12 MARKET STRUCTURE

12.1 MARKET STRUCTURE

Market is usually understood as a place where sellers (producers) and buyers meet for settling a transaction. A market is also defined "as a group of firms and individuals that are in touch with each other in order to buy or sell some good." In today's situation with the progress in the communication system, it is not necessary to have a physical or personal contact in a physical or geographical market area. Transactions take place through electronic commerce, mobile commerce or with the help of other communication media. What is essential is to have a communication between the buyer and seller for settling a transaction.

Depending on the commodity and supporting factors a market can be local, national or international. For company stocks / shares the markets have become national and in certain cases they are internationally traded. Currency market is an example of international market.

A given type of market within the market structure depends on many factors such as (i) nature of commodity, (ii) freedom of entry and exit, (iii) control over supply, (iv) control over price, etc. Based on the above and other factors there are different types of markets which together form the market structure in the economy.

12.2 TYPES OF MARKET

A market structure comprises different forms of markets. To which type a market belongs depends on a number of factors. They include the number of sellers and buyers, the nature and characteristics of a commodity, the influence exercised by the sellers or buyers in the market, the role, need and effects of advertisement or selling cost and a host of other factors.

In this section we are dealing with commodity markets, that is, where goods and services are bought and sold. In economic analysis, commodity markets are generally classified into four categories, that is (1) Perfect Competition, (2) Monopoly, (3) Oligopoly and (4) Monopolistic Competition.

1. **Perfect Competition** is a market situation where we have a large number of sellers and buyers. The commodity sold is identical with no quantitative and qualitative differences. The large number of buyers and sellers naturally prevent a single seller or buyer from influencing the price. In a perfect competition a seller is a price taker. He accepts the price determined in the market by the total demand and supply. Commodity being identical there is no scope for any price differential and discrimination. Both sellers and buyers have complete information of market which helps establish uniform price.

   There is no restriction for any person to produce and sell the existing commodity. So also whoever wants to exit from the market is free to do so.

   Factors of production are perfectly mobile geographically and occupationally. There is no transport cost.

   Market for agricultural commodities is cited as near example for perfect competition. Stock market is another example for this type of market.

   (For detail explanation refer Topic 13.1)

2. **Monopoly** market is different from perfect competition. Here we have one producer (seller) selling the homogeneous or an unique product. The producer has almost near total control on the supply hence he can decide the price and output. However in order to maximise the profit he would control either price or output. Being a sole supplier he could discriminate the price between buyers as well as between markets.

   Like perfect competition it is difficult to have a real situation of monopoly market where a producer has a total control over the supply.

The nearest example that we can have are the public utility services which are usually controlled by the government. At present we have the case of water supply in Mumbai where BMC is the sole supplier. Railway services are the monopoly of the Central Government.

It is expected that the government would not exploit the consumers since it has a responsibility to promote the welfare of the community. Wherever such a monopoly is allowed in the private sector, the government acts as a regulator.

Entry to the market is highly restricted or almost nil. If the entry is allowed then the market would not remain as a monopoly.

Advertising may be resorted to only as a informative devise in order to make consumers aware of the existence and usefulness of the product.

(For detail explanation refer Topic 14.1)

Oligopoly market has few sellers selling standardised or differentiated commodities. The common examples are airlines, automobile manufacturers, computer manufacturers, steel, cement, medical drugs, chemicals, petroleum, broadcasting / telecasting.

Entry to oligopoly market is free, however in reality it is very difficult as there are many barriers such as technology, finance etc. Being small in number there is a possibility of these firms joining together and forming a cartel, as is the case of organisation of petroleum exporting countries (OPEC). Oligopoly firms may have an implicit understanding whereby they influence price, as alleged in case of domestic airlines.

Each firm may have some influence over the price specially when the product is differentiated. Price of a oligopoly product can be decided by a dominant firm which becomes a leader.

Advertising is also resorted since oligopoly firms compete with each other. They also indulge in non-price competition to attract customers.

If the number is small, there is always a tendency for the firms to come together and form a cartel for the purpose of increasing price and profits.

There is also a possibility of the oligopoly marketing turning into monopoly through mergers and acquisition.

(For detail explanation refer Topic 16.1 and 16.2)

4. **Monopolistic competition** is a market situation where there are many sellers, selling differentiated products. Garments, soaps and detergents are some examples. Monopolistic competition is clearly visible in retail trade where sellers sell differentiated products.

Entry to the market is not difficult though not as free as perfect competition. Since a product is differentiated, restricting the entry through patent right is difficult.

Product differentiation is done through different design, size, colour and other characteristics associated with the product. However the products remain close substitute to each other.

Selling cost is the essential aspect of monopolistic competition. Each producer tries to convince the consumer that his product is better than that of his competitors. Advertisements through different media is resorted to engage in non-price competition.

Demand for the product of a monopolistic competitive firm is elastic since the products are close substitutes.

Though price is determined by the market forces yet there is enough scope for price differentiation based on product differentiation. Each firm may claim its product is superior to its substitute in terms of quality attributes.

(For detailed explanation refer Topic 15.1)

Table 12.1 : Market Structure and Characteristics

Market Structure	Examples	No. of Producers	Nature of Product	Power to influence Price	Barriers to Entry	Non price Competition
Perfect Competition	Some agricultural commodities	Large	Standardised (identical)	None	Nil	None
Monopoly	Public utilities	One	Unique Product	Considerable	Very High	Advertising
Oligopoly	Computers, Crude oil, Steel, Airlines	Few	Standardised or Differentiated	Some	High	Advertising and Product differentiation
Monopolistic Competition	Garments (retail trade)	Many	Differentiated	Some	Low	Advertising and Product differentiation

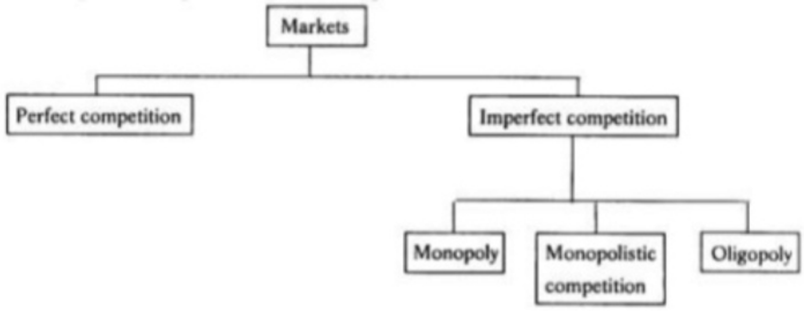
MARKET

Market is a place where buyer and seller meet, goods and services are offered for the sale and transfer of ownership occurs. A market may be also defined as the demand made by a certain group of potential buyers for a good or service. The former one is a narrow concept and later one, a broader concept. Economists describe a market as a collection of buyers and sellers who transact over a particular product or product class (the housing market, the clothing market, the grain market etc.). For business purpose we define a market as people or organizations with wants (needs) to satisfy, money to spend, and the willingness to spend it. Broadly, market represents the structure and nature of buyers and sellers for a commodity/service and the process by which the price of the commodity or service is established. In this sense, we are referring to the structure of competition and the process of price determination for a commodity or service. The determination of price for a commodity or service depends upon the structure of the market for that commodity or service (i.e., competitive structure of the market). Hence the understanding on the market structure and the nature of competition are a pre-requisite in price determination.

Different Market Structures

Market structure describes the competitive environment in the market for any good or service. A market consists of all firms and individuals who are willing and able to buy or sell a particular product. This includes firms and individuals currently engaged in buying and selling a particular product, as well as potential entrants.

The determination of price is affected by the competitive structure of the market. This is because the firm operates in a market and not in isolation. In marking decisions concerning economic variables it is affected, as are all institutions in society by its environment.



Perfect Competition

Perfect competition refers to a market structure where competition among the sellers and buyers prevails in its most perfect form. In a perfectly competitive market, a single market price prevails for the commodity, which is determined by the forces of total demand and total supply in the market.

Characteristics of Perfect Competition

The following features characterize a perfectly competitive market:

1. **A large number of buyers and sellers:** The number of buyers and sellers is large and the share of each one of them in the market is so small that none has any influence on the market price.
2. **Homogeneous product:** The product of each seller is totally undifferentiated from those of the others.
3. **Free entry and exit:** Any buyer and seller is free to enter or leave the market of the commodity.
4. **Perfect knowledge**: All buyers and sellers have perfect knowledge about the market for the commodity.
5. **Indifference:** No buyer has a preference to buy from a particular seller and no seller to sell to a particular buyer.
6. **Non-existence of transport costs**: Perfectly competitive market also assumes the non-existence of transport costs.
7. **Perfect mobility of factors of production**: Factors of production must be in a position to move freely into or out of industry and from one firm to the other.

Under such a market no single buyer or seller plays a significant role in price determination. One the other hand all of them jointly determine the price. The price is

determined in the industry, which is composed of all the buyers and seller for the commodity. The demand curve facing the industry is the sum of all consumers' demands at various prices. The industry supply curve is the sum of all sellers' supplies at various prices.

Pure competition and perfect competition

The term perfect competition is used in a wider sense. Pure competition has only limited assumptions. When the assumptions, that large number of buyers and sellers, homogeneous products, free entry and exit are satisfied, there exists pure competition. Competition becomes perfect only when all the assumptions (features) are satisfied. Generally pure competition can be seen in agricultural products.

Monopoly

The word monopoly is made up of two syllables, Mono and poly. Mono means single while poly implies selling. Thus monopoly is a form of market organization in which there is only one seller of the commodity. There are no close substitutes for the commodity sold by the seller. Pure monopoly is a market situation in which a single firm sells a product for which there is no good substitute.

Features of monopoly

The following are the features of monopoly.

1. **Single person or a firm:** A single person or a firm controls the total supply of the commodity. There will be no competition for monopoly firm. The monopolist firm is the only firm in the whole industry.
2. **No close substitute:** The goods sold by the monopolist shall not have closely competition substitutes. Even if price of monopoly product increase people will not go in far substitute. For example: If the price of electric bulb increase slightly, consumer will not go in for kerosene lamp.
3. **Large number of Buyers:** Under monopoly, there may be a large number of buyers in the market who compete among themselves.
4. **Price Maker:** Since the monopolist controls the whole supply of a commodity, he is a price-maker, and then he can alter the price.
5. **Supply and Price:** The monopolist can fix either the supply or the price. He cannot fix both. If he charges a very high price, he can sell a small amount. If he wants to

sell more, he has to charge a low price. He cannot sell as much as he wishes for any price he pleases.
6. **Downward Sloping Demand Curve:** The demand curve (average revenue curve) of monopolist slopes downward from left to right. It means that he can sell more only by lowering price.

Types of Monopoly

Monopoly may be classified into various types. The different types of monopolies are explained below:

1. **Legal Monopoly:** If monopoly arises on account of legal support or as a matter of legal privilege, it is called Legal Monopoly. Ex. Patent rights, special brands, trade means, copyright etc.
2. **Voluntary Monopoly:** To get the advantages of monopoly some private firms come together voluntarily to control the supply of a commodity. These are called voluntary monopolies. Generally, these monopolies arise with industrial combinations. These voluntary monopolies are of three kinds (a) cartel (b) trust (c) holding company. It may be called artificial monopoly.
3. **Government Monopoly:** Sometimes the government will take the responsibility of supplying a commodity and avoid private interference. Ex. Water, electricity. These monopolies, created to satisfy social wants, are formed on social considerations. These are also called Social Monopolies.
4. **Private Monopoly:** If the total supply of a good is produced by a single private person or firm, it is called private monopoly. Hindustan Lever Ltd. Is having the monopoly power to produce Lux Soap.
5. **Limited Monopoly:** if the monopolist is having limited power in fixing the price of his product, it is called as 'Limited Monopoly'. It may be due to the fear of distant substitutes or government intervention or the entry of rivals firms.
6. **Unlimited Monopoly:** If the monopolist is having unlimited power in fixing the price of his good or service, it is called unlimited monopoly. Ex. A doctor in a village.
7. **Single Price Monopoly:** When the monopolist charges same price for all units of his product, it is called single price monopoly. Ex. Tata Company charges the same price to all the Tata Indiaca Cars of the same model.
8. **Discriminating Monopoly:** When a Monopolist charges different prices to different consumers for the same product, it is called discriminating monopoly. A doctor may take Rs.20 from a rich man and only Rs.2 from a poor man for the same treatment.
9. **Natural Monopoly:** Sometimes monopoly may arise due to scarcity of natural resources. Nature provides raw materials only in some places. The owner of the place will become monopolist. For Ex. Diamond mine in South Africa.

Monopolistic competition

Perfect competition and pure monopoly are rate phenomena in the real world. Instead, almost every market seems to exhibit characteristics of both perfect competition and monopoly. Hence in the real world it is the state of imperfect competition lying between these two extreme limits that work. Edward. H. Chamberlain developed the theory of monopolistic competition, which presents a more realistic picture of the actual market structure and the nature of competition.

Characteristics of Monopolistic Competition

The important characteristics of monopolistic competition are:

1. **Existence of Many firms:** Industry consists of a large number of sellers, each one of whom does not feel dependent upon others. Every firm acts independently without bothering about the reactions of its rivals. The size is so large that an individual firm has only a relatively small part in the total market, so that each firm has very limited control over the price of the product. As the number is relatively large it is difficult for these firms to determine its price- output policies without considering the possible reactions of the rival forms. A monopolistically competitive firm follows an independent price policy.

2. **Product Differentiation:** Product differentiation means that products are different in some ways, but not altogether so. The products are not identical but the same time they will not be entirely different from each other. IT really means that there are various monopolist firms competing with each other. An example of monopolistic competition and product differentiation is the toothpaste produced by various firms. The product of each firm is different from that of its rivals in one or more respects. Different toothpastes like Colgate, Close-up, Forehans, Cibaca, etc.,

provide an example of monopolistic competition. These products are relatively close substitute for each other but not perfect substitutes. Consumers have definite preferences for the particular verities or brands of products offered for sale by various sellers. Advertisement, packing, trademarks, brand names etc. help differentiation of products even if they are physically identical.
3. **Large Number of Buyers:** There are large number buyers in the market. But the buyers have their own brand preferences. So the sellers are able to exercise a certain degree of monopoly over them. Each seller has to plan various incentive schemes to retain the customers who patronize his products.
4. **Free Entry and Exist of Firms:** As in the perfect competition, in the monopolistic competition too, there is freedom of entry and exit. That is, there is no barrier as found under monopoly.
5. **Selling costs:** Since the products are close substitute much effort is needed to retain the existing consumers and to create new demand. So each firm has to spend a lot on selling cost, which includes cost on advertising and other sale promotion activities.
6. **Imperfect Knowledge:** Imperfect knowledge about the product leads to monopolistic competition. If the buyers are fully aware of the quality of the product they cannot be influenced much by advertisement or other sales promotion techniques. But in the business world we can see that thought the quality of certain products is the same, effective advertisement and sales promotion techniques make certain brands monopolistic. For examples, effective dealer service backed by advertisement-helped popularization of some brands through the quality of almost all the cement available in the market remains the same.
7. **The Group:** Under perfect competition the term industry refers to all collection of firms producing a homogenous product. But under monopolistic competition the products of various firms are not identical through they are close substitutes. Prof. Chamberlin called the collection of firms producing close substitute products as a group.

Oligopoly

The term oligopoly is derived from two Greek words, oligos meaning a few, and pollen meaning to sell. Oligopoly is the form of imperfect competition where there are a few firms in the market, producing either a homogeneous product or producing products, which are close but not perfect substitute of each other.

Characteristics of Oligopoly

The main features of oligopoly are:

1. **Few Firms:** There are only a few firms in the industry. Each firm contributes a sizeable share of the total market. Any decision taken by one firm influence the actions of other firms in the industry. The various firms in the industry compete with each other.
2. **Interdependence:** As there are only very few firms, any steps taken by one firm to increase sales, by reducing price or by changing product design or by increasing advertisement expenditure will naturally affect the sales of other firms in the industry. An immediate retaliatory action can be anticipated from the other firms in the industry every time when one firm takes such a decision. He has to take this into account when he takes decisions. So the decisions of all the firms in the industry are interdependent.

3. **Indeterminate Demand Curve:** The interdependence of the firms makes their demand curve indeterminate. When one firm reduces price other firms also will make a cut in their prices. So he firm cannot be certain about the demand for its product. Thus the demand curve facing an oligopolistic firm loses its definiteness and thus is indeterminate as it constantly changes due to the reactions of the rival firms.
4. **Advertising and selling costs:** Advertising plays a greater role in the oligopoly market when compared to other market systems. According to Prof. William J. Banumol "it is only oligopoly that advertising comes fully into its own". A huge expenditure on advertising and sales promotion techniques is needed both to retain the present market share and to increase it. So Banumol concludes "under oligopoly, advertising can become a life-and-death matter where a firm which fails to keep up with the advertising budget of its competitors may find its customers drifting off to rival products."
5. **Price Rigidity:** In the oligopoly market price remain rigid. If one firm reduced price it is with the intention of attracting the customers of other firms in the industry. In order to retain their consumers they will also reduce price. Thus the pricing decision of one firm results in a loss to all the firms in the industry. If one firm increases price. Other firms will remain silent there by allowing that firm to lost its customers. Hence, no firm will be ready to change the prevailing price. It causes price rigidity in the oligopoly market.