Market

Meaning of Market:
Ordinarily, the term “market” refers to a particular place where goods are purchased and sold. But, in economics, market is used in a wide perspective. In economics, the term “market” does not mean a particular place but the whole area where the buyers and sellers of a product are spread.

In the words of A.A. Cournot, “Economists understand by the term ‘market’, not any particular place in which things are bought and sold but the whole of any region in which buyers and sellers are in such free intercourse with one another that the price of the same goods tends to equality, easily and quickly.”

The essential features of a market are:
(1) An Area:
In economics, a market *does not mean a particular place* but the whole region where sellers and buyers of a product are spread. Modern modes of communication and transport have made the market area for a product very wide.

(2) One Commodity:
In economics, a market is not related to a place but to a particular product. Hence, there are separate markets for various commodities. For example, there are separate markets for clothes, grains, jewellery, etc.

(3) Buyers and Sellers:
The presence of buyers and sellers is necessary for the sale and purchase of a product in the market. In the modem age, the market can be a physical or a virtual space where buyers and sellers interact for exchanging goods / services.

(4) Free Competition:
There should be free competition among buyers and sellers in the market. This competition is in relation to the price determination of a product among buyers and sellers.

(5) One Price:
The price of a product is the same in the market because of free competition among buyers and sellers.

On the basis of above elements of a market, its general definition may be as follows:
The market for a product refers to the whole region where buyers and sellers of that product are spread and there is such free competition that one price for the product prevails in the entire region.

Market Structure:

Market structure refers to the nature and degree of competition in the market for goods and services. The structures of market both for goods market and service (factor) market are determined by the nature of competition prevailing in a particular market.

Determinants:
There are a number of determinants of market structure for a particular good.

They are:
(1) The number and nature of sellers.
(2) The number and nature of buyers.
(3) The nature of the product.
(4) The conditions of entry into and exit from the market.
(5) Economies of scale.

They are discussed as under:
1. Number and Nature of Sellers:
The market structures are influenced by the number and nature of sellers in the market. They range from large number of sellers in perfect competition to a single seller in pure monopoly, to two sellers in duopoly, to a few sellers in oligopoly, and to many sellers of differentiated products.

2. Number and Nature of Buyers:

The market structures are also influenced by the number and nature of buyers in the market. If there is a single buyer in the market, this is buyer's monopoly and is called monopsony market. Such markets exist for local labour employed by one large employer. There may be two buyers who act jointly in the market. This is called duopsony market. They may also be a few organized buyers of a product. This is known as oligopsony. Duopsony and oligopsony markets are usually found for cash crops such as rice, sugarcane, etc. when local factories purchase the entire crops for processing.

3. Nature of Product:
It is the nature of product that determines the market structure. If there is product differentiation, products are close substitutes and the market is characterized by monopolistic competition. On the other hand, in case of no product differentiation, the market is characterized by perfect competition. And if a product is completely different from other products, it has no close substitutes and there is pure monopoly in the market.

4. Entry and Exit Conditions:
The conditions for entry and exit of firms in a market depend upon profitability or loss in a particular market. Profits in a market will attract the entry of new firms and losses lead to the exit of weak firms from the market. In a perfect competition market, there is freedom of entry or exit of firms. But in monopoly and oligopoly markets, there are barriers to entry of new firms. Usually, governments have a monopoly in public utility services like postal, air and road transport, water and power supply services, etc. By granting exclusive franchises, entries of new suppliers are barred. In oligopoly markets, there are barriers to entry of firms because of collusion, tacit agreements, cartels, etc. On the other hand, there are no restrictions in entry and exit of firms in monopolistic competition due to product differentiation.

5. Economies of Scale:
Firms that achieve large economies of scale in production grow large in comparison to others in an industry. They tend to weed out the other firms with the result that a few firms are left to compete with each other. This leads to the emergence of oligopoly. If only one firm attains economies of scale to such a large extent that it is able to meet the entire market demand, there is monopoly.

Forms of Market Structure:

On the basis of competition, a market can be classified in the following ways:
1. Perfect Competition
2. Monopoly
3. Duopoly
4. Oligopoly
5. Monopolistic Competition

1. Perfect Competition/Pure competition:
A perfectly competitive market is one in which the number of buyers and sellers is very large, all engaged in buying and selling a homogeneous product without any artificial restrictions and possessing perfect knowledge of market at a time. In the words of A. Koutsoyiannis, "Perfect competition is a market structure characterized by a complete absence of rivalry among the individual firms."

Characteristics of Perfect Competition:

(1) Large Number of Buyers and Sellers:
The first condition is that the number of buyers and sellers must be so large that none of them individually is in a position to influence the price and output of the industry as a whole. The demand of individual buyer relative to the total demand is so small that he cannot influence the price of the product by his individual action.

Similarly, the supply of an individual seller is so small a fraction of the total output that he cannot influence the price of the product by his action alone. In other words, the individual seller is unable to influence the price of the product by increasing or decreasing its supply.

Rather, he adjusts his supply to the price of the product. He is "output adjuster". Thus no buyer or seller can alter the price by his individual action. He has to accept the price for the product as fixed for the whole industry. He is a "price taker".

(2) Freedom of Entry or Exit of Firms:
The next condition is that the firms should be free to enter or leave the industry. It implies that whenever the industry is earning excess profits, attracted by these profits some new firms enter the industry. In case of loss being sustained by the industry, some firms leave it.

(3) Homogeneous Product:
Each firm produces and sells a homogeneous product so that no buyer has any preference for the product of any individual seller over others. This is only possible if units of the same product produced by different sellers are perfect substitutes. In other words, the cross elasticity of the products of sellers is infinite.

(4) Absence of Artificial Restrictions:
The next condition is that there is complete openness in buying and selling of goods. Sellers are free to sell their goods to any buyers and the buyers are free to buy from any sellers. In other words, there is no discrimination on the part of buyers or sellers. Moreover, prices are liable to change freely in response to demand-supply conditions. There are no efforts on the part of the producers, the government and other agencies to control the supply, demand or price of the products.

(5) Profit Maximization Goal:
Every firm has only one goal of maximizing its profits.

(6) Perfect Mobility of Goods and Factors:
Another requirement of perfect competition is the perfect mobility of goods and factors between industries. Goods are free to move to those places where they can fetch the highest price. Factors can also move from a low-paid to a high-paid industry.

(7) Perfect Knowledge of Market Conditions:
This condition implies a close contact between buyers and sellers. Buyers and sellers possess complete knowledge about the prices at which goods are being bought and sold, and of the prices at which others are prepared to buy and sell. They have also perfect knowledge of the place where the transactions are being carried on. Such perfect knowledge of market conditions forces the sellers to sell their product at the prevailing market price and the buyers to buy at that price.

(8) Absence of Transport Costs:
Another condition is that there are no transport costs in carrying of product from one place to another. This condition is essential for the existence of perfect competition which requires that a commodity must have the same price everywhere at any time. If transport costs are added to the price of the product, even a homogeneous commodity will have different prices depending upon transport costs from the place of supply.

(9) Absence of Selling Costs:
Under perfect competition, the costs of advertising, sales-promotion, etc. do not arise because all firms produce a homogeneous product.

Perfect Competition vs. Pure Competition:
Perfect competition is often distinguished from pure competition, but they differ only in degree. The first five conditions relate to pure competition while the remaining four conditions are also required for the existence of perfect competition. According to Chamberlin, pure competition means, competition unalloyed with monopoly elements," whereas perfect competition involves perfection in many other respects than in the absence of monopoly." The practical importance of perfect competition is not much in the present times for few markets are perfectly competitive except those for staple food products and raw materials. That is why; Chamberlin says that perfect competition is a rare phenomenon."

Though the real world does not fulfill the conditions of perfect competition, yet perfect competition is studied for the simple reason that it helps us in understanding the working of an economy, where competitive behavior leads to the best allocation of resources and the most efficient organization of production. A hypothetical model of a perfectly competitive industry provides the basis for appraising the actual working of economic institutions and organizations in any economy.

2. Monopoly:
Monopoly is a market situation in which there is only one seller of a product with barriers to entry of others. The product has no close substitutes. The cross elasticity of demand with every other product is very low. This means that no other firms produce a similar product. According to D. Salvatore, "Monopoly is the form of market organization in

which there is a single firm selling a commodity for which there are no close substitutes." Thus the monopoly firm is itself an industry and the monopolist faces the industry demand curve.

The demand curve for his product is, therefore, relatively stable and slopes downward to the right, given the tastes, and incomes of his customers. It means that more of the product can be sold at a lower price than at a higher price. He is a price-maker who can set the price to his maximum advantage.

However, it does not mean that he can set both price and output. He can do either of the two things. His price is determined by his demand curve, once he selects his output level. Or, once he sets the price for his product, his output is determined by what consumers will take at that price. In any situation, the ultimate aim of the monopolist is to have maximum profits.

The main features of monopoly are as follows:

1. Under monopoly, there is one producer or seller of a particular product and there is no difference between a firm and an industry. Under monopoly a firm itself is an industry.

2. A monopoly may be individual proprietorship or partnership or joint stock company or a cooperative society or a government company.

3. A monopolist has full control on the supply of a product. Hence, the elasticity of demand for a monopolist's product is zero.

4. There is no close substitute of a monopolist's product in the market. Hence, under monopoly, the cross elasticity of demand for a monopoly product with some other good is very low.

5. There are restrictions on the entry of other firms in the area of monopoly product.

6. A monopolist can influence the price of a product. He is a price-maker, not a price-taker.

7. Pure monopoly is not found in the real world.

8. Monopolist cannot determine both the price and quantity of a product simultaneously.

9. Monopolist's demand curve slopes downwards to the right. That is why, a monopolist can increase his sales only by decreasing the price of his product and thereby maximize his profit.

3. Duopoly:

Duopoly is a special case of the theory of oligopoly in which there are only two sellers. Both the sellers are completely independent and no agreement exists between them. Even though they are independent, a change in the price and output of one will affect the other, and may set a chain of reactions. A seller may, however, assume that his rival is unaffected by what he does, in that case he takes only his own direct influence on the price.

If, on the other hand, each seller takes into account the effect of his policy on that of his rival and the reaction of the rival on himself again, then he considers both the direct and the indirect influences upon the price. Moreover, a rival seller's policy may remain unaltered either to the amount offered for sale or to the price at which he offers his product. Thus the duopoly problem can be considered as either ignoring mutual dependence or recognizing it.

4. Oligopoly:

Oligopoly is a market situation in which there are a few firms selling homogeneous or differentiated products. It is difficult to pinpoint the number of firms in 'competition among the few.' With only a few firms in the market, the action of one firm is likely to affect the others. An oligopoly industry produces either a homogeneous product or heterogeneous products.

The former is called pure or perfect oligopoly and the latter is called imperfect or differentiated oligopoly. Pure oligopoly is found primarily among producers of such industrial products as aluminum, cement, copper, steel, zinc, etc. Imperfect oligopoly is found among producers of such consumer goods as automobiles, cigarettes, soaps and detergents, TVs, rubber tyres, refrigerators, laptops etc.

Characteristics of Oligopoly:

(1) Interdependence:
There is recognized interdependence among the sellers in the oligopolistic market. Each oligopolistic firm knows that changes in its price, advertising, product characteristics, etc. may lead to counter-moves by rivals. When the sellers are a few, each produces a considerable fraction of the total output of the industry and can have a noticeable effect on market conditions.

He can reduce or increase the price for the whole oligopolistic market by selling more quantity or less and affect the profits of the other sellers. It implies that each seller is aware of the price-moves of the other sellers and their impact on his profit and of the influence of his price-move on the actions of rivals.

Thus there is complete interdependence among the sellers with regard to their price-output policies. Each seller has direct and ascertainable influences upon every other seller in the industry. Thus, every move by one seller leads to counter-moves by the others.

(2) Advertisement:
The main reason for this mutual interdependence in decision making is that one producer’s fortunes are dependent on the policies and fortunes of the other producers in the industry. It is for this reason that oligopolistic firms spend much on advertisement and customer services.

As pointed out by Prof. Baumol, “Under oligopoly advertising can become a life-and-death matter.” For example, if all oligopolists continue to spend a lot on advertising their products and one seller does not match up with them he will find his customers gradually going in for his rival’s product. If, on the other hand, one oligopolist advertises his product, others have to follow him to keep up their sales.

(3) Competition:
This leads to another feature of the oligopolistic market, the presence of competition. Since under oligopoly, there are a few sellers, a move by one seller immediately affects the rivals. So each seller is always on the alert and keeps a close watch over the moves of its rivals in order to have a counter-move. This is true competition.

(4) Barriers to Entry of Firms:
As there is keen competition in an oligopolistic industry, there are no barriers to entry into or exit from it. However, in the long run, there are some types of barriers to entry which tend to restraint new firms from entering the industry. They may be: (a) Economies of scale enjoyed by a few large firms; (b) control over essential and specialized inputs; (c) high capital requirements due to plant costs, advertising costs, etc. (d) exclusive patents and licenses; and (e) the existence of unused capacity which makes the industry unattractive. When entry is restricted or blocked by such natural and artificial barriers, the oligopolistic industry can earn long-run super normal profits.

(5) Lack of Uniformity:
Another feature of oligopoly market is the lack of uniformity in the size of firms. Firms differ considerably in size. Some may be small, others very large. Such a situation is asymmetrical. This is very common in the American economy. A symmetrical situation with firms of a uniform size is rare.

(6) Demand Curve:
It is not easy to trace the demand curve for the product of an oligopolist. Since under oligopoly the exact behavior pattern of a producer cannot be ascertained with certainty, his demand curve cannot be drawn accurately, and with definiteness. How does an individual seller s demand curve look like in oligopoly is most uncertain because a seller’s price or output moves lead to unpredictable reactions on price-output policies of his rivals, which may have further repercussions on his price and output.

(7) No Unique Pattern of Pricing Behavior:
The rivalry arising from interdependence among the oligopolists leads to two conflicting motives. Each wants to remain independent and to get the maximum possible profit. Towards this end, they act and react on the price-output movements of one another in a continuous element of uncertainty.

On the other hand, again motivated by profit maximization each seller wishes to cooperate with his rivals to reduce or eliminate the element of uncertainty. All rivals enter into a tacit or formal agreement with regard to price-output changes. It leads to a sort of monopoly within oligopoly.

They may even recognize one seller as a leader at whose initiative all the other sellers raise or lower the price. In this case, the individual seller’s demand curve is a part of the industry demand curve, having the elasticity of the latter.

Given these conflicting attitudes, it is not possible to predict any unique pattern of pricing behavior in oligopoly markets.

5. Monopolistic Competition:
Monopolistic competition refers to a market situation where there are many firms selling a differentiated product. “There is competition which is keen, though not perfect, among many firms making very similar products.” No firm can have any perceptible influence on the price-output policies of the other sellers nor can it be influenced much by their actions. Thus monopolistic competition refers to competition among a large number of sellers producing close but not perfect substitutes for each other.

The following are the main features of monopolistic competition:
(1) Large Number of Sellers:
In monopolistic competition the number of sellers is large. They are “many and small enough” but none controls a major portion of the total output. No seller by changing its price-output policy can have any perceptible effect on the sales of others and in turn be influenced by them. Thus there is no recognized interdependence of the price-output policies of the sellers and each seller pursues an independent course of action.

(2) Product Differentiation:
One of the most important features of the monopolistic competition is differentiation. Product differentiation implies that products are different in some ways from each other. They are heterogeneous rather than homogeneous so that each firm has an absolute monopoly in the production and sale of a differentiated product. There is, however, slight difference between one product and other in the same category.

Products are close substitutes with a high cross-elasticity and not perfect substitutes. Product “differentiation may be based upon certain characteristics of the products itself, such as exclusive patented features; trade-marks; trade names; peculiarities of package or container, if any; or singularity in quality, design, color, or style. It may also exist with respect to the conditions surrounding its sales.”

(3) Freedom of Entry and Exit of Firms:
Another feature of monopolistic competition is the freedom of entry and exit of firms. As firms are of small size and are capable of producing close substitutes, they can leave or enter the industry or group in the long run.

(4) Nature of Demand Curve:
Under monopolistic competition no single firm controls more than a small portion of the total output of a product. No doubt there is an element of differentiation nevertheless the products are close substitutes. As a result, a reduction in its price will increase the sales of the firm but it will have little effect on the price-output conditions of other firms, each will lose only a few of its customers.

Likewise, an increase in its price will reduce its demand substantially but each of its rivals will attract only a few of its customers. Therefore, the demand curve (average revenue curve) of a firm under monopolistic competition slopes downward to the right. It is elastic but not perfectly elastic within a relevant range of prices of which he can sell any amount.

(5) Independent Behavior:
In monopolistic competition, every firm has independent policy. Since the number of sellers is large, none controls a major portion of the total output. No seller by changing its price-output policy can have any perceptible effect on the sales of others and in turn be influenced by them.

(6) Product Groups:
There is no ‘industry’ under monopolistic competition but a ‘group’ of firms producing similar products. Each firm produces a distinct product and is itself an industry. Chamberlin lumps together firms producing very closely related products and calls them product groups, such as cars, cigarettes, etc.

(7) Selling Costs:
Under monopolistic competition where the product is differentiated, selling costs are essential to push up the sales. Besides, advertisement, it includes expenses on salesman, allowances to sellers for window displays, free service, free sampling, premium coupons and gifts, etc.

(8) Non-price Competition:

Under monopolistic competition, a firm increases sales and profits of his product without a cut in the price. The monopolistic competitor can change his product either by varying its quality, packing, etc. or by changing promotional programs.

Comparison of the features of market structures:

Features	**Market forms**			
	Perfect competition	**Monopoly**	**Monopolistic competition**	**Oligopoly**
1. No. of firms	Large	One	Varied but not too many	Few
2. Nature of product	Homogeneous	Single type	Product differentiation	Homogeneous or differentiated
3. Entry of firms	Free	No entry	Free	Restricted
4. Degree of monopoly power	Zero	Full	Limited	Limited due to product differentiation
5. Price policy of the firm	Price-taker	Price-maker	Price-maker	Price-maker
6. Market knowledge	Complete	Incomplete	Incomplete	Incomplete
7. Elasticity of demand	Perfectly elastic	Inelastic	Less elastic	Less elastic
8. Selling costs	Nil	Small	Huge	Small