Unit 4
Market Structure and Pricing Theory

Market structure refers to the organizational and other characteristics of a market that influence the nature of competition and pricing.

PERFECT COMPETITION

Definition
A market structure where there are a large number of buyers and sellers dealing in a homogeneous product without any control over the market price.
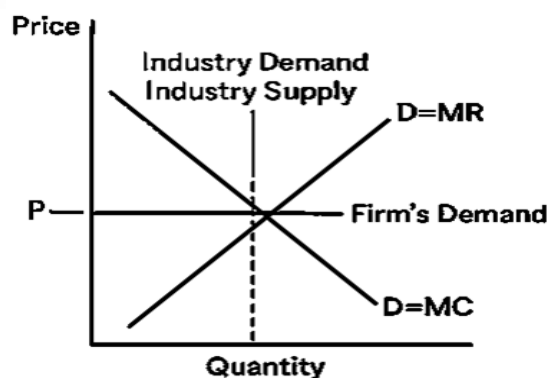
Characteristics
1. *Large number of buyers and sellers:* No single buyer or seller can influence the market price.
2. *Homogeneous product:* All firms sell identical products, e.g., agricultural goods.
3. *Free entry and exit:* Firms can enter or leave the industry freely.
4. *Perfect knowledge:* Buyers and sellers have complete knowledge of market conditions.
5. *No transportation cost:* Products are assumed to be sold at the same location.
6. *Price taker:* Firms accept the price determined by market demand and supply.

Price Determination
- Price is determined by the intersection of industry demand and supply.
- Firm's demand curve is perfectly elastic (horizontal line).

Profit Maximization
- Short Run: Can earn normal, supernormal, or incur losses.
- Long Run: Only normal profits due to free entry and exit.

MONOPOLY

Definition
A market structure where a single firm is the sole producer of a product with no close substitutes.

Characteristics
1. *Single seller:* One firm dominates the entire market.
2. *No close substitutes:* Product is unique.

3. *High entry barriers:* Legal, technical, or economic barriers prevent entry.
4. *Price maker:* Monopoly firm has full control over price.
5. *Price discrimination:* Can charge different prices to different customers.

Price Determination

- The monopolist sets output where MR = MC (Marginal Revenue = Marginal Cost).
- The price is set from the demand curve at that output level.

Profit Maximization

- Can earn long-run supernormal profits due to lack of competition.
- Inefficient compared to perfect competition (deadweight loss).
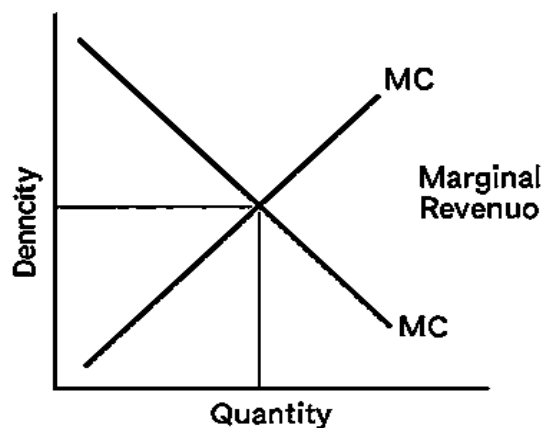
MONOPOLISTIC COMPETITION

Definition

A market structure with many sellers offering differentiated but similar products.
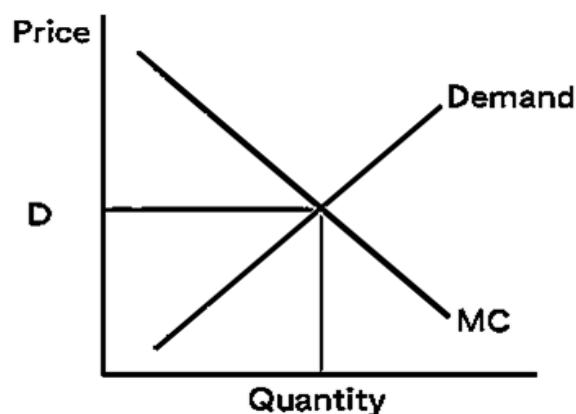
Characteristics

1. *Many sellers:* Competition exists, but products are not identical.
2. *Product differentiation:* Each firm offers a unique version of the product (e.g., soap, toothpaste).
3. *Free entry and exit*: Firms can enter or leave the industry in the long run.
4. *Selling costs:* Firms invest in advertising and branding.
5. *Some price control:* Due to brand loyalty.

Price Determination

- Each firm faces a downward-sloping demand curve.
- Price is set where MR = MC.

Profit Maximization

- *Short Run:* Can earn abnormal profit or loss.
- *Long Run:* Only normal profits due to free entry/exit.

OLIGOPOLY

Definition

A market structure dominated by a few large firms, which are interdependent in decision-making.

Characteristics

1. *Few sellers:* Small number of large firms dominate the market.
2. *Interdependence:* One firm's decision affect other.
3. *Barriers to entry:* High startup costs or strong brand loyalty.
4. *Product type:* Can be homogeneous (e.g., cement) or differentiated (e.g., automobiles).
5. *Non-price competition:* Branding, quality, advertising used to attract customers.

Types

- *Collusive Oligopoly:* Firms cooperate, may form a cartel.
- *Non-Collusive Oligopoly:* Firms act independently, but carefully observe competitors.

Kinked Demand Curve Model

- *Price rigidity:* Firms do not change prices frequently.
- If one firm cuts price, others follow; if it raises price, others do not.
- Leads to kink in the demand curve and discontinuity in MR curve.
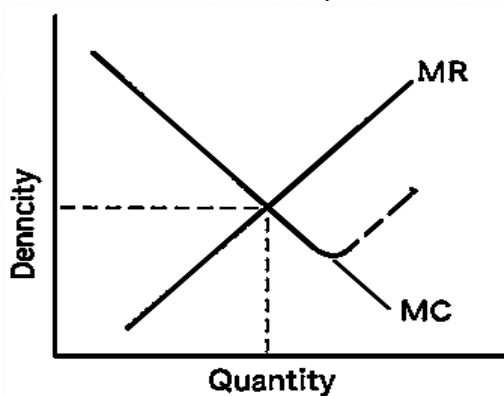
Price Determination

- No unique price-output solution.
- Often price leadership exists (one dominant firm sets the price).

SUMMARY TABLE

Feature/Structure	Perfect Competition	Monopoly	Monopolistic Competition	Oligopoly
Number of Sellers	Many	One	Many	Few
Product Nature	Homogeneous	Unique	Differentiated	Either
Price Control	None	Full	Some	Considerable
Entry/Exit	Free	Blocked	Free	Blocked
Long Run Profit	Normal	Abnormal	Normal	Abnormal