

Cambridge IGCSE · Economics 0455 · Notes

Market structure

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What you need to know

This topic has two syllabus outcomes. In plain words, you should be able to:

1. **Competitive markets:** explain what happens to **price, quality, choice and profit** when a market has a **large number of firms**.
2. **Monopoly markets:** describe the **characteristics** of a monopoly and explain its **advantages and disadvantages**.

The theory of perfect and imperfect competition is **not** in the syllabus, and you never need a diagram for this topic. Everything is written answers and multiple choice.

Understand it

What "market structure" means

A market's **structure** is how many firms sell in it, how big they are, and how easy it is for new firms to join. At one end is a **competitive market** with many sellers; at the other is a **monopoly** with a single seller. Most real markets sit somewhere between, and the questions ask what changes as a market moves along that line: when firms enter, when firms close, or when firms merge into one.

The key idea linking the two ends is **barriers to entry**: anything that makes it hard or expensive for a new firm to start selling in the market.

- **Low barriers:** anyone with a small amount of money can start (a café, a market stall, a hairdresser). New firms keep arriving, so there are many sellers.
- **High barriers:** starting needs something most firms can't get, so the firms already there are protected.

Competitive markets: many firms

In a competitive market there are **many firms**, each selling a product that has **close substitutes** from its rivals, and **barriers to entry are low**. Many buyers face many sellers, and no single firm controls the market.

Having lots of firms affects the four things the syllabus names:

- **Price is low.** Each firm knows that if it charges more than its rivals, customers will switch to them. So firms keep prices down, and some cut prices to win a bigger **market share** (their slice of the market's total sales).
- **Quality tends to be high.** Firms can't only compete on price, so they try to make their product better, more reliable or more attractive than rivals'. Competition also pushes them to be **efficient** and to **innovate** with new products and better methods, or they lose customers.
- **Choice is wide.** Many firms offer different versions, styles and price levels, so consumers can buy what suits their tastes. Firms also respond quickly to what consumers want (**consumer sovereignty**), because a firm that ignores its customers loses them.
- **Profit is low.** Each firm has only a small share of sales and can't raise its price, so profits are low. If one kind of business does earn high profits, the low barriers let new firms enter and compete those profits away. Inefficient firms make losses and close.

Competition also has **drawbacks**:

- Firms stay **small**, so they may not gain **economies of scale**: their average costs stay higher than a large firm's.
- With low profits, firms have less money for **research and development** (R&D) and new equipment.
- Firms may spend heavily on **advertising** to stand out, which raises their costs and can raise prices.
- Some firms cut costs by cutting quality (a "race to the bottom"), or overuse resources and pollute.
- Many firms each building the same shops, networks or factories can be **wasteful duplication**.
- Consumers may face so many choices that comparing them takes time and effort.

Monopoly: one firm

A **monopoly** is a market with a **single seller** (or one firm so dominant that it controls the market). Its characteristics are:

- **Only one firm**, with all or nearly all the market share and no effective competition. There are **many buyers** but a **single seller**.
- **High barriers to entry**, which stop new firms entering and protect the monopoly. Examples:
 - **legal barriers**: a patent, a licence, or the government giving one firm the sole right to supply;
 - **very high start-up costs**, such as building a railway, an electricity network or water pipes;
 - **economies of scale**: the existing firm's average cost is so low that a small new firm can't match its price;
 - **control of raw materials** or of the shops that sell the product;
 - **strong brand loyalty** built up by years of advertising.
- **Price maker.** The monopoly sets its own price. Consumers have no close substitutes, so demand for its product tends to be **inelastic**; raising the price loses few customers.
- **It controls supply.** By limiting how much it sells, it can keep the price high.
- **High profits in the long run.** Because new firms can't enter, high profits are **not competed away**. This is the main difference from a competitive market, where high profits attract entrants.

- **A unique product** with no close substitutes.
- Often a **large firm**, benefiting from economies of scale.

A firm in a competitive market is closer to a **price taker**: it has to charge roughly what its rivals charge.

From many firms to one

Questions often describe a change in the number of firms and ask what happens. Work it out from the ideas above.

When a competitive market becomes a monopoly (or firms close) Likely change

Price	rises
Output	falls (the monopoly restricts supply)
Choice for consumers	falls
Competition	falls
Profit of the firm(s) left, in the long run	rises
Barriers to entry	rise
Size of the firm	rises
Economies of scale	rise
Market share of the firm	rises

The same logic works in reverse: when **more firms enter** a market, price, profit and market share per firm tend to fall, while choice, output and competition rise.

For example, if several of the cafés in a town centre close, the ones left face less competition: they can charge a bit more, and they get the customers who used to go elsewhere, so their **prices and profits rise**, and consumers have **less choice**.

Advantages of monopoly

A monopoly is not always bad. It can bring:

- **Economies of scale.** A single large firm can buy in bulk, use the most advanced machinery and borrow cheaply. Its **average cost** falls, and if it passes this on, **prices can be lower** than many small firms could manage.
- **Money for research and development.** High, secure profits can be spent on new products, better quality and new technology. This is why governments grant **patents**: a temporary monopoly rewards the firm for its R&D.
- **No wasteful duplication.** It would be wasteful for several firms each to lay water pipes or rail tracks to every home; one network serving everyone is cheaper.
- **Less time and effort choosing.** Consumers don't have to compare many suppliers.

- **A state-owned monopoly** may aim at **social welfare** rather than profit: it can keep prices low and serve remote areas that a profit-seeking firm would ignore.

Disadvantages of monopoly

- **Higher prices:** the monopoly can restrict supply and raise its price, because consumers have no substitutes to switch to.
- **Lower output** than a competitive market would supply.
- **Less choice:** one firm's product range.
- **Lower quality and less innovation:** with no rivals, there is no pressure to improve, and consumers can't switch if the quality is poor.
- **Inefficiency:** with no competitive pressure to keep costs low, the firm may become **complacent**, wasting resources and letting average costs rise.
- **Diseconomies of scale:** a very large firm may suffer poor communication, weak control and poor industrial relations, pushing average costs up.
- **High profits may not be reinvested;** they may go to owners while consumers, especially those on low incomes, pay high prices for necessities such as electricity or water.

What limits a monopoly's power

Even a single seller can't charge any price it likes:

- **Substitutes from other industries.** The only rail company between two cities still competes with buses, cars and planes. Raise fares too far and passengers switch.
- **Imports.** A country's only producer may face competition from foreign firms.
- **Government:** the government may set a **maximum price** for a monopoly's product, regulate it, or stop mergers that would create one.
- **Low demand.** If people will only buy a small amount, even a monopoly can't sell much at a high price.

Key facts and formulas

This topic has no formulas. "Learn it" means you must remember it.

Fact	Status
Competitive market: many sellers, many buyers, low barriers to entry, close substitutes	Learn it
Many firms → lower price, higher quality, more choice, lower profit per firm	Learn it
Monopoly: single seller, many buyers, high barriers to entry, price maker, no close substitutes	Learn it

Fact	Status
Monopoly profits stay high in the long run because barriers stop new firms entering	Learn it
Competitive → monopoly: price ↑, profit ↑, barriers, firm size and economies of scale ↑; output ↓, choice ↓, competition ↓	Learn it
Advantages of monopoly: economies of scale, R&D from profits, no wasteful duplication, state monopoly may aim at welfare	Learn it
Disadvantages of monopoly: higher prices, lower output, less choice, lower quality, complacency, diseconomies of scale	Learn it

How to do it

We have tagged 34 questions on this topic (2021–2025): 20 multiple choice on Paper 1 and 14 structured questions on Paper 2. Each structured question has one part about this topic, so there are 34 question parts in all. They came up this often.

Question type	Question parts
Multiple choice (concept)	20
Discuss (8 marks)	9
Analyse (6 marks)	4
Explain (4 marks)	1

1. Multiple choice (concept) (20 question parts)

- Decide which end of the scale the question is about:** many firms (competitive) or one firm (monopoly), or a change from one to the other.
- Check each option against the characteristics:** number of sellers, barriers to entry, price maker or taker, long-run profit.
- For a change, go through the "From many firms to one" table** row by row: price, output, profit, choice, barriers, economies of scale, size.

Variations you will meet:

- Features and causes of each structure** (9 parts): a monopoly has **many buyers and a single seller**, **high barriers**, is a **price maker** and makes **high long-run profit**; a competitive market has **low barriers and many sellers**. What makes a monopoly more likely? **Big economies of scale**. What do many small firms suggest? **Few barriers to entry**. Why can a monopoly keep profits high? It can **restrict the entry** of new firms (barriers). Traps: "single **buyer**" (a monopoly is a single **seller**), "price taker", "elastic demand", "many substitutes", "freedom of entry" and "diseconomies of scale" never explain monopoly profit.

- **Predict the effect of a change in the number of firms** (6 parts): competitive → monopoly gives **output down, price up; long-run profits up, competition down; barriers, economies of scale and firm size all up**. Firms closing (cafés, small energy suppliers) gives the survivors **higher prices and higher profits**, and consumers **less choice**. Compared with a monopoly, a competitive market has **lower price and lower profit**.
- **Advantages, disadvantages and limits** (5 parts): the most likely advantage of monopoly for consumers is that **economies of scale may reduce prices** (not more choice or more output). Governments allow some monopolies so that profits can **fund research and development**. The outcome of a competitive market is **low prices and wide choice**, and competition **encourages the efficient use of resources**. What stops a monopoly rail firm charging very high fares? **Competition from road transport**, a substitute in another industry.

2. Discuss (8 marks) (9 question parts)

These are **levels-marked**: Level 3 (6–8) needs **both sides developed** with a judgement; a one-sided or undeveloped answer stays in Level 2 (3–5).

Plan:

1. **Define** the market structure in one line (competitive market or monopoly).
2. **Why it might**: two developed chains, each point → how → the effect on the group in the question.
3. **Why it might not**: two **new** chains, not the first side reversed.
4. **Judgement**: what the answer depends on (whether the monopoly is state-owned or private, whether it gains economies of scale, how strong competition from substitutes or imports is, whether the product is a necessity).

Variations you will meet:

- **Do consumers benefit from competition, fewer firms or a monopoly?** (5 parts). Competition good: lower prices, higher quality, more choice, more innovation, firms small enough to avoid diseconomies of scale. Against: lower profits so less R&D and quality improvement, no economies of scale, advertising costs passed on in prices, a race to the bottom on quality, too much choice to compare, resource depletion and pollution. Monopoly (or fewer firms) good: economies of scale → lower average cost → lower prices; secure profits → R&D → better quality; less time choosing; firms that polluted may be the ones that closed. Against: higher prices, less choice, poor quality with no substitute to switch to, diseconomies of scale, no pressure to be efficient. For "one firm", say **why** the price might be low (economies of scale, or a state monopoly aiming at welfare): examiners saw many answers that just said "price may be low".
- **Effects on an economy, a firm, workers or costs** (4 parts):
 - **More firms and the economy**: more competition → lower prices, higher quality and more choice; less monopoly power; more output and jobs. Against: smaller firms miss economies of scale; wasteful duplication; lower profits → less investment and innovation.
 - **Is competition harmful to a firm?** Harmful: it must cut prices, so profit falls; it must spend on advertising and quality, raising costs; it may lose customers and close. Not harmful: it pushes the firm to be efficient and innovative, it can win market share if it is better than rivals, and it may be able to

recruit skilled workers from rivals.

- **Is competition always a disadvantage to workers?** For: firms cut wages to cut costs; firms that lose out close, causing job losses; pressure to work harder. Against: more firms means more employers wanting workers, so more job choice; firms train workers to be more productive; rivals may offer higher pay to attract skilled staff.
- **Do all monopolies have low costs?** Yes: economies of scale (bulk buying, technical, financial, managerial). No: diseconomies of scale (control and communication problems); no competitive pressure to keep costs down; a monopoly in a small or niche market is not big enough for economies of scale. Keep to **costs**: examiners saw answers drift into prices.

3. Analyse (6 marks) (4 question parts)

A mark for each link in a chain. Write **three developed chains** that end at the effect the question asks about. A list of points caps you at about 3.

Variations you will meet:

- **Benefits (or effects) for consumers of a competitive market** (3 parts): define it: many firms, low barriers to entry, substitutes available (1 + 1). Then: **low prices** (1) because firms compete to win customers and market share (1), raising consumers' purchasing power (1); **high quality** (1) because competition drives efficiency and innovation (1); **choice** (1) because firms make different versions (1); firms **respond to consumer demand** (1), consumer sovereignty (1). For "effects of increased competition amongst firms" you can also use effects on firms: lower profits because demand is shared between more firms (1 + 1), weaker firms close (1), more spending on advertising raises costs (1), or lower quality from cost cutting (1).
- **How the closure of firms may harm consumers** (1 part): less competition → more monopoly power and market share for the firms left → higher prices (the mark scheme gave **only 1 mark in total** for higher price, so don't repeat it); less need to innovate → lower quality; slower response to changes in demand; **less choice**; consumers may have to **travel further** or spend time finding alternatives; lost external economies of scale → higher average costs → higher prices.

4. Explain (4 marks) (1 question part)

Two points, each 1 mark to identify + 1 mark to explain.

- **Explain two characteristics of monopoly**: only one firm (1), so it has a dominant market share and no effective competition (1); high barriers to entry (1), so new firms find it hard to enter the industry (1); price maker (1), able to set its price because consumers have no alternative (1); controls supply (1), which lets it raise price and profit (1); large size (1), gaining economies of scale (1).

Worked examples

Example 1

Explain two reasons why a monopoly may earn high profits in the long run. [4]

It is protected by high barriers to entry (1), such as a patent or the huge cost of building a network, so new firms can't enter and compete its profits away as they would in a competitive market (1).

It is a price maker (1): consumers have no close substitutes, so demand is inelastic and it can restrict supply and raise its price without losing many customers (1).

Example 2

The number of firms selling mobile phone data plans in a country has risen from two to eight. Analyse how this may affect consumers. [6]

The market has become more competitive: there are more sellers offering close substitutes (1). Each firm now risks losing customers to seven rivals if its price is too high, so firms cut prices to win market share (1), and consumers can buy more data with the same income (1).

Firms also try to stand out by offering faster connections and better customer service (1), because consumers who are unhappy can easily switch provider (1).

Consumers get more choice (1): the firms offer different plans, some with more data and some cheaper, so each consumer can pick the plan that suits them (1). (Any 6.)

Example 3

A city's bus services are all run by one private firm. Discuss whether or not consumers benefit from there being only one bus firm. [8]

A monopoly is a market with a single seller, protected by high barriers to entry.

Why they might. One firm running every route can gain economies of scale: it buys buses and fuel in bulk and plans one timetable for the whole city, so its average cost is lower than several small firms' would be. If it passes the saving on, fares can be lower (developed point for).

Its secure profits can be spent on new, cleaner buses and ticketing technology, improving the quality of the service; small competing firms with low profits might not afford this. One network also avoids several firms running half-empty buses on the same busy routes (developed point for).

Why they might not. With no rival bus firm, passengers who have no car can't switch, so the firm can raise fares and still keep most of its customers; people on low incomes lose most (developed point against).

With no competitive pressure, the firm has little reason to keep buses clean and on time or to add routes; it may become complacent and inefficient, and consumers must put up with poor quality and little choice of service (developed point against).

Judgement. It depends on how the firm uses its power. If the government sets a maximum fare or the firm faces competition from trains, taxis and cycling, consumers may gain from its economies of scale. If passengers have no alternative and the firm is unregulated, it is more likely to charge high fares for a poor service. Both sides are developed and the judgement says what the answer depends on, so this meets the Level 3 descriptor (6–8 marks).

Common mistakes

- **Saying a monopoly will charge low prices without saying why.** Examiners saw many answers that stated "prices may be low" with no reason. Link it to economies of scale lowering average cost, or to a state monopoly aiming at welfare.
- **Stating points without explaining them.** "A monopoly produces good quality because it has no competitors" earns little: explain **how** (its secure profits pay for R&D). Every point needs a because.
- **Drifting off the question.** In "do all monopolies have low costs?", examiners saw candidates write about prices instead of costs. In a question about consumers, write about consumers; about workers, write about workers.
- **Writing one side only in a Discuss question.** Level 3 needs both sides developed and a judgement.
- **Confusing seller and buyer.** A monopoly is a **single seller** facing **many buyers**, not a single buyer.
- **Thinking a monopoly is a price taker.** It is a **price maker**; a firm among many rivals is closer to a price taker.
- **Mixing up short run and long run.** Firms in competitive markets may earn high profits for a while, but new firms enter and those profits fall; only barriers let a monopoly keep them.
- **Repeating "higher prices" in an Analyse answer.** The mark scheme may credit it only once; use other effects (quality, choice, innovation, travel time).
- **Drawing diagrams.** None are needed for this topic, and demand and supply diagrams earn nothing here.

How to get the marks

- **Explain two ...** (4 marks): identify (1) + explain (1), twice, with two clearly different characteristics or reasons.
- **Analyse** (6 marks): three developed chains, each running from the market structure to the effect asked about (price, quality, choice, profit). Starting with a one-line definition of a competitive market can earn a mark on its own.
- **Discuss** (8 marks): define the structure, give two developed points each side, then a judgement that says **what it depends on** (economies of scale, regulation, substitutes, state or private ownership). Use the case in the question (buses, shampoo, restaurants).

- **Use the four words:** price, quality, choice, profit. They are what the syllabus asks about competitive markets and what the mark schemes reward.
- **Multiple choice:** 1 mark each, no penalty for guessing. For a grid of "increase / decrease", decide each column on its own before looking at the options.

Quick check

1. Which is most likely to be a barrier to entry into a market?
 - **A** many small firms already selling in the market
 - **B** low costs of setting up a firm
 - **C** a patent held by the firm already in the market
 - **D** a product with many close substitutes
2. The number of shops selling bicycles in a town rises from 2 to 12. What is most likely to happen to the price of bicycles and the choice available to consumers?
 - **A** price falls, choice increases
 - **B** price falls, choice decreases
 - **C** price rises, choice increases
 - **D** price rises, choice decreases
3. Which is a disadvantage of monopoly for consumers?
 - **A** its profits can fund research and development
 - **B** it can gain economies of scale
 - **C** consumers cannot switch to a rival if its quality is poor
 - **D** it avoids wasteful duplication of networks
4. A country's only cement producer is privately owned. What is most likely to limit the price it can charge?
 - **A** a patent on its production method
 - **B** imports of cement from other countries
 - **C** the high cost of building a cement factory
 - **D** the lack of substitutes for cement
5. Explain two ways consumers may be affected when a market changes from having many firms to having one firm. **[4]**

Answers

1. **C.** A patent legally stops other firms using the method, so it keeps them out. A and B mean entry is easy; D describes a competitive market. (1)
2. **A.** More sellers compete for customers, so prices fall and there are more shops and models to choose from. (1)
3. **C.** With no rival, poor quality can't be escaped. A, B and D are advantages. (1)
4. **B.** Imports give buyers a substitute supplier, so a high price would lose sales to foreign firms. A, C and D all protect the monopoly. (1)
5. Prices may rise (1): the single firm faces no competitors and consumers have no substitutes, so it can restrict supply and charge more (1). Choice falls (1): there is only one firm's range of products, so consumers can't pick a version that suits them better (1). (Also: quality may fall with no pressure to improve; or prices may fall if the firm gains economies of scale.)

Past questions to try

- **0455/23/M/J/25 Q3:** part (d), whether competitive markets benefit consumers.
- **0455/23/O/N/24 Q2:** part (b), two characteristics of monopoly.
- **0455/22/M/J/24 Q2:** part (c), how the closure of firms may harm consumers.
- **0455/11/M/J/24 Q16:** what changes when a competitive market becomes a monopoly.