Block – 4 Fundamental of Markets

Unit – 12 Market

Market - A market is any structure that allows buyers and sellers to exchange any type of goods, services and information. The exchange of goods or services, with or without money, is a transaction. The market may be physical like a retail outlet, where people meet face-to-face, or virtual like an online market, where there is no direct physical contact between buyers and sellers.

A competitive market is characterized by only one market-established price. Three conditions characterize a competitive product market:

- Entry into and exit from the market by individual firms is easy,
- All firms in the industry sell a homogenous or a standardized product,
- The number of firms is so large that no individual producer is able to influence the market price of the product.

If a firm has the ability to influence the market price of a product, **an imperfectly competitive market** condition is said to prevail. Imperfect competition or price control is characterized by:

(a) barriers to entry and exit in the market;
(b) products that are not perfectly identical, but rather are unique or differentiated in some way;
(c) a small number of firms, enabling each producer to influence product price.

Unit – 13 Types of Market

The term 'market structure' refers to the organizational features of an industry that influence the firm's behaviour in its choice of price and output.

1. Perfect Market - Perfect market is a market in which there are large number producers. Under this competition, each individual producer produces such an insignificant part of the total market production that he assumes that his actions will have no effect on the market price.

- A large number of producers,
- A homogeneous good,
- No artificial restrictions placed upon price or quantity,
- Easy entry into and exit from.

2. Imperfect Market Competition –

- **Product differentiation:** One characteristic of imperfect competition is the existence of a differentiated product. Sometimes the differentiation is real and at other times it is contrived in the eyes of the buyer.
- **Product promotion:** Firms in an imperfect market also distinguish their output in part through promotional expenditures on qualitative differences. Depending upon the degree and character of the imperfect market, producers engage in advertising to promote alleged and real qualitative differences in hopes of convincing consumers that their product is unique from and superior in one way or another to the products of other firms.
- **Entry barriers**: Imperfect competition also may be typified by the existence of barriers which make it difficult or impossible for other firms to enter the industry. Large financial requirements, highly technical capital resources, patent laws, and exclusive ownership or control of limited supplies of raw materials are different types of entry barriers.
- **Price control:** The above three characteristics of imperfect competition are complemented by the existence of limited numbers of firms in relation to market size. Thus, the important feature of imperfect competition is the extent or degree to which firms can control or influence market price through their decisions.

Both monopolistic competition and oligopoly are forms of imperfect product markets that are quite typical of firms in the economy.

Monopolistic Competition - Monopolistic competition is the form of market organization in which there are many sellers of a heterogeneous or differentiated product, and entry into and exit from the industry is rather easy in the long run. Differentiated products are those which are similar, but not identical and satisfy the same basic need.

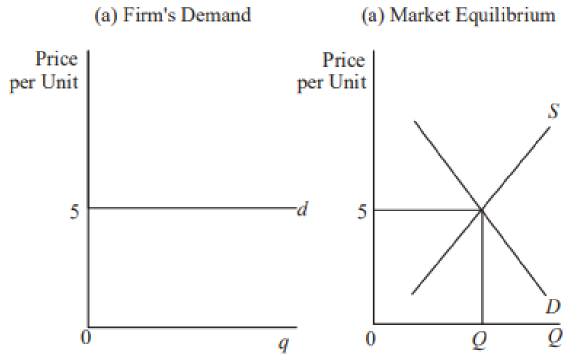
Monopolistic competition is most common in the retail and service sectors of our economy. Clothing, cotton textiles, and food processing are the industries that come close to monopolistic competition at the national level.

Oligopoly - Oligopoly is the form of market organization in which there are few sellers of a homogeneous or differentiated product. If there are only two sellers, we have a duopoly. If the product is homogeneous, we have a pure oligopoly. If the product is differentiated, we have, a differentiated oligopoly. While, entry into an oligopolistic industry is possible, it is not easy (as evidenced by the fact that there are only a few firms in the industry). The sources of oligopoly are generally the same as for monopoly

Unit – 14 Profit Maximization under different market Structure

Under Prefect Competition-

1. Determination of Price and Demand Curve -In perfect competition, the price of a product is determined in an industry with the forces of total demand and total supply and this price determined by industry is accepted by the firm.



Once, the market price has been determined, individual firms can supply all they want at that price. Thus, firms in perfectly competitive markets, as price takers, must offer their product for sale at whatever price is established by the market.

'In perfect competition there is no competition'. Ironically, two neighbouring corn farmers in perfect competition are not really competing in the sense of being rivals. The amount that one farmer grows will have no effect on the price the other receives. They both are free to sell as much corn as they choose at the price determined in that market.

A firm will produce where marginal revenue (MR) is equal to marginal cost (MC). Marginal revenue is addition to total revenue by one extra unit and marginal cost is addition to total cost by one extra unit.

In perfect competition, the goal of a firm is to maximize profit. However, because the market is characterized by freedom of entry and exit, a firm might want to leave one market and enter another.

- **Initial Equilibrium** - In initial equilibrium the firm produces q units of output and earns a normal profit. At point e, price, marginal cost, short-run average total cost, and long run average cost are all equal.
- **Equilibrium in short run** - In the short run, a firm may incur losses or earn abnormal profit. If a firm incurs losses, it will leave the industry and if firm earns abnormal profit, new firms will enter and these new firms will compete with old firms and in that case only normal profit will be available to existing firms.
- **Equilibrium in Long Run -** In the long run firm and industry will get only normal profit.

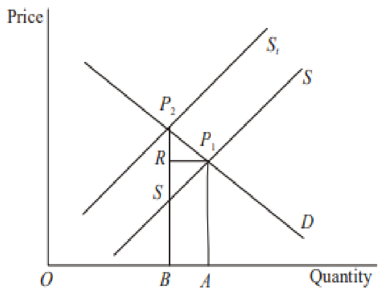


Fig. 14.7 Perfect Competition and Tax

Perfect Competitions and Tax - Suppose that a tax is imposed on the producers of a commodity, the tax is on each unit for they produce. Naturally, the producers wish they could pass the tax on to the consumers. However, they could only do so if they could raise their prices. This is impossible in perfect competition because individual producers have no control over price at all. The tax, however, is an added cost. It increases the marginal costs of the firms, thus causing them to produce less at any given price.

Therefore, the industry supply curve shifts upward and to the left. The new equilibrium price is higher than the old. The tax, accordingly, does result in a higher price — not because of the producers' wishes, but because of the decrease in supply. The rise in price is not, however, equal to the tax.

Under Imperfect Competition -

- **Barriers in Monopolistic Market-**
    - **Legal and natural barriers:** When a law makes it illegal to enter and compete in the market, it is a legal barrier. For example, patents and copyright. Natural barriers indicate the availability of some natural resources in some countries and non-availability in others.
    - **Tariffs and quotas:** It can happen that a firm has a dominant position in its home country, but faces competition internationally. A tariff raises the price of goods imported into the domestic economy and a quota restricts the volume that can be imported. They therefore protect domestic industry from international competition.
    - **Capital costs:** The third aspect of monopolist is capital costs. Certain businesses, such as international airlines and chemical companies, have relatively high set-up costs.
    - **Natural barriers to entry:** Some markets have natural barriers to entry, which can be caused by geography or technology. A firm can have a monopoly because it owns the only source of an input, for example gold mine.

- Monopolies, of course, do not always earn above-normal profits. There may be normal and in the short run may even be below normal profit. If profits are below normal in the short run, the monopolist will leave the industry. Thus, in the long run, the monopolist's profits will be either normal or above normal.

Price Discrimination - Price discrimination occurs when the same consumer is charged different prices for the same product or when different consumers are charged different prices for the same product. The aim of price discrimination is to increase the profits of the discriminating firm.

Conditions of Price Discrimination - In order for a firm to practice price discrimination, certain conditions must exist.

(a) First degree price discrimination: If a monopolist can charge a different price for each unit sold, it may be able to practice perfect price discrimination. By setting the price of each unit equal to the maximum amount consumers are willing to pay for that unit.
(b) Second degree price discrimination: This occurs when the same consumer pays a certain price for some units of a commodity and a different price for further units of the commodity.
(c) Third degree price discrimination: Third degree price discrimination occurs when the same product is sold to different consumers at different prices. This is probably the most common form of price discrimination.

Price Determination and Profit Maximization under Monopolistic Competition – Need to study (242)