-Modules-

MARKET STRUCTURE

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Basic Concepts

- Plant – it is a technical unit of production. its size is determined by the technical level of production.
- Firm – it is a unit of organization involving decision making regarding production activity. It includes one plant or multi plant.
- Industry – is a group of firms in a region engaged in the same or similar production activity.
- Market – market represents mechanism of exchange of a product which may be homogeneous or differentiated.

Market structure represents the existence of degree of competitiveness among firms operating in the market.

Factors Influencing Market Structure

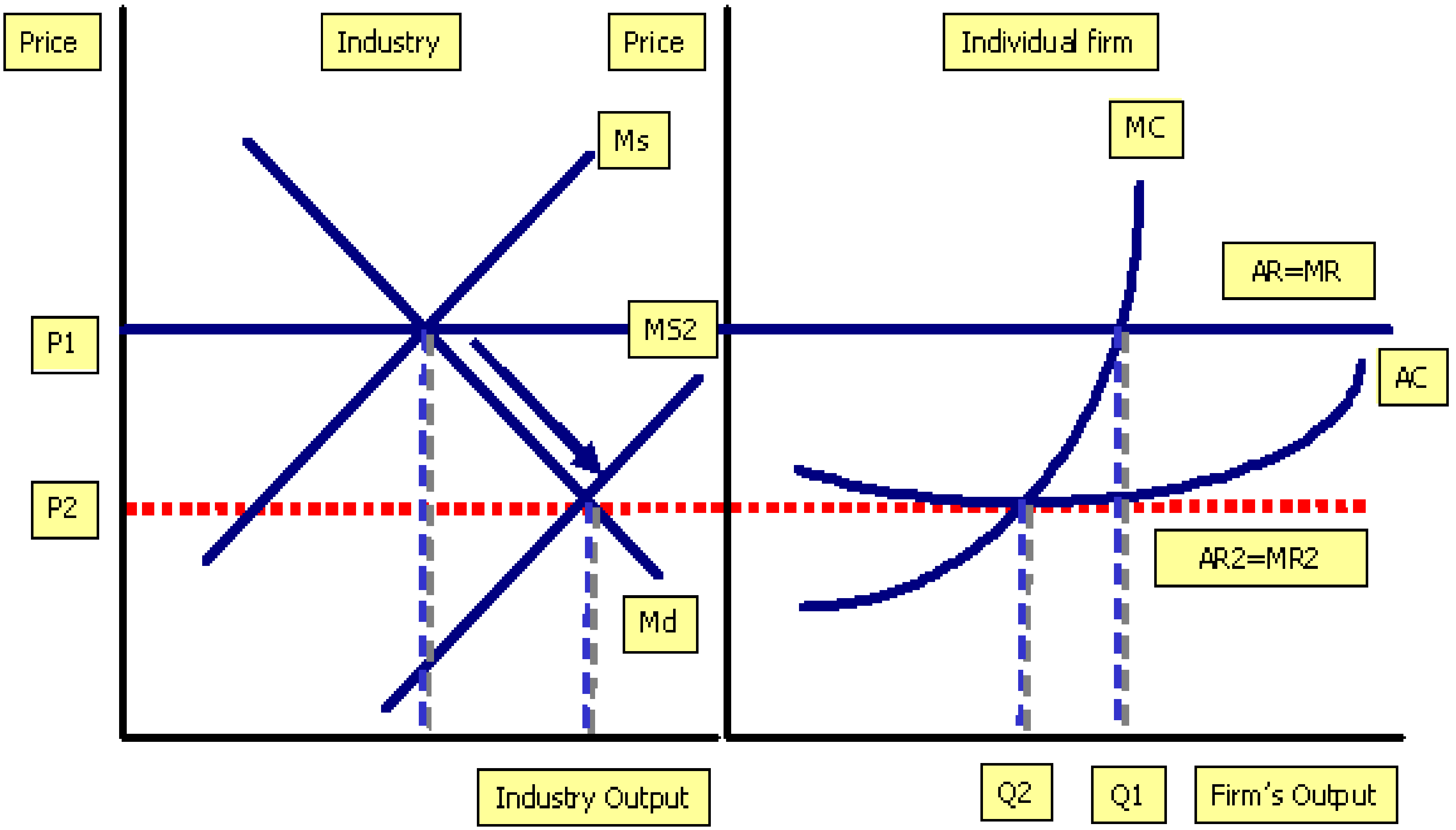
Factors	Description
Number of buyers	Very large/one
Number of sellers	Very large/many/few/two/one
Nature of the commodity	Homogeneous/differentiated
Entry in the market	Free/restricted
Knowledge of the market	Perfect/imperfect
Demand curve as seen by seller	Perfectly elastic/negatively sloping/kinked.

Perfect Competition

Perfect competition is a condition of market in which there exist very large number of buyers and sellers of a homogeneous product having no control over price.

Features - Perfect Competition

- A large number of buyers and sellers – The number of buyers and sellers are large and the share of each one of them in the market is so small that none has any influence on the market price.
- Homogeneous product – The product of each seller is totally undifferentiated from those of the others.
- Free entry and exit – Any buyer and seller is free to enter or leave the market of the commodity.
- Perfect knowledge – All buyers and seller have perfect knowledge about the market for the commodity.
- Indifference – No buyer has a preference to buy from a particular seller and no seller to sell to a particular buyer.
- Knowledge of the market – both the buyers and sellers possess perfect knowledge of the market. This is the case with respect to knowledge of the present conditions as also of the future conditions. Hence there are no uncertainties of the future in this market.
- There is no government intervention in the market, there is perfect mobility of factors of production and there are no costs of transport so that the commodity is available everywhere at the same price.
- In perfect competition no single buyer or seller plays a significant role in price determination. However all of them jointly determine the price. The price is determined in the industry, which is composed of all the buyers and sellers for the commodity.

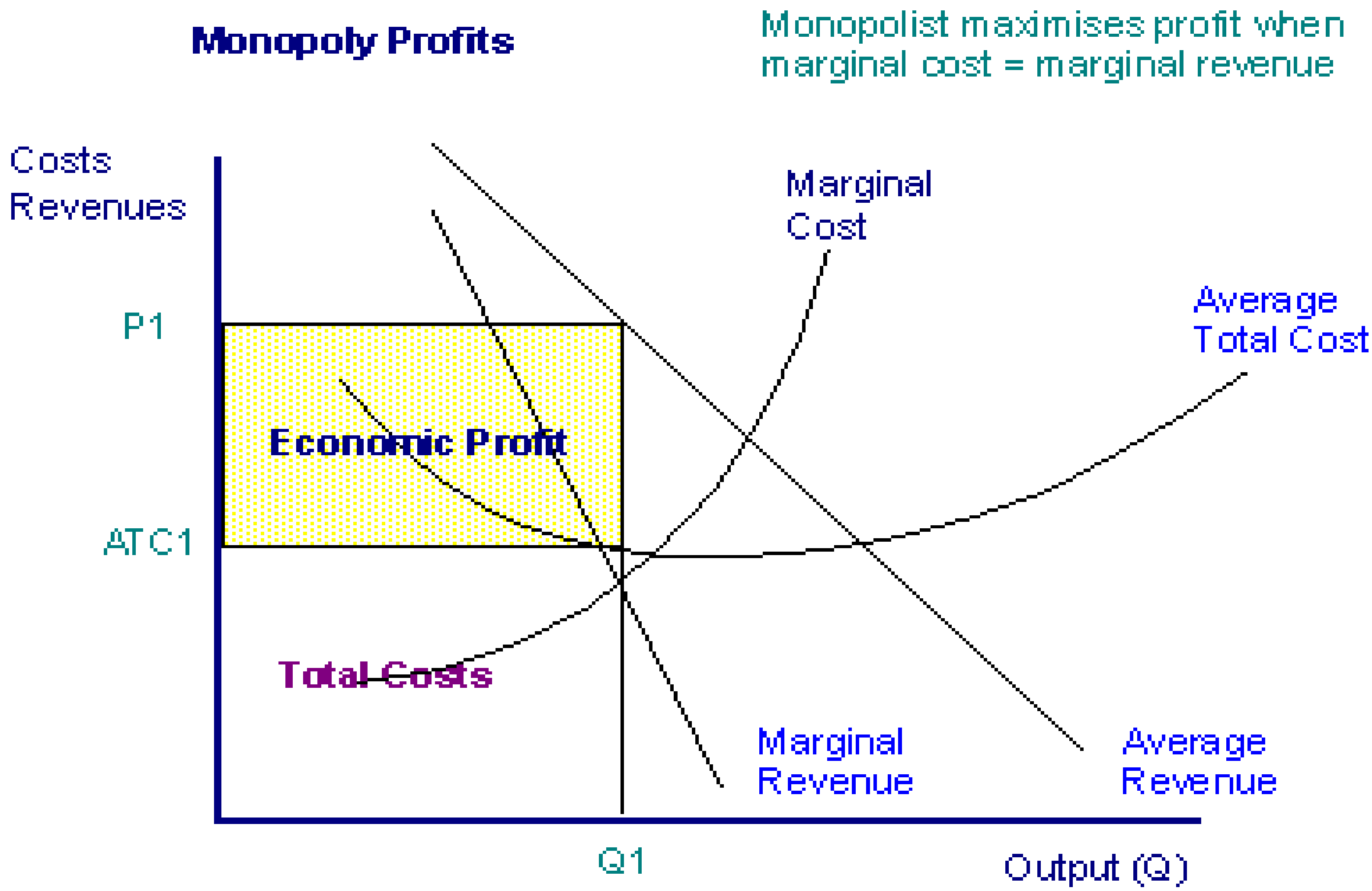

Price
Industry
Price
Individual firm
Ms
MC
AR=MR
P1
MS2
AC
P2
AR2=MR2
Md
Industry Output
Q2
Q1
Firm's Output

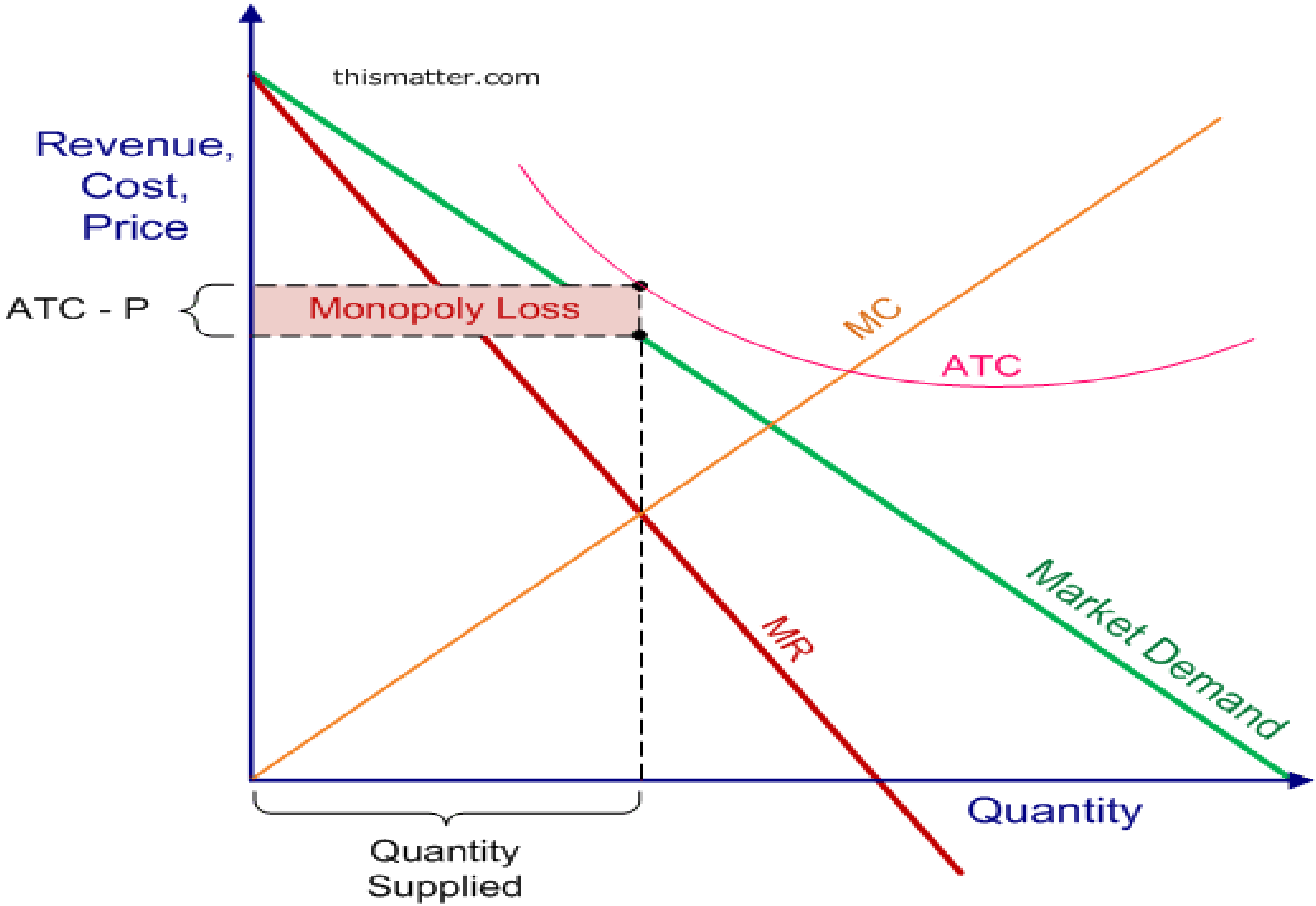
Monopoly

Monopoly is a condition of market in which there exists only one seller of a homogeneous commodity having control over price.

Features - Monopoly

- Single seller – There is only one seller of the commodity or number of firms under a single control (multi firm monopoly).
- Large buyers – the number of buyers is very large.
- No close substitutes – There are no close substitutes for the monopolist's product and the seller faces no imminent threat of competition.
- For newcomer firms entry in monopoly is difficult. Monopolist restricts the entry of new firms by following legal protections like patents, copy rights, sole operation etc. of by economic barriers like price-cutting, huge capital investment etc.
- Knowledge of the market – both the buyers and the sellers has perfect knowledge of the market. Therefore no uncertainties.
- Under such market, the firm and the industry coincide by definition. The demand function facing a monopolist is the same as that facing the industry.


Monopoly Profits
Monopolist maximises profit when marginal cost = marginal revenue
Costs
Revenues
Marginal Cost
Average Total Cost
P1
ATC1
Economic Profit
Total Costs
Marginal Revenue
Average Revenue
Q1
Output (Q)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Revenue,
Cost,
Price
ATC - P
Monopoly Loss
MC
ATC
Market Demand
MR
Quantity
Quantity
Supplied

Monopolistic Competition

Monopolistic competition is a condition of market in which there exist many sellers of differentiated but close substitute products having no control over price.

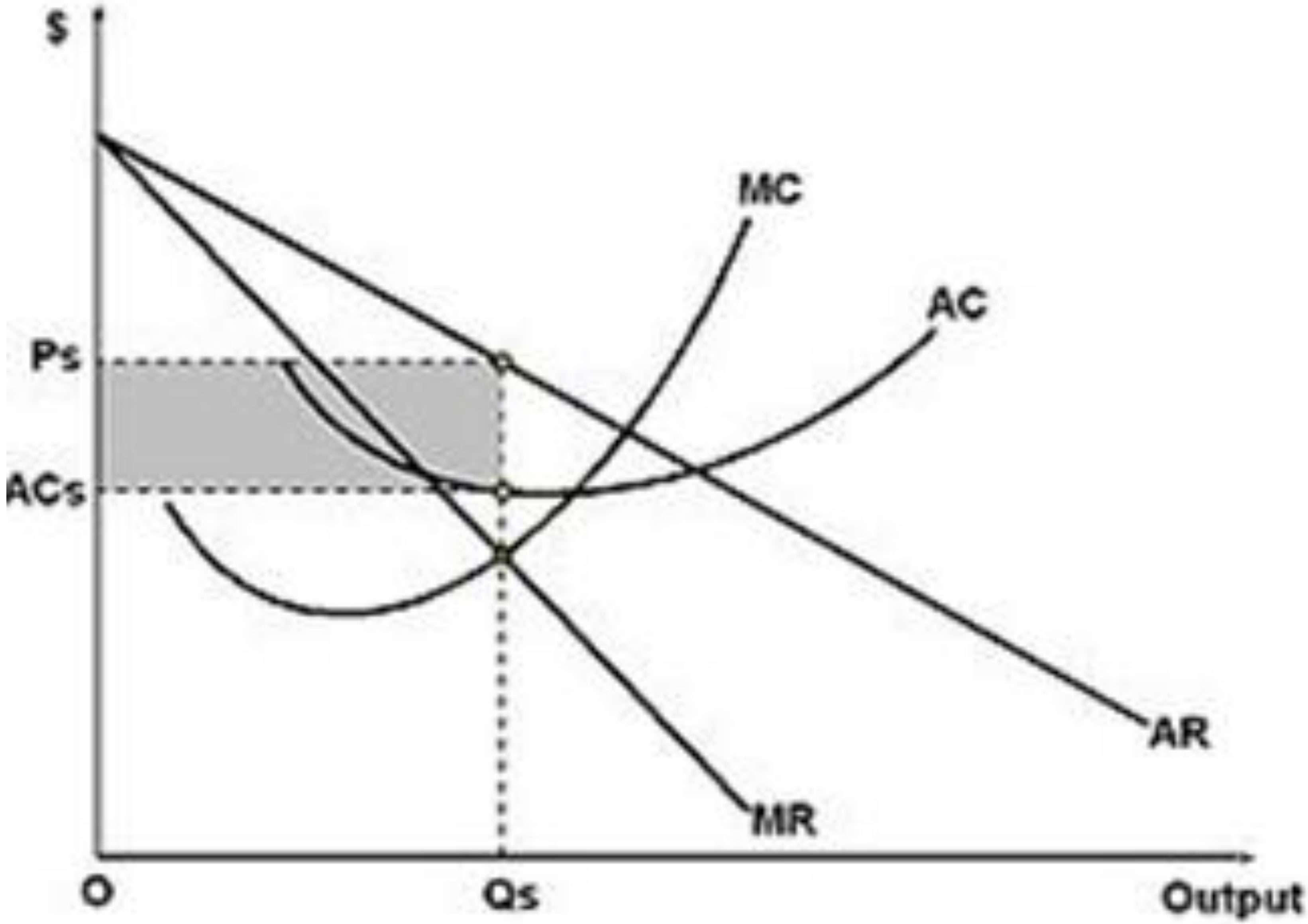
Features - Monopolistic Competition

- A large number of buyers and sellers – There are many sellers of a commodity each with an insignificant share of the market so that the activities of each have no effect on others. Similarly, there are large numbers of buyers in such market.
- Differentiated product – Each firm produces basically the same product but endeavors to distinguish it from its rivals by product differentiation. The difference will often only be marginal or a matter of branding or packaging, but the manufacturer sets out to establish his product as unique even though it has in fact very close substitutes.
- Free entry and exit – Individual buyers and sellers are free to enter or leave the market.
- Natures of the commodity – the commodity offered in this market are (1) differentiated product and (2) it has close substitutes in the market.

- Product differentiation refers to creating a different and distinct image of the commodity produced by each seller. Basically commodity is one but it is sold under different brand names and with differences of external nature and facilities. (eg. Commodity - Hair Oils, Brands – Parachute, Bajaj Almond, Navarantna etc.)

- Various brand of a product are close substitutes to each other (eg. In toothpaste, Miswak – Babool – Close – up – Pepsodent etc.)

- Since products are similar but not identical, there will be no unique price. Instead there will be a cluster of market prices reflecting consumer opinions of comparative qualities of differentiated products. The price of an individual firm's product is determined by its cost function, demand, its own objective and by government regulations.


$
Ps
ACs
MC
AC
AR
MR
O
Qs
Output

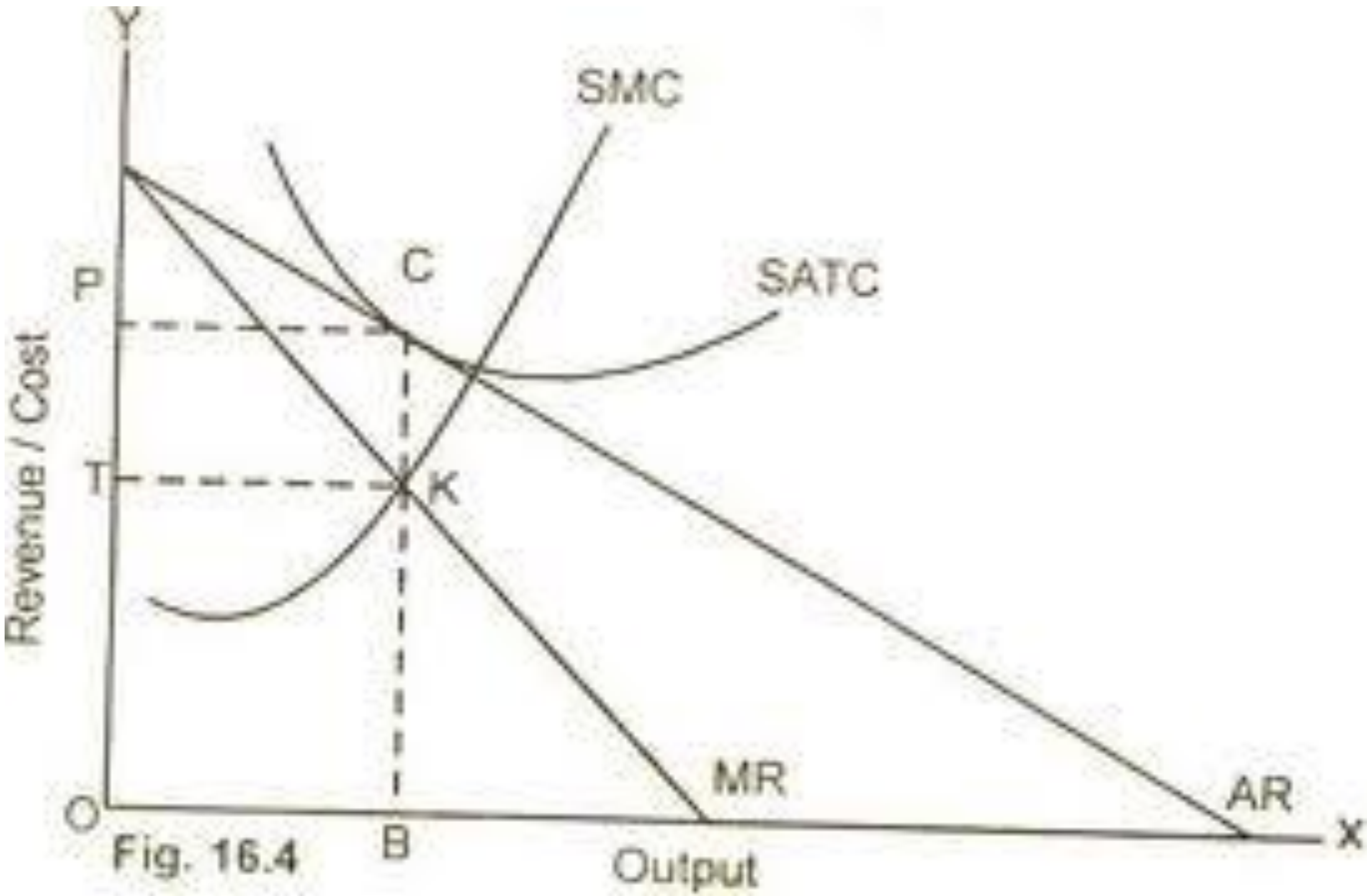
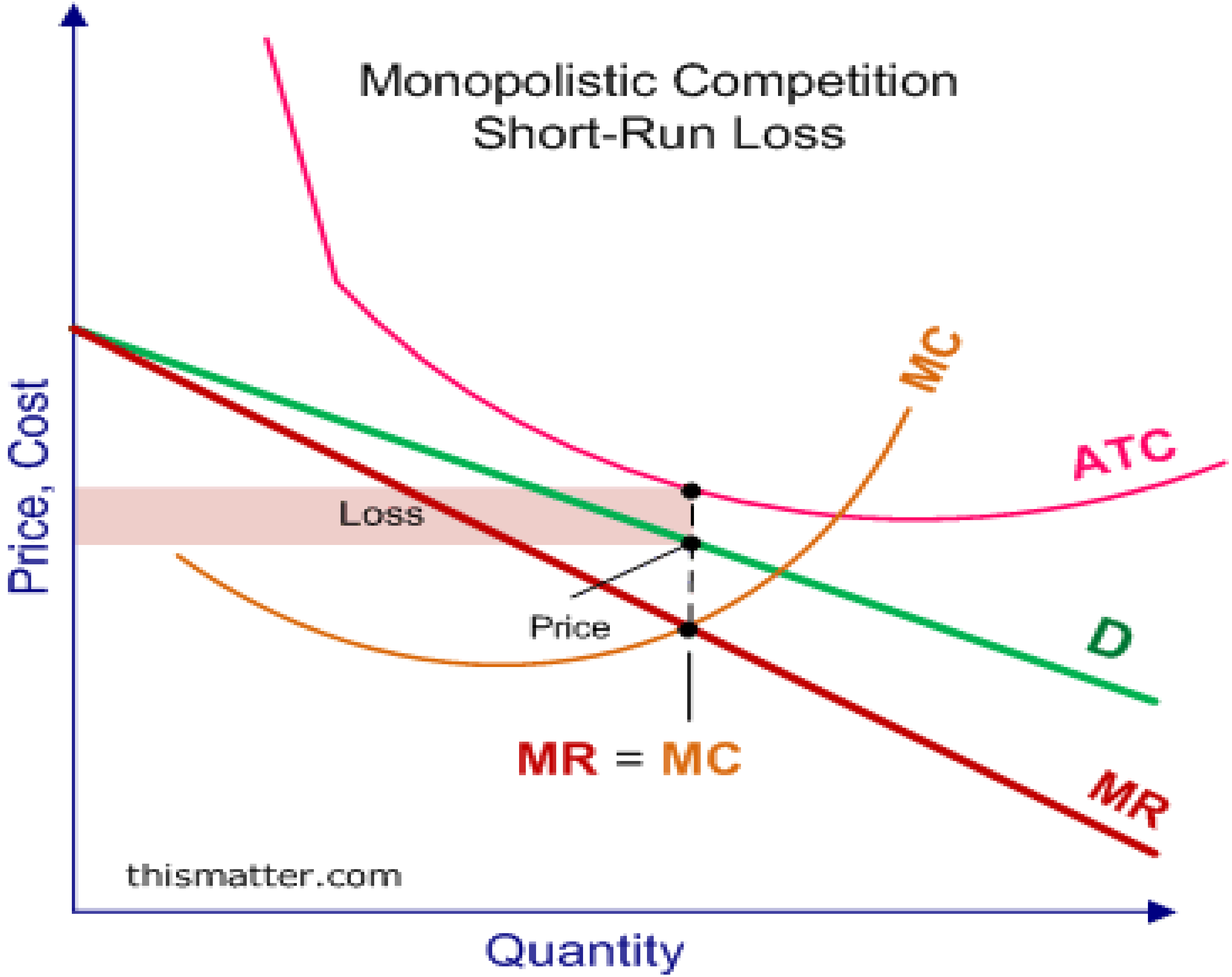


Fig. 16.4


Monopolistic Competition
Short-Run Loss
Price, Cost
MC
ATC
Loss
Price
D
MR = MC
MR
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Quantity

Oligopoly

Oligopoly is a situation of market in which there exist few sellers of a homogeneous or differentiated but close substitute products having control over price.

Features - Oligopoly

- Number of buyers – the number of buyers is very large, so large that no single buyer by his individual or collective action with other buyers can influence market price by changing demand.
- Number of sellers – only few sellers exists in this market. Generally more than three and last in single digit. If numbers of sellers are two then it is Duopoly.
- The number of sellers being too small, each seller controls a substantial portion of supply and hence can influence the market price by changing the supply. Therefore the seller is a price maker.
- Because of small number, each seller is in intense competition with all the other sellers. So they are not simple competitors rather they are rivals of each others.
- Fewness of number results into mutual interdependence of all the sellers. If one seller changes price, introduces a new product or goes on for new effort of product differentiation, all the rivals react to that by their own counter actions.
- Because of small number the rivals can follow two different policies
- Non collusive oligopoly – though sellers actions are interdependent at times they may decide to ignore this and follow their own independent policy without considering the probable reaction of the rivals, this is non collusive oligopoly.
- Sellers are interested in avoiding cut throat competition and therefore they join hands for common programmes this is described as collusive oligopoly.
- Nature of commodity – there are two possibilities, (1) Homogeneous product – all sellers may be selling perfectly identical product and therefore price assumes importance. Products like petrol, diesel, kerosene, cooking gas, cement etc. Market of this kind is described as, 'Pure Oligopoly'. (2) Differentiated Product – Oligopolists have the choice of product differentiation in Cellular telephones, tyres, refrigerators, detergent soaps, soft drinks, automobiles etc. there is brand preference and thereby linkage of the buyers with sellers. Hence every seller enjoys a limited monopoly power in the market. Market model of this kind is described as, 'differentiated oligopoly'.
- Entry in the market – in the oligopoly market entry for firms is either free or restricted.
- Knowledge of the market – the buyers and sellers possess complete knowledge of the market due to small number of sellers.

Pricing under Oligopoly

- Price leadership
- Price wars
- Price cuts to weed out competition
- Collusion – business syndicates formed by competing firms and agree to charge a uniform price to eliminate price retaliation. Such collusion implies monopoly. The business collusion is considered illegal.
- Cartel – existing sellers forms an agreement on controlling market supply jointly and determining the price for their output with the creation of monopoly power. The OPEC nations.

Discussion