INSTITUTE OF ACTUARIAL & QUANTITATIVE STUDIES

Subject: Business economics (micro)

Chapter: Unit 4

Category: Practice questions

MCQ

1. Subject CT7 April 2011 Question 14

Which of the following is NOT usually given as a reason why firms form strategic alliances?

A. New markets
B. Risk sharing
C. Capital pooling
D. Economies of scale

Answer – D

2. Subject CT7 September 2011 Question 3

Under the Cournot model of duopoly a firm:

A. attempts to maximise sales after assuming that the other firm will attemptto maximise sales.
B. assumes the other firm will produce a given output and then chooses its profit maximising output.
C. assumes the other firm's price is given and then chooses its profit maximising price.
D. will attempt to collude with the other firm so as to set a price and output level which will maximise industry level profits.

Answer – B

3. Subject CT7 September 2011 Question 9

A monopolist facing a downward sloping demand curve for its product will set its price in the region of the demand curve where the demand:

A. has price elasticity equal to minus unity.
B. is price inelastic.
C. is price elastic.
D. has price elasticity equal to zero.

Answer – C

4. Subject CT7 April 2012 Question 11

A perfectly competitive firm is producing at a level of output where short run marginal cost is rising and exceeds marginal revenue. What should the firm do to maximise its short run profits?

A. Reduce its output.
B. Raise its output.
C. Raise its price.
D. Reduce its price.

Answer – A

5. Subject CT7 April 2012 Question 14

A profit maximising oligopolistic firm has marginal cost of £3 at all levels of output and operates under the belief that the demand curve for its output is kinked at a price of £10. Provided its marginal costs are between £2 and £4, it sells its commodity at a price of £10. If new technology reduces its marginal cost to £1.50 at all levels of output the firm should:

A. lower the price and raise output.
B. maintain the existing price and output.
C. lower the price but maintain existing output.
D. maintain the existing price and raise output.

Answer – A

6. Subject CT7 September 2012 Question 10

The idea that an oligopolistic firm faces a kinked demand curve is based upon the assumption that:

A. a firm's competitors match both its price increases and price decreases.
B. one firm in the industry sets the price for all other firms.
C. a firm's competitors match its price decreases but ignore its price increases.
D. prices can either rise or fall; it depends on what happens to a firm's competitors' prices.

Answer – C

7. Subject CT7 September 2012 Question 11

First degree price discrimination refers to the situation where:

A. a firm charges customers different prices according to how much they purchase.
B. consumers are grouped into independent markets and a separate price is charged in each market.
C. a firm charges each customer the maximum price he/she is prepared to pay.
D. different firms charge different prices for the same product.

Answer – C

8. Subject CT7 April 2013 Question 13

Which of the following statements is FALSE?

A. For a firm under perfect competition in the short run, marginal revenue will be equal to the average revenue.
B. In an oligopoly industry, firms make decisions taking into account the possible reactions of their competitors.
C. For a monopolist facing a linear demand curve, average revenue is always less than marginal revenue.
D. A profit maximising monopoly firm with positive marginal costs of production charges a price in the region of the demand curve where demand is price elastic.

Answer – C

9. Subject CT7 October 2015 Question 10

The short run supply curve for a firm in a perfectly competitive industry is its:

A. average total cost curve.
B. average variable cost curve.
C. marginal cost curve above the lowest point of the average variable cost curve.

D. marginal cost curve above the lowest point of the average total cost curve
Answer – C

10. Subject CT7 October 2015 Question 12
Which of the following is NOT usually given as a reason why firms form strategic alliances?

A. risk sharing
B. entry into new markets
C. capital pooling
D. economies of scale

Answer – D

11. Subject CT7 October 2015 Question 13
Third degree price discrimination refers to the situation where:

A. different firms charge different prices for the same product.
B. a firm charges each customer the maximum price he/she is prepared to pay.
C. a firm charges customers different prices according to how much they purchase.
D. consumers are grouped into independent markets and a separate price is charged in each market.

Answer – D

12. Subject CT7 April 2016 Question 9
The managing director of a monopoly firm is given the following data:
Marginal revenue = £11, Marginal cost = £10
Average cost = £13, Average revenue = £15
To maximise profits the firm should:

A. reduce price and increase output.
B. reduce price and reduce output.
C. increase price and increase output.
D. increase price and reduce output.

Answer – A

13. Subject CT7 April 2016 Question 11
Which one of the following is NOT a feature of an industry characterised by monopolistic competition?

A. Some degree of monopoly power ensures that in the long run firms can make supernormal profits.
B. There is freedom of entry and exit into the industry in the long run.
C. Firms in the industry produce differentiated products.
D. Firms in the industry charge prices above their marginal costs of production.

Answer – A

14. Subject CT7 September 2016 Question 10
A perfectly competitive firm has fixed and variable costs of production. It produces output at the long-run profit maximising level. Which of the following statements is correct?

A. Marginal cost exceeds average total cost.
B. Marginal cost equals average variable cost.
C. Marginal cost exceeds average variable cost.
D. Marginal cost is less than average variable cost.
Answer - C

15. Subject CT7 September 2016 Question 11
Which of the following statements is FALSE?

A. Collusion may occur between firms in oligopolistic competition.
B. A firm in perfect competition faces a perfectly inelastic demand curve.
C. In monopolistic competition, supernormal profits cannot be made in the long run.
D. Price discrimination would allow the monopolist to produce the socially efficient level of output.
Answer - B

16. Subject CT7 September 2016 Question 13
When the owner of a patented product allows another firm to produce it for a fee, the arrangement is referred to as a:

A. merger.
B. franchise.
C. joint venture.
D. licensing agreement.
Answer - D

17. Subject CT7 April 2017 Question 12
Which of the following is NOT usually given as a reason why firms form strategic alliances?

A. entry into new markets
B. risk sharing
C. capital pooling
D. to reduce overall managerial remuneration
Answer – D

18. Subject CT7 April 2017 Question 7
Increasing long run average costs are associated with:

A. constant returns to scale.
B. decreasing returns to scale.
C. increasing returns to scale.
D. the law of diminishing returns.
Answer - B

19. Subject CT7 October 2017 Question 7
Which of the following is NOT a motive for advertising by an existing firm in an industry?

A. to make the demand for the product more price elastic

B. to shift the demand for the firm's product to the right
C. to increase barriers to entry
D. to increase sales and so help the firm exploit economies of scale
Answer – A

20. Subject CT7 October 2017 Question 10

Which of the following statements is FALSE?

A. In monopolistic competition, supernormal profits cannot be made in the long run.
B. Price discrimination is impossible under perfect competition.
C. Collusion may occur between firms in oligopolistic competition.
D. A firm in perfect competition faces a perfectly inelastic demand curve
Answer – D

21. Subject CT7 October 2017 Question 11

When a monopolist maximises profits, price exceeds marginal revenue. The difference between price and marginal revenue occurs because:

A. the firm has to charge a price higher than the marginal cost of producing the last unit.
B. any decision by the monopolist to sell an additional unit of output does not affect price.
C. the firm has to reduce the price on all units sold in order to sell the additional unit.
D. the law of diminishing returns directly affects the price of an imperfectly competitive firm's product.
Answer – C

22. Subject CT7 October 2017 Question 13

An implicit or explicit agreement amongst firms in an industry NOT to compete with each other is known as:

A. the dominant firm hypothesis.
B. collusion.
C. non-cooperative oligopoly.
D. product differentiation.
Answer – B

23. Subject CT7 October 2017 Question 17

The socially efficient output for a monopoly is at the point where:

A. the marginal cost curve cuts the marginal revenue curve.
B. the marginal cost curve cuts the demand curve.
C. the average cost curve cuts the marginal revenue curve.
D. the average cost curve cuts the demand curve.
Answer – B

24. Subject CT7 April 2018 Question 8

A firm is selling 1,000 units of output at a price of £20, with a marginal cost of £5 and average variable cost of £8 at that level of output. What is the supernormal profit that the monopoly firm is making?

A. £15,000

B. £12,000
C. £7,000
D. not possible to calculate from the information given
Answer – D

25. Subject CT7 September 2018 Question 9

A perfectly competitive firm has fixed and variable costs of production. It produces at the long run profit maximising level. Which of the following statements is correct?

A. Marginal cost exceeds average variable cost.
B. Marginal cost equals average variable cost.
C. Marginal cost is less than average variable cost.
D. Marginal cost exceeds average total cost.
Answer – A

26. Subject CT7 September 2018 Question 10

When a monopolist maximises profits, price exceeds marginal revenue. The difference between price and marginal revenue occurs because:

A. the firm has to charge a price higher than the marginal cost of producing the last unit.
B. any decision by the monopolist to sell an additional unit of output does not affect price.
C. the firm has to reduce the price on all previous units sold in order to sell the additional unit.
D. the law of diminishing returns directly affects the price of an imperfectly competitive firm's product.
Answer – C

27. Subject CT7 September 2018 Question 23

If the government imposes a minimum wage that is above the market equilibrium wage we would expect:

A. an increase in the quantity of labour demanded.
B. the labour supply curve to shift to the left.
C. an increase in the quantity of labour supplied.
D. the demand for the labour curve to shift to the left.
Answer – C

Longer questions

1. Subject CT7 April 2011 Question 28

(i) Draw a diagram to show a profit maximising monopoly in long run equilibrium.

(ii) Use this diagram to:

a. Identify "deadweight welfare loss".
b. Explain why this firm will produce a less than socially efficient level of output.

2. CT7 April 2011 Q30

(i) Draw one fully labelled diagram to illustrate the long run equilibrium position of a firm under perfect competition and a firm under monopolistic competition. Assume that both firms have the same Long Run Average Total Cost Curve.

(ii) Identify, with reference to your diagram, the excess capacity relating to the firm in monopolistic competition.
(iii) Explain how, compared to perfect competition, the price and output decision under monopolistic competition affects the consumer.

3. Subject CT7 September 2011 Question 31

(i) Using supporting diagrams show how a profit maximising firm will practice third degree price discrimination by dividing its market into two distinct markets A and B with different demand elasticities. Show the price in the market with inelastic demand (Market A) and in the market with a more elastic demand (Market B) and the overall output of the firm made up of demand in both Market A and Market B.
(ii) Give an example of second degree and third degree price discrimination.

4. Subject CT7 April 2012 Question 28

A perfectly competitive firm sells Good X at a market price of £18 per unit. The firm's short run total fixed cost is £450 per day and the daily wage rate paid by the firm is £130 per employee. No other costs are involved in production.
The output of the firm varies with the level of employment as follows:

Number of Employees	*nits of output per day*
0	0
1	22
2	42
3	58
4	66
5	67

If the firm employs three workers per day, determine the firm's daily:
i.Total Revenue
ii.Total Cost

5. Subject CT7 April 2013 Question 27

Discuss four methods by which a firm producing laptop computers can attempt to differentiate its products from those of its competitors.

6. Subject CT7 April 2013 Question 28

(i) Explain what is meant by a perfectly contestable market.
(ii) Explain what the implications for a monopoly firm in a perfectly contestable market are with respect to its price and output decisions, compared to being in a non contestable market.
(iii) Explain what is meant by "sunk costs" and comment on how sunk costs can be a barrier to

entry.

7. Subject CT7 April 2013 Question 29

(i) Explain with the aid of a diagram, how in the Cournot model of duopoly, Firm A which has positive marginal costs will decide on its equilibrium price and output for a given output level of its rival Firm B.

(ii) Comment on how in the Cournot equilibrium for a duopoly industry, the price and output compares with that of a monopoly industry.

8. Subject CT7 September 2013 Question 29

(i) Draw a diagram to show a typical monopolistically competitive firm, such as a coffee shop, which is wishing to operate but is making a loss. Your diagram should show all the relevant cost and revenue curves and the area corresponding to the firm's losses.

(ii) Now assume that consumer demand for hot drinks increases. Show, with the use of a new diagram, the effect this will have on the market price and quantity traded in the short run, assuming that the firm now makes a profit.

9. Subject CT7 September 2013 Question 30

List four factors which favour collusion amongst oligopolistic firms.

10. Subject CT7 September 2013 Question 31

Describe two reasons why firms might wish to form strategic alliances.

11. CT7 September 2014 Q31

For each of the following, explain whether it represents a potentially contestable market.

(a) airline routes

(b) savings accounts

(c) hospital catering

12. Subject CT7 April 2015 Question 34

(i) Describe, with examples, what is meant by a horizontal strategic alliance. (ii) Describe three reasons why firms may decide to form a strategic alliance.

13. Subject CT7 April 2015 Question 36

The company Toshisoni sells a memory stick in Japan for ¥700 but it offers three memory sticks for ¥1800 and five memory sticks for ¥2500.

(i) Identify the type of price discrimination strategy that the company is exercising and explain the reason why some firms adopt this type of strategy.

(ii) Assuming that the profit maximising price is ¥600, draw a diagram showing the relevant curves for the type of pricing strategy in (i) above and label your diagram as follows:

Demand and marginal revenue curves labelled D and MR respectively; Average cost and marginal

cost curves labelled AC and MC respectively; Label the quantities corresponding to the prices given above by Q, Q', Q".
(iii) On your diagram identify the price *Pn* and the quantity *Qn* at which the Firm would make normal profits.
Assume now that Toshisoni sells the memory stick at a single price of ¥600 in Japan and at a price equivalent to ¥900 in pounds in the UK.
(iv) Comment on the type of price discrimination that the company exercises in this case.

14. Subject CT7 October 2015 Question 30
A monopoly firm is making losses but has sufficient revenue to continue production in the short run.
(i) Draw a diagram to illustrate the short run profit maximising price and output for the firm.

Label the diagram as follows:

- AC1 average cost curve, MC1 marginal cost curve
- P1 price, Q1 quantity
- AVC1 average variable cost curve, C1 average cost
- MR1 marginal revenue curve, AR1 average revenue curve

(ii) Show the total loss on the diagram.

15. Subject CT7 October 2015 Question 31
Outline FIVE different forms of barriers to entry that enable monopolies to maintain their position as sole supplier to the market.

16. Subject CT7 October 2015 Question 32
Explain with the use of appropriate examples the difference between first and second degree price discrimination.

17. Subject CT7 April 2016 Question 31
(i) (Draw a diagram for a monopolistically competitive firm making normal profits including following curves R for average revenue, MR for marginal revenue, AC1 for average cost and MC1 for marginal cost. Denote the equilibrium price as P1, average cost as C1 and quantity as Q1.
(ii) Demonstrate on the diagram you have drawn in part (i) above, the short run impact of a fall in wages using new cost curves AC2 and MC2. Indicate the new price P2, new average cost C2 and new quantity Q2.
(iii) Explain the effect of the fall in wages in (ii) above on profits in the short run.
(iv) Explain what will happen to the demand and profits in the long run.

18. Subject CT7 September 2016 Question 27
Describe the difference between uncertainty and risk.
Describe, with the use of an example, how firms might seek to reduce uncertainty.

Unit 4

PRACTICE QUESTIONS

19. Subject CT7 September 2016 Question 28

Explain, with examples, TWO forms of product differentiation that a car manufacturer may use to differentiate its product from competitors.

20. Subject CT7 September 2016 Question 31

(i) Describe the term "loss leader" and the main factor that a firm should consider in using a "loss leader" as a successful pricing strategy.

(ii) Discuss how a sports clothing store may use a successful "loss leader" pricing strategy.

21. CT7 April 2017 Q29

The table below shows the annual profits for Company A and Company B which produce Good X. The profits vary according to whether each charges £15 or £10.

		B's price	
		£15	***£10***
A's price	***£15***	£12 million each	£6 million for Company A £18 million for Company B
	£10	£18 million for Company A £6 million for Company B	£8 million each

(i) State the price Company A should charge if it were to renege on an agreement previously reached with Company B to maximise their joint profits.

(ii) State the price Company A should charge if it makes its pricing decision completely independently of Company B.

(iii) Explain why this situation is known as a dominant strategy game.

(iv) State the Nash equilibrium in terms of the price and profits of both firms, if the game is played only once

22. Subject CT7 April 2018 Question 28

Draw a diagram for each of (i) and (ii) illustrating the profit maximising price and output of a firm operating under conditions of monopolistic competition to show the firm making:

(i) excess profits, clearly indicating the total excess profits.

(ii) a loss, clearly indicating the total loss.

You should label the curves on each diagram as: MR for Marginal Revenue, AR for Average Revenue, MC for Marginal Cost, AC for Average Cost. Price and Quantity should be labelled P1 and Q1 respectively and the average cost per unit as C1.

(iii) Explain whether the firm under monopolistic competition will make excess profits in the long run.

23. CT7 September 2018 Q31

(i) Describe a collusive oligopoly.

Two airlines are considering working together.

(ii) Discuss THREE factors which would create a more favourable environment for a successful collusion.

24. CB2 April 2019 Q27

(i) Describe how each firm in the Cournot model of oligopoly arrives at its demand curve.

(ii) Describe with the aid of a diagram how Firm A, in the Cournot model, will decide on its profit maximising price and output if Firm B decides to produce an output level of QB. In your diagram include the market demand curve (DM), the demand curve facing Firm A (DA), the marginal revenue of Firm A (MRA) and the marginal cost of Firm A (MCA).

25. CB2 April 2019 Q28

Describe with the aid of a diagram (or diagrams) why a firm operating in a monopolistic competition environment will make only normal profits in the long run, even though it is making excess profits in the short run.

26. CB2 September 2019 Q30

Describe with the aid of a diagram (or diagrams) why a firm operating in a monopolistic competition environment will make only normal profits in the long run, even though it is making excess profits in the short run.

27. CB2 September 2020 Q27

(i) Describe the characteristics of an oligopolistic market structure.

(ii) Explain four characteristics of an oligopolistic market structure that differ from the characteristics of a monopoly market structure.

28. CB2 April 2021 Q30

Discuss the relevant barriers to entry that new entrants would be likely to face when seeking to enter the banking sector.

29. CB2 April 2021 Q35

Discuss the similarities and differences between monopolistic competition and monopoly as market structures.

In your answer, you should include the likely advantages and disadvantages to consumers from these differing market structures.

30. CB2 September 2022 Q30

Explain, with reference to the characteristics of the specific market, why a gymnasium is unlikely to be associated with a model of perfect competition.