Industrial-Economics-Module-3-Important-Topics

For more notes visit

https://rtpnotes.vercel.app

---

1. Perfect competition

Perfect competition

Perfect competition is a market situation in which there are larger number of buyers and sellers dealing in a homogeneous product with perfect knowledge of the market conditions and perfect mobility of goods and factors of production.

Features of Perfect competition

- Large number of buyers and sellers
- Homogeneous Product
    - All sellers are selling identical product, same in appearance color, quality.
- Freedom of entry and exit
- Perfect knowledge
- Perfect mobility of goods and factors of productions
    - Assumed that goods and factors of production are free to move from one place to another
- Absence of transport cost
- Perfectly elastic demand curve

---

2. Monopoly

- Monopoly means a single seller
- Its a market situation in which a single seller controls the entire supply for a commodity
- Example: Indian Railway is a monopoly of the government

Features of Monopoly

- **Single seller** : under monopoly there is only a single seller who controls entire production and distribution of a commodity.
    - Since there is only one seller there is no competition and the seller can charge any price for his product.
- **No close substitutes** : Monopolist is selling a product which has no close substitutes. Close substitute means goods which satisfy the same want.
- **Barriers to entry**

    - Freedom of entry is restricted in monopoly
    - Form of
        - Legal restrictions
        - Exclusive ownership
        - Technical Knowhow
- **Price Maker**
    - Can fix any price for the product, because there are no other competition

---

3. Monopolistic Competition

What is Monopolistic Competition

- It is a market situation in which there are a large number of buyers and sellers dealing in a differentiated product
- The product produced by each seller is not identical, they are close substitutes. They may differ in color, shape, taste etc.
- Examples are Bath soap, softdrinks

Features of monopolistic competition

- **Large number of buyers and sellers**
    - Similar to perfect competition there are large number of buyers and sellers in monopolistic competition
- **Product differentiation**
    - It can be in the form of changes in color, shape, quality, packing, etc
- **Selling cost**
    - Each seller is selling a product which are close substitutes
    - They spend huge amounts on ads and other sales promotional activities. This is called selling cost
- **Freedom of entry and exit**
    - There are no restrictions on the entry or exit of firms
    - New firms can enter into the industry or loss making firms can leave the market at any time
- **Imperfect knowledge**

- The information about market condition like price, quality, cost etc is not uniformly available to all buyers and sellers

4. Oligopoly and kinked demand

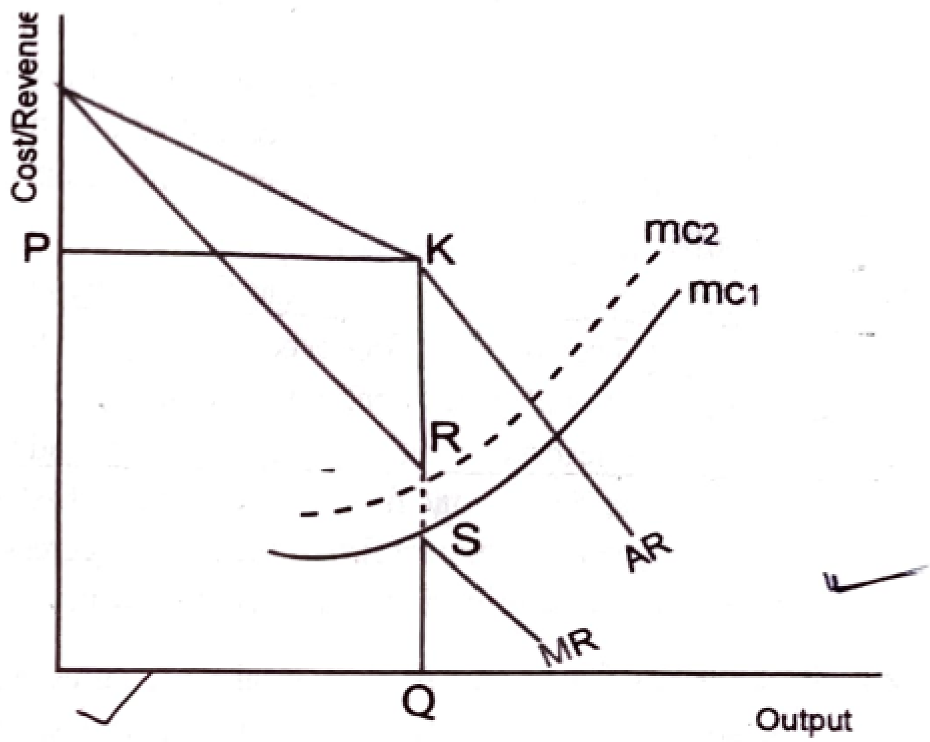
- Oligopoly is a market situation in which there are a few sellers selling either a homogenous or differentiated product.
- Examples include Aviation and Telecommunication industry
- Since there are only a few firms, they are interdependent to each other

Features of Oligopoly

- **Few Sellers**
  - Few sellers dominate the entire industry
- **Homogenous or differentiated product**
  - Homogeneous Example -> Petrol
  - Heterogenous Example -> Automobiles
- **Barriers to entry**
  - Economic Barriers prevent the entry of new firms
    - Form of huge investment requirement
    - Strong Customer loyalty
- **Mutual Interdependence**
  - Firms are influenced by each others decision
- **Existence of price rigidity**
  - Firms do not prefer to change price of their product because it will not be beneficial for them
    - If one firm decreases the price others will also reduce price
    - If the firm increases the price, others will not increase the price and hence it will lose its customers
  - Firms resort to non price competition like ads
- **Indeterminate Demand Curve**
  - Demand curve is unknown under oligopoly

Kinked demand Curve

- Kinked demand curve explains price rigidity under oligopoly on the basic of the following assumptions
  - If a firm increases its price others will follow
  - If a firm decreases its price others will also do the same
- Usually in oligopoly, firms will not enter into a price war, price remains rigid
- If one firm decreases price, others will decrease price
- If the firm increases the price, others will not increase the price and hence it will lose its customers
- This behaviour is explained by **kinked demand curve**



- The lower part in the demand curve is less elastic because the firm cannot gain from the price cut
- Upper part is more elastic because there will be substantial fall in demand if theres a price hike
- In the diagram we can see a kink K.
  - This creates a discontinuity in the MR curve
  - At the kink, MR remain unchanged between S and R
- Marginal cost curve mc1 intersect MR curve at S and OQ is the equilibrium level of output

- Suppose cost increases and MC curve shift upwards as mc2
  - There will not be any change in equilibrium price and quantity till MC reached point R in gap

5. Collusive Oligopoly

- Under oligopoly firms are interdependent and face cut throat competition
- **To avoid price war and loss, firms enter into an agreement regarding uniform price and output**
- **This agreement is known as collusion**
- Collusion denotes a situation in which two or more firms jointly set their prices or output, divide the market among them or make business decisions
- Under collusion, sometimes the dominant firm in the industry sets the price and others follow it.

6. Pricing Strategies

The pricing Strategies are

Cost Plus or Markup Pricing

- Under this strategy price is th esum of cost and a profit margin
- Average cost is used for this price
- Price = AC + m
- Where m is the percentage of markup
- Markup is fixed arbitarily and Determined at 10 percent

Target Return Pricing

- Similar to cost plus pricing
- But in cost plus pricing, the profit margin is decided arbitarily
- But in this method, producer rationally decides the minimum rate of return

Penetration Pricing

- When a firm wants to enter into a market which is already dominated by existing firms, the only option is charging a price less than the existing price.
- This price is called penetration price
- Example: Reliance with using penetration price with Jio

Predatory Pricing

- Under predatory pricing, the predator, already a dominant firm, sets its prices too low for a sufficient period of time so that its competitors leave the market and others deterred from entering.
- This predation is done on the expectation that these present losses will be compensated by future gains.

Going Rate Pricing

- This is the strategy of following the prevailing market price instead of separate pricing strategy of their own. In this case, the price is fixed by a dominant firm and others accept it.
- Going rate pricing strategy is adopted when the products sold by the sellers are very close substitutes.
- This strategy is adopted when the product is generic like mineral water

Price Skimming

- Its a strategy in which high price is charged at the time of introduction of the product an a lower price during maturity.
- Once the product is established, and reached maturity, producers will reduce the profit margin and charge a lower. This will attract the lower income group.

Administered Pricing

- The term administered pricing is used to denote the price charged by the monopolists.
- Administered prices are not fixed by the market mechanism
- In the case of india, Administered price is fixed by the government
  - Example: Price of cooking gas