum efficient scale point on the LRATC to lower costs.

B) Operate at the minimum efficient scale point on the long run average total cost curve (LRATC).

C) Maintain the current level of production.

Question 6

A dairy farm operating in a perfectly competitive market sells milk. What will be the *most likely* impact if the farm increases its milk production and unit sales by 15%?

A) a 15% increase in average revenue.

B) an increase in total revenue of less than 15%.

C) a 15% increase in total revenue.

Question 7

A firm operates in an industry with very few players. The barriers to entry are high and the firm has significant pricing power. The best characterization of this firm's market is:

A) monopoly.

B) monopolistic competition.

C) oligopoly.

Question 8

In order to maximize profits a firm should operate at a quantity such that marginal revenue is:

A) Greater than marginal cost.

B) Greater than average cost.

C) Equal to marginal cost.

Question 9

Zain Enterprises operates in an industry, which is characterized by a few sellers of a homogeneous product. The pricing decisions of the firms in this industry are interdependent. This industry is best characterized as:

A) monopolistic competition.

B) oligopoly.

C) perfect competition.

Question 10

A firm operates in an industry where the barriers to entry are comparatively low. Its competitors offer substitute products, but with differentiated features, quality and pricing. The firm has some pricing power, but it is low due to high number of substitutes and high number of competitors. The best characterization of this firm's market is:

A) oligopoly.

B) monopolistic competition.

C) perfect competition.

Question 11

Two analysts make the following statements:

Analyst 1: Compared to perfect competition, monopolies are always inefficient.

Analyst 2: Monopolies may sometimes be more efficient than perfect competition.

Which analyst is *most likely* correct?

A) Analyst 1.

B) Analyst 2.

C) Neither.

Question 12

A market structure characterized by a single seller who has significant pricing power is best described as:

A) monopoly.

B) monopolistic competition.

C) oligopoly.

Question 13

In which of the following cases is collusion *most likely* to occur?

A) When the product is homogeneous.

B) When there are many small companies in the industry.

C) When the cost structures of companies are different.

Question 14

Acme Enterprises operates in an industry with many sellers who differentiate their products. This industry is best characterized as:

A) oligopoly.

B) monopolistic competition.

C) perfect competition.

Question 15

A firm operates in an industry with very low barriers to entry. The number of players in the market is high and they are competing with each other to provide goods at the lowest prices. None of the players have any pricing power. The best characterization of this firm's market is:

A) monopolistic competition.

B) perfect competition.

C) oligopoly.

Question 16

A monopolist faces the following demand and cost schedules:

Output (units)	Price ($/unit)	Total Costs ($)
0	5,000	800
20	4,800	20,800
40	4,600	64,800
60	4,400	122,800
80	4,200	244,800
100	4,000	350,800

The optimal output level for this producer is closest to:

A) 40.

B) 60.

C) 80.

Question 17

Indus Manufacturing is one of many companies in an industry. Indus produces widgets which are similar to those produced by its competitors up to the point they are labeled. The labeled brand sells for £3.50 per unit. Other firms in the industry sell their products for £2.50 per unit. This industry is best characterized as:

A) monopoly.

B) monopolistic competition.

C) perfect competition.

Question 18

A firm in an industry characterized by monopolistic competition will *most likely* maximize profits when its output quantity is set such that the:

A) average cost is minimized.

B) marginal revenue equals marginal cost.

C) total cost is minimized.

Question 19

Two dominant companies operating in the smart phone manufacturing industry agree not to reduce price below a certain limit. Based on whether or not each company honors the agreement, the possibilities are:

Possibilities	Company A honors	Company A breaches
Company B honors	Company A earns USD1 million Company B earns USD1 million	Company A earns USD1.5 million Company B earns USD0.5 million
Company B breaches	Company A earns USD0.5 million Company B earns USD1.5 million	Company A earns USD0.7 million Company B earns USD0.7 million

Considering game theory and Nash equilibrium, what will be the *most likely* outcome?

A) Company A will agree and B will breach the agreement.

B) Both companies will breach the agreement.

C) Both companies will honor the agreement.

Question 20

Which of the following statements is *most* accurate?

A) Collusion is less likely when the product is homogeneous.

B) Collusion is less likely when the companies have similar market shares.

C) Collusion is less likely when the cost structures of companies are similar.

Question 21

Which of the following models *most likely* describes a situation in which no firm can increase profits by changing its price/output choice?

A) Kinked demand curve model.

B) Cournot model.

C) Dominant firm model.

Question 22

Engro is the price leader in its market. One of its competitors tries to gain market share by selling at a lower price set by Engro. The market share of Engro will *most likely*:

A) decrease.

B) increase.

C) stay the same.

Question 23

Analyst 1: Over time, the market share of the dominant company in an oligopolistic market will most likely increase.

Analyst 2: Over time, the market share of the dominant company in an oligopolistic market will most likely decrease.

Which analyst is correct?

A) Analyst 1.

B) Analyst 2.

C) Neither.

Question 24

Below is the market share of firms in the FMCG industry. The market shares are before merger of A and B.

Firm	Market share
A	30%
B	20%
C	15%
D	15%
E	10%
F	10%

What is the 4-firm concentration ratio before and after merger?

A) Before merger – 75%, after merger – 90%.

B) Before merger – 80%, after merger – 90%.

C) Before merger – 85%, after merger – 95%.

Question 25

A market has 5 suppliers, each of them with 20 percent of the market. What are the concentration ratio and the HHI of the top three firms?

A) Concentration ratio 6 percent and HHI 12.

B) Concentration ratio 60 percent and HHI 1.2.

C) Concentration ratio 60 percent and HHI 0.12.

Question 26

One of the disadvantages of the Herfindahl-Hirschman index is that the index:

A) is difficult to compute.

B) fails to reflect the effect of mergers.

C) fails to reflect low barriers to entry.