1.31 Alternative Business Objectives and the Principal-Agent Problem: Test Pack

AQA 7136 · Calculators not allowed · about 15 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for the scenario question and the extended evaluate question.

1 Divorce of ownership from control in modern firms: define the concept and explain why it arises in large UK public limited companies.

(Total for Question 1 is 2 marks)

2 Non-pecuniary manager motives: state two non-financial reasons a manager might avoid profit maximisation, each briefly explained, in the context of a UK public company.

(Total for Question 2 is 2 marks)

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3 Sales revenue maximisation as an alternative objective: explain why a manager might target sales revenue and state one likely effect on price compared with the profit-maximising outcome.

(Total for Question 3 is 2 marks)

4 Compare sales revenue maximisation and sales volume maximisation: state one clear difference in how each objective is likely to affect output level and one difference in how each is likely to affect price, relative to profit maximisation.

(Total for Question 4 is 3 marks)

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Mark scheme · 1.31 Alternative Business Objectives and the Principal-Agent Problem: Test Pack

Question 1

definition: ownership and control are separated when shareholders legally own the firm but day-to-day decisions are taken by professional managers or directors **B1**

explanation: arises because share ownership is widely dispersed in large public companies, so individual shareholders lack the time or information to run the firm and appoint managers to do so **B1**

Answer: Ownership and control are separated when shareholders own the firm while managers run it; this arises in large public companies where shares are dispersed and professional managers run daily operations.

Question 2

reason 1: job security, explained as managers preferring stable but lower profit outcomes that reduce the risk of takeover or dismissal **B1**

reason 2: personal utility from power or prestige, explained as managers valuing the status and influence of running a larger organisation even if it reduces profits **B1**

Answer: Two non-financial motives: job security, since stable acceptable results reduce the risk of dismissal or takeover; and power or prestige, where managers value running a larger organisation even if it lowers profit.

Question 3

reason: managers may target sales revenue to increase market share, meet turnover-related bonuses, or improve perceived firm size and stability **B1**

effect on price: price is likely to be lower than the profit-maximising price to boost revenue and sales, other things equal **B1**

Answer: Managers may target sales revenue to grow market share or receive turnover-linked incentives; this tends to lead to a lower price than profit maximisation would set.

Question 4

output: sales volume maximisation focuses on maximizing units sold, so output is likely to be higher than the profit-maximising level; sales revenue maximisation may increase output but could be less extreme depending on price elasticity **B1**

price: sales revenue maximisation often targets a price that maximises total revenue (which may be lower than profit-maximising price), while sales volume maximisation typically uses lower prices to maximise units sold **B1**

distinctive point: sales revenue maximisation may tolerate higher marginal costs if total revenue rises, whereas volume maximisation aims explicitly to expand quantity even if margins shrink **B1**

Answer: Volume maximisation usually raises output above the profit-maximising level more clearly than revenue maximisation; both tend to reduce price relative to profit maximisation, but revenue maximisers pick the price to maximise total revenue while volume maximisers push price down to maximise units.

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