Module 3

Market

Part I

Market is a place or a process where the interaction between buyers and sellers takes place in order to buy or sell a product.

There are different types of market structures in an economy. It depends on the nature of competition, type of product, number of buyers and sellers, freedom of entry and exit from the market etc.

Perfect Competition

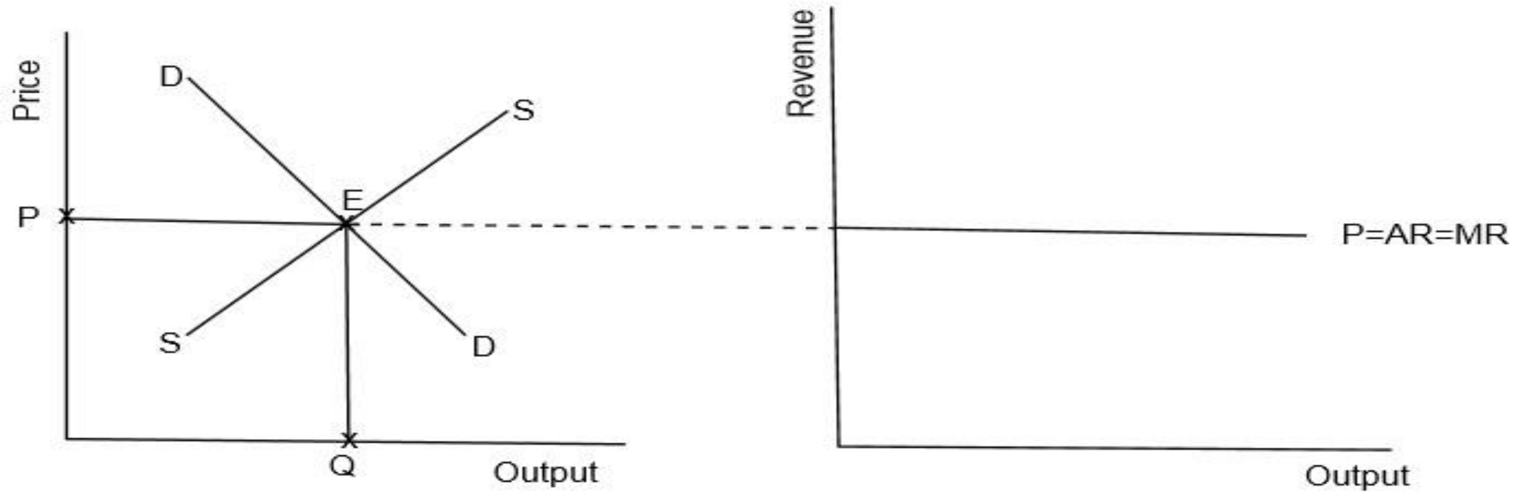
Perfect competition is a market situation in which there are a large number of buyers and sellers dealing in a homogeneous product with perfect knowledge about the market conditions and perfect mobility of goods and factors of production.

The following are the important features of perfect competition.

1. **Large number of buyers and sellers**
2. **Homogeneous product**
3. **Freedom of entry and exit**
4. **Perfect knowledge**
5. **Perfect mobility of goods and factors of production**
6. **Absence of transport cost**
7. **Perfectly elastic demand curve**.

AR curve and MR curve of a firm under perfect competition

Under perfect competition price of a product is determined for the entire industry by the forces of market demand and market supply. This price is accepted by each firm in the industry. Therefore a seller under perfect competition is called a price taker. A seller can sell any amount of the commodity at this price. Hence the demand curve facing a seller under perfect competition is perfectly elastic. It is a horizontal straight line parallel to the x-axis.

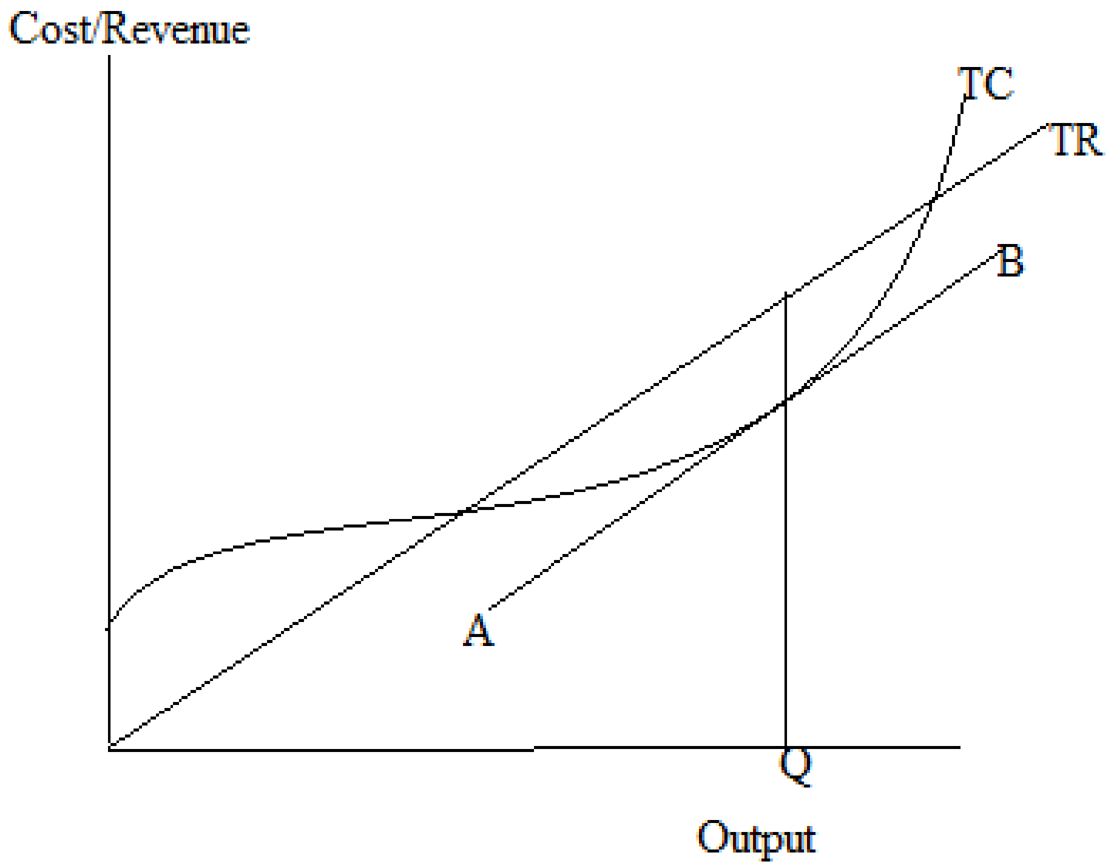


Equilibrium of a Firm

Under any market situation a firm is in equilibrium when it gets maximum profit.

TC, TR Approach

Under this approach a firm will be in equilibrium when it produce that level of output where the difference between TR and TC(profit) is the maximum



MC MR Approach

Under this approach profit will be maximum when the following two conditions are satisfied.

1. At the equilibrium point marginal cost of the firm should be equal to its marginal revenue (MC = MR)
2. At the point of equilibrium MC should be rising

Industrial Economics and Foreign Trade

Module 3 – Market - Part 2

By

Dr. Johnson T T

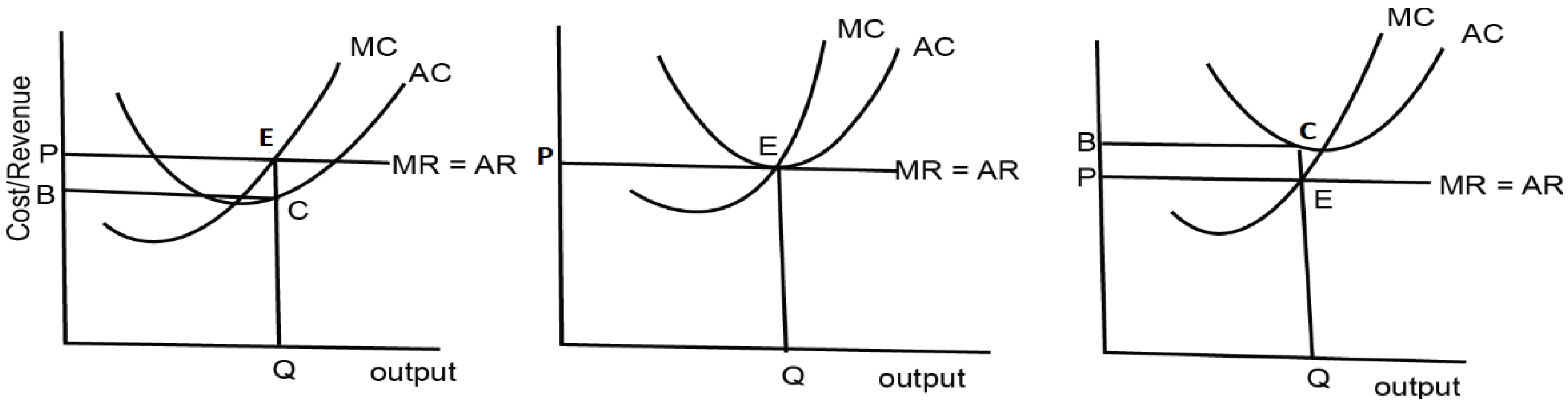
Assistant Professor in Economics

CET

Mob. 9447450408

MC, MR Approach under perfect competition

A firm is in equilibrium when it gets maximum profit. Profit will be maximum when it satisfy the two equilibrium conditions. That is ***MC = MR and MC is rising at the point of equilibrium.*** Usually in the short period a firm may earn supernormal profit, normal profit or incur a loss. But in the long run a firm get normal profit only because whenever there is supernormal profit new firms will enter and when there is loss some of the existing firms will leave the market.



Monopoly

Monopoly means a single seller. ***It is a market situation in which a single seller controls the entire supply of a commodity.***

Features of monopoly

1. **Single seller**
2. **No close substitutes**
3. **Barriers to entry**
4. **Price maker**
5. **Downward sloping demand curve**

MR curve and AR curve(demand curve) of a monopolist

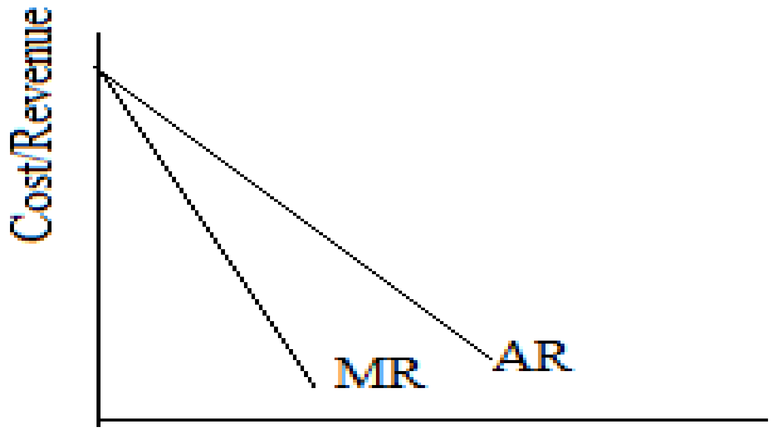


Fig.5.6 AR and MR

Equilibrium Price and Output Determination

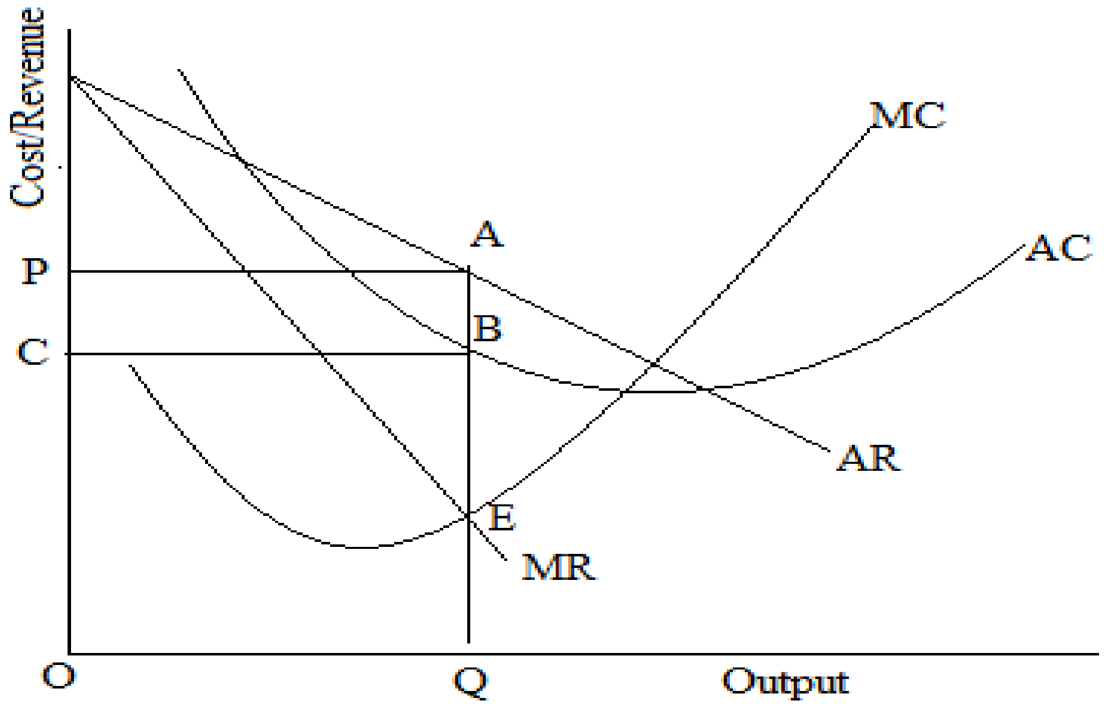


Fig 5.9 Equilibrium under Monopoly

Regulation of Monopoly

Gregory Mankiw has suggested the following measures to control monopoly.

1. **Increasing competition with Antitrust Laws**
2. **Regulation**
3. Public Ownership

Monopolistic Competition
It is a market situation in which, there are a large number of buyers and sellers dealing in a differentiated product.

Since the product is differentiated, the product of each seller has a unique feature.

At the same time product of each seller is a close substitute for the product of another producer and there are large number of buyers and sellers. Hence the competitive element is present. Thus monopolistic competition is a combination of perfect competition and monopoly.

Features of Monopolistic competition

1. **Large number of buyers and sellers**
2. **Product differentiation**
3. **Selling cost**
4. **Freedom of entry and exit**
5. **Downward sloping more elastic demand curve**

Price and output determination

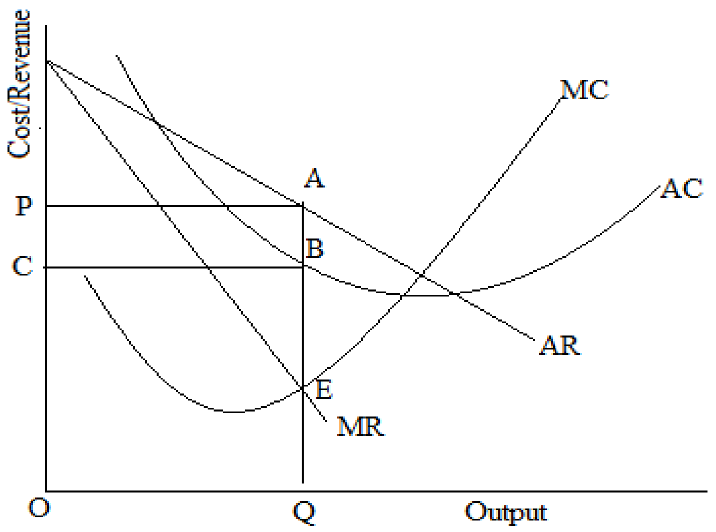
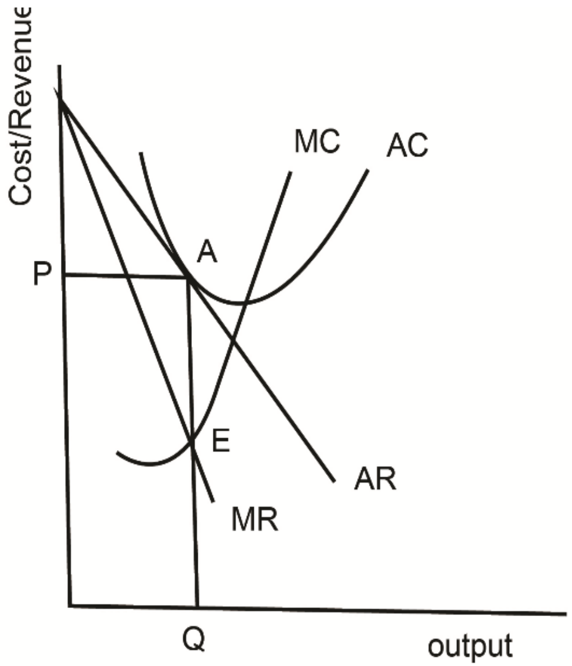
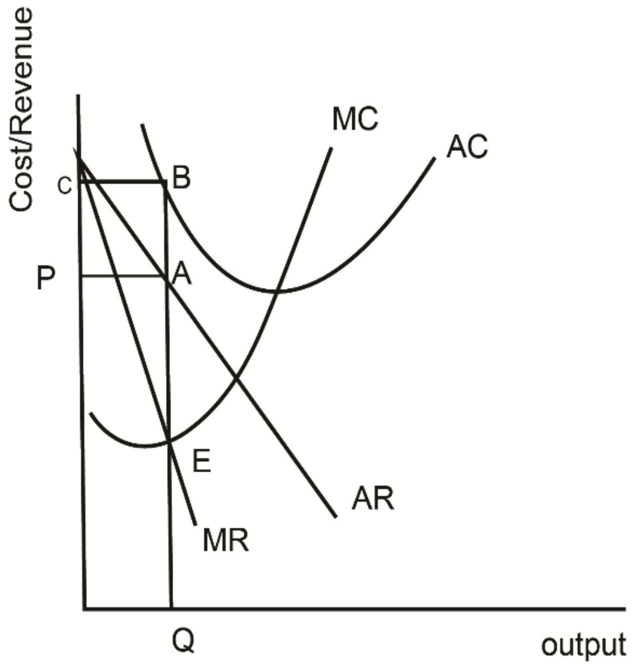


Fig 5.11 Equilibrium under Monopolistic competition





Industrial Economics and Foreign Trade

Module 3 – Part 3 Oligopoly

By

Dr. Johnson T T

Assistant Professor in Economics

CET

Mob. 9447450408

Oligopoly

Oligopoly is a market situation in which there are a few sellers selling either a homogenous or differentiated product.

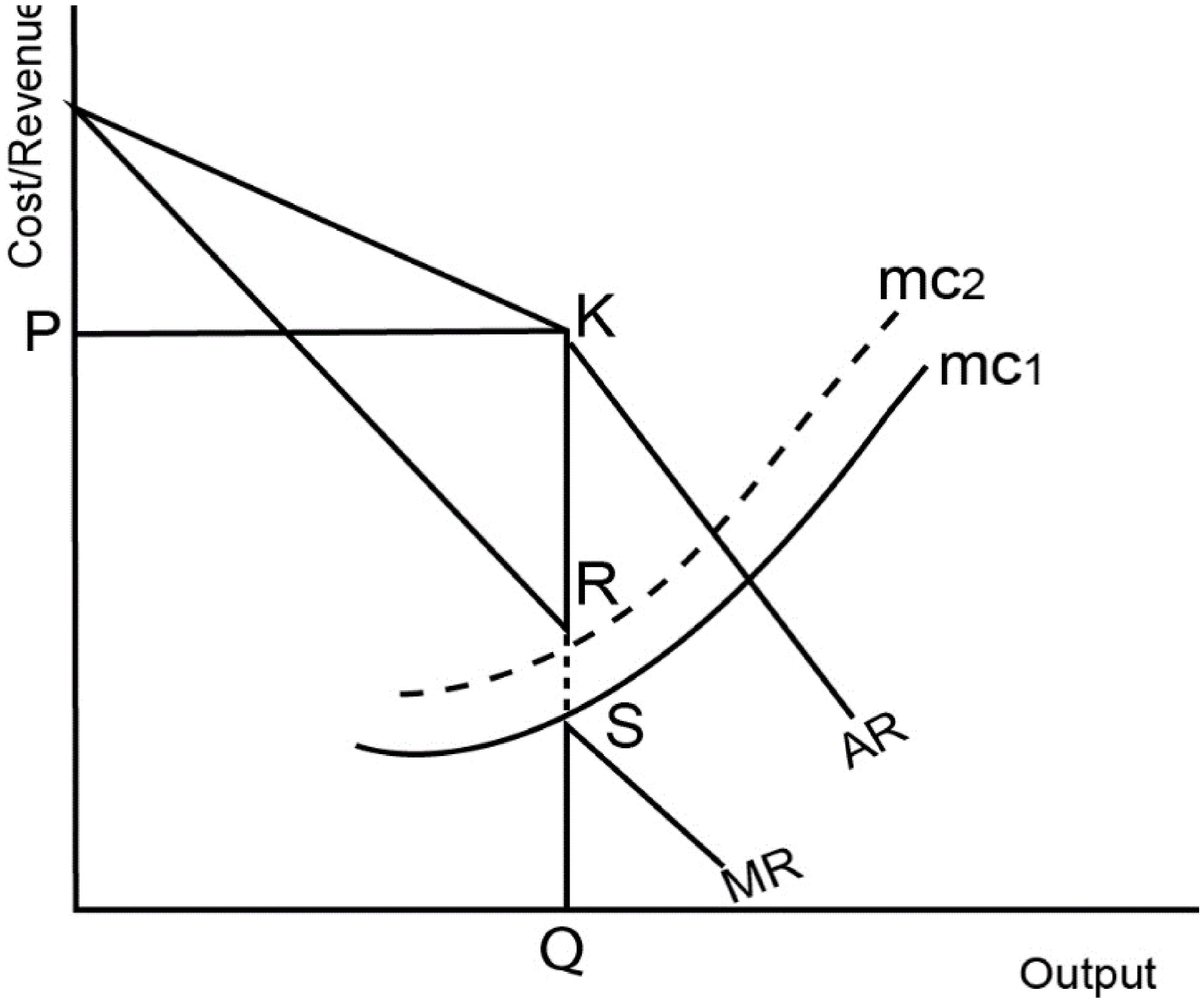
Features

1. **Few sellers** –
2. **Homogenous or differentiated product –**.
3. **Barriers to entry**
4. **Mutual Interdependence –**
5. **Existence of price rigidity -**
6. **Indeterminate Demand Curve**

Price and output determination-Kinked demand curve model

The kinked demand curve model was developed by Paul M Sweezy in 1939. Kinked demand curve explains price rigidity under oligopoly on the basis of following assumptions.

i. If a firm increases its price others will not follow.
ii. If a firm decreases its price others will also do the same.



Cost/Revenue
P
K
mc2
mc1
R
S
AR
MR
Q
Output

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 helps the firms in preventing uncertainties, prevent the entry of new firms and strengthen the bargaining power of the firms against buyers. Collusion may be formal or tacit in nature. In formal collusion, there will be an explicit agreement among the firms. The most common form of explicit collusion is cartel On the other hand, in tacit collusion firms collide in an informal way. In a tacit or implicit collusion firms do not form a cartel, but informally agree to charge the same price.

Non-Price Competition

Non-price competition is a marketing strategy that typically includes promotional expenditures such as sales staff, sales promotions, special offers, free gifts, coupons, and advertising. In other words, it means marketing a firm's brand and quality of products, rather than lowering prices.

There are two main branches of non-price competition. They are product differentiation and promotion or advertising. Product differentiation means differentiating the product with respect to packing, colour, smell, quality etc. This helps to attract more customers and to increase the market share. Promotion includes advertising, branding, public relations etc. Advertising can be informative or persuasive.

The following are some of the examples of non-price competition.

Loyalty card –

Subsidized delivery –

Offering good after-sales service:.

Advertising/brand loyalty

Cultivation of good reviews: .

Coupons and free gifts

Perfect Competition	Monopoly	Monopolistic Competition	Oligopoly
Large no. of buyers and sellers	Single Seller and large no. of buyers	Large number of buyers and sellers	Few sellers and large no of buyers
Homogenous product	Single product without close substitutes	Differentiated product	Homogenous or Differentiated product
Freedom of entry and Exit	Freedom of entry restricted	Freedom of entry and exit	Barriers to entry
No selling cost	No selling cost	Selling cost	Selling cost
Perfectly elastic demand curve	Downward sloping less elastic demand curve	Downward sloping more elastic demand curve	Indeterminate demand curve

Product Pricing

The following are the important pricing strategies.

1. **Cost Plus or Markup Pricing -** Price = AC + m
2. **Target Return Pricing**
3. **Penetration Pricing**
4. **Predatory Pricing**
5. **Going Rate Pricing**
6. **Price Skimming**
7. **Administered Pricing**