



**Economics Questions By Topic:**

**Monopolistic Competition (3.4.3)**

**A-Level Edexcel Theme 3**

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## SECTION A

Write your answers in the spaces provided.

- 1 According to the Royal Mail, more hair and beauty salons opened on UK high streets last year than any other type of independent business, with a net increase of 10%, representing 626 new salons.

(Source: adapted from <https://www.theguardian.com/small-business-network/2016/nov/18/beauty-boom-or-bust-uk-too-many-salons>)

- (a) The UK hair and beauty industry is an example of monopolistic competition because:

(1)

- A firms spend nothing on advertising and research
- B the industry is dominated by a few large firms
- C the products are homogenous
- D there are low barriers to entry and exit

- (b) Draw a cost and revenue diagram to show the **long-run** equilibrium of a firm in monopolistic competition.

(4)



(Total for Question 1 = 5 marks)

2 A firm faces the following cost and revenue schedule. (Spaces have been left for your working.)

Output per day	Total revenue (£)	Average revenue/ Marginal revenue (£)	Total cost (£)	Average cost (£)	Marginal cost (£)
0	0		12	–	–
1	10		22	22	10
2	20			14	
3	30			11	
4	40			10	
5	50			10	
6	60			13.5	

The firm is attempting to maximise profit. From this information it can be concluded that the firm is operating under conditions of

(1)

- A monopolistic competition in the short run and will operate at 4 units
- B monopolistic competition in the long run and will operate at 5 units
- C perfect competition making a supernormal profit at an output of 1 unit
- D perfect competition making a supernormal profit at an output of 3 units
- E perfect competition making normal profit at an output of 5 units

Answer

Explanation

(3)

A series of horizontal dotted lines for writing an explanation.

**(Total for Question 2 = 4 marks)**

**3** Shoe repairing firms in a large city are providing similar services, and they are making normal profits. Customers tend to be loyal to certain firms. The market structure most resembles

(1)

- A** perfect competition in the short run
- B** perfect competition in the long run
- C** monopsony in the short run
- D** monopolistic competition in the long run
- E** oligopoly in the short run

Answer

Explanation

(3)

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**(Total for Question 3 = 4 marks)**

4 Which of the following characteristics is shared by a monopolist and a firm operating under conditions of monopolistic competition?

(1)

- A Low or no barriers to entry to the industry
- B Productive efficiency in the long run
- C Some degree of price setting power
- D Supernormal profits in the long run
- E Allocative efficiency in the long run

Answer

Explanation

(3)

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**(Total for Question 4 = 4 marks)**









## SECTION B

Read all extracts/figures before answering.

Write your answers in the spaces provided.

### 8 Brand loyalty in contrasting industries

#### Extract 1 Know your customers



Long before focus groups, marketing surveys or loyalty programmes, businesses knew their customers because they saw them face to face. The corner shop owner knew who liked a particular brand of jam and kept it in stock for them. He knew when people tended to come in and kept his shop open to accommodate them. Stuart Aitken, the chief executive of Dunnhumby, a leading force in the growing field of data analysis, says he keeps this vision in mind as he uses the latest technology to provide companies with insights about their customers. "This is back to basics," he says. "What we're seeing is that businesses have driven down costs, they've got economies of scale, but they've forgotten who their customer is. What we do is allow businesses to reconnect with their customers, to become the corner store on a large scale."

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As data management becomes more sophisticated and gives clearer pictures of customer behaviour, it is increasingly useful for business decision-making. The pioneers have reaped tremendous rewards. Tesco depended so heavily on the customer profiles delivered by Dunnhumby that it ended up buying the company. Dunnhumby used the data collected by Tesco's Clubcard programme to build detailed customer profiles. It now has detailed knowledge of 80% of its 15 million customers. Dunnhumby's work is widely credited with helping Tesco open a wide lead over its UK supermarket rivals.

15

(Source: adapted from © The Financial Times Ltd, Philip Delves Broughton, 7 March 2011)

## Extract 2 The hairdressing industry

70% of a hairdresser's customers can be described as fully loyal – customers who will continue to go to a particular stylist, even if there are cheaper or more convenient alternatives available. Research at the University of Melbourne in 2010 found that women are loyal to a particular stylist and, when a stylist leaves a salon, the customers are also likely to go elsewhere, creating problems for the business.

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The research suggests that devising loyalty programmes, cutting prices or offering short-term financial inducements to customers may consequently be a waste of time. Customer loyalty is directly related to retaining employees says the research, something which is within the control of the service manager or owner. "Keep hold of your good staff and you are far more likely to prevent the customers you can't afford to lose from moving on," says Professor Lester Johnson.

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(Source: adapted from © The Financial Times Ltd, Linda Anderson, 12 February 2010)

**Figure 1 Four-firm concentration ratios in selected industries, 2011**

Supermarkets	76.1%
Hairdressers*	Less than 5%

\*excluding franchise

(Source: © The Press Association, Reproduced with Kind Permission)



(Total for Question 8 = 8 marks)

## Question 9

### Hand car wash (HCW) firms in the UK

#### Extract A

#### What is the true human cost of your £5 hand car wash (HCW)?

The UK's hand car washes (HCWs) are extremely price competitive, but they have also been linked to modern slavery. Are they ever fair for workers?

There is little agreement about how many HCWs there are in the UK. Estimates range from 10 000 to 20 000. This lack of accurate information about the industry makes government regulation very difficult. Automated car washes, with their fierce rotating bristles, used to be the first option for drivers in a hurry. Now there is more choice. While the economy slows and incomes fail to keep up with inflation, demand for HCWs has grown. Many people see paying £5 for a car washed by someone else, rather than cleaning it at home, as a small expense which yields a high utility. But what is the true cost of a £5 car wash – and what should we be paying?

The growth of HCWs is partly the result of changes in the structure of industry in the UK. Many petrol stations have closed as drivers fill up at supermarkets. Garages and their forecourts have closed as cars become more reliable and locked into service agreements. The available sites for HCWs have therefore increased significantly and rents have fallen.

HCW entrepreneurs have identified available land and have benefitted from changes in the labour market, partly as a result of EU migration. UK drivers are now able to obtain cheap and effective hand car washing. For many migrants, car washes are a first job. "They accept car washing for a short period while they improve their language skills and move into other industries," says Ian Clark, a professor of work and employment at Nottingham Business School. "But there are also car-wash workers without networks who are in a dead end, working there for long periods."

Many drivers are only interested in getting the cheapest wash. If the price is very low, it probably means that workers are receiving less than the minimum wage and working in poor conditions. Crude calculations illustrate the problem. A £5 HCW employing five workers for 10 hours a day would need to wash 79 cars a day to just cover the wage costs. This assumes the workers are paid the minimum wage. This is one car every seven and a half minutes. Even if the profit can be higher on valet services, the price of which can be as little as £12 for a full inside-and-out clean, it's hard to see how a car wash price as low as £5 pays a living wage. This ignores all other costs which HCWs incur such as business rates and rent.

Evidence from car-wash workers is limited but Clark and others have been able to build a picture of some of the tougher conditions on drenched forecourts. "Like nail bars and small garment manufacturers, car washes are what we call 'hard-to-reach places,'" Clark explains. As part of the research, Clark and his team spoke to workers from 45 HCWs in the Midlands.

Clark and his team met and observed workers who lacked waterproof boots or trousers, or hi-vis jackets and gloves. "They're spraying around hydrochloric acid solution for alloy wheels, breathing in the vapour and fumes," Clark says. Some workers were paid a little over half the minimum wage.

(Source adapted from: <https://www.theguardian.com/world/2018/jul/16/true-human-cost-5-pound-hand-car-wash-modern-slavery>)

## Extract B

### Government intervention in the HCW industry

There are three main areas of government intervention that might impact on labour intensive firms such as HCWs:

First, there is the planning issue which focuses on the impact on the environment, for example, the disposal and recycling of waste water and chemicals. There could be planning regulations to prevent the use of tarmac rather than concrete on forecourts. Tarmac allows waste water and chemicals to seep into the sub soil. It could also be a requirement to have a sludge trap to stop the waste entering waterways. 5

Second, there is the health and safety issue for workers. Prolonged exposure to chemicals and lack of protective clothing puts the health of workers at risk. Performance targets could involve minimum levels of protective clothing and rest breaks for the workers. 10

Third, there is the issue of tax. The informal nature of the business type makes tax evasion easier.

Not all UK HCWs violate regulations. There are legitimate, regulated HCW firms as well as examples of good practice by independent outlets. One national supermarket, Tesco, has banned all independent hand car washes from its car parks. It is now in a partnership agreement with national car wash operator Waves. It uses a WashMark certificate of quality and compliance which was introduced by the industry to improve working conditions. Other major supermarkets are considering similar changes. One adviser believes £9 is a reasonable minimum price for a basic wash. Some pressure groups have developed a mobile phone app where evidence of unreasonable conditions can be reported by drivers. 15 20

Involving drivers in the issue, and making them demand fairer car washes, creates an incentive for good businesses to improve practices and come forward to get a WashMark certificate. 25

(Source adapted from: <https://www.parliament.uk/documents/commons-committees/environmental-audit/Hand-Car-Wash-evidence.pdf> research into HCWs by Professor Ian Clark, Nottingham Business School May 2018)



