MARKET UNIT-III (4)

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Definition :- " Market is a place where buyers & selle are meet and goods & services are offered for the sa and transfer of ownership occures".

On the basis of competition market can be classif into '2' types.

- Market structure
  - Perfect competition
  - Imperfect competition
    - Mono poly competition
    - monopolistic competition
    - oligopoly competition

Perfect competition :- Refers to a market structure whe competition among the sellers and buyers preveals in it more perfect form.

features (or) characteristics of perfect competition :-

(1) **Large number of buyers and sellers :-** The number of buyers & Sellers are large. The share of each one of them in the market is so small, that done no influence on the market Price.

(2) **Homogeneous product :-** The product of each Selles is totally undifferentiated from those of others.

(3) **free entry & exit :-** Any buyer & Seller is free to entry or leave the market of the commodity.

(4) perfect knowledge :- All buyers & Sellers have perfect knowledge about the market for the commodity.

(5) indifference :- No buyer has a preferance to buy from a particular seller and no seller to sell to 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 productive must be in a position to move freely into (or) out of the Industry and from one firm to the other.

Equilibrium of a firm & Industry under perfect competition :-

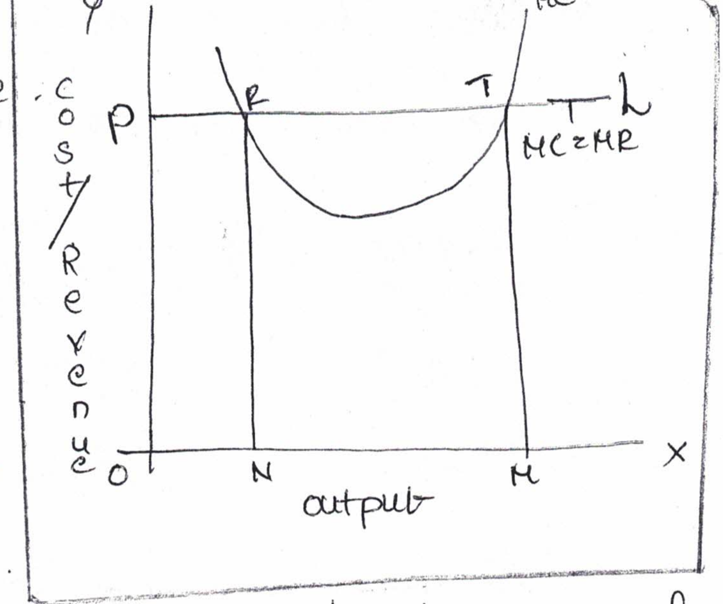
Equilibrium is a position where the firm has no insentive either to expand or constrast its output the firm is said to be inequilibrium it earns maximum Profit. There are two conditions for attaining equilibrium by a firm.

(1) Marginal cost must be equal to marginal revenue. that is MC = MR.

(2) Marginal cost curve must cut the marginal revenue curve from below.

where OY axis indicate Cost/revenue

OX represent output.

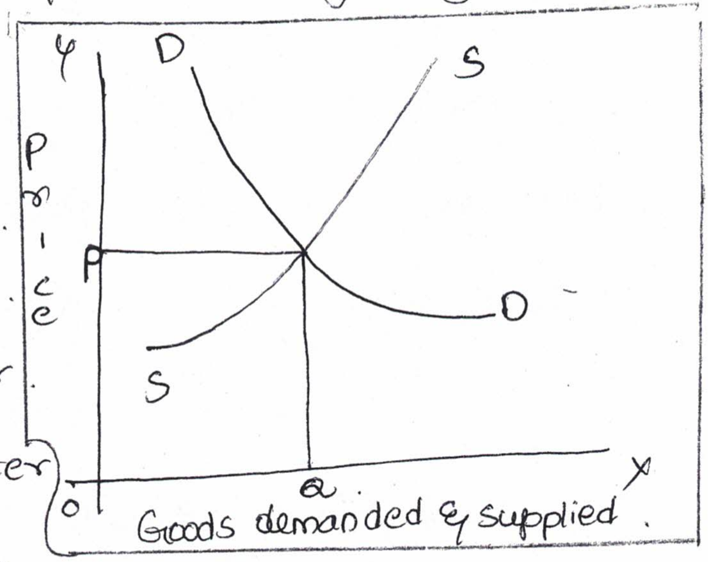


At point 'R': MC=MR. But 'MC' curve did not cut 'MR' curve from below. so it is not equilibrium.

At point 'T': MC=MR and 'MC' curve cut the 'MR' curve from the below. So it is equilibrium.

Perfect competition: The industry equilibrium:

Price is determined by the market forces, that is demand & supply for a given product or service. The pricing strategy in perfect competition is charge the same Price as other firms charge. As discussed above, firm have no control over the prices they charge for their Products.



The supply curve SS. Normally slopes upwards which means that the producer will offer more quantity to sell at higher Price it is the price that determines the quantity demand & quantity ~~demanded is equal to the~~ Supplied. The ultimate price that prevails in that market is one at which the quantity demanded is equal to the quantity supplied.

This price is also called equilibrium price, as it balances the forces of demand and supply.

What happen if the price is higher than op?
If the price is higher than 'op' supply will more and hence the price is likely to fall due to lack of demand.

What happen if the price falls below op:- If the price fals below op, the quantity demand will exced the supply and hence the price is likely to rise.

Price output determination incase of perfect Competition

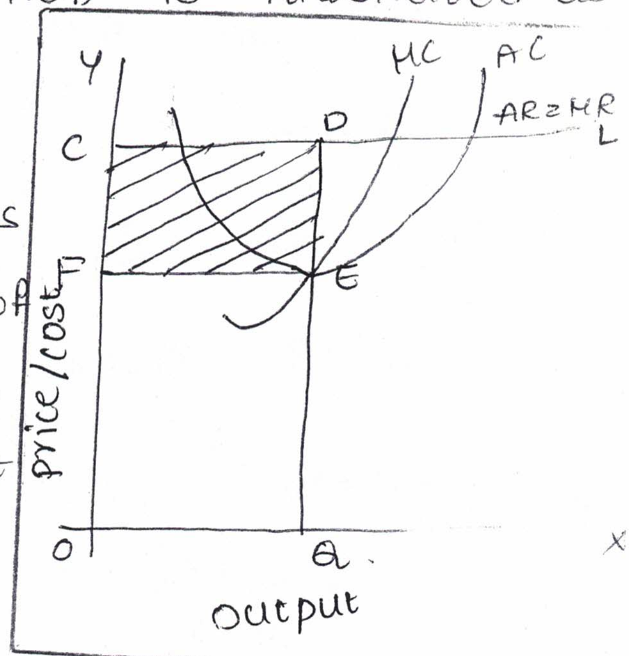
① short-run:- The price & output of the firm are determined, under perfect Competition, based on the industry price & its own costs. The industry price has greater say in this process because the firm's own sales are very small & insignificant.

The price output determination under Perfect Competition should satisfy both condition.

ⓐ MC = MR

ⓑ MC curve must cut MR curve from below

The process of Price output determination incase of perfect competition is illustrated as below.



The firm gets higher profits as long as the price (incase of MC or MR) it receives for each unit exceds the average cost (AC) of production.

OC = QD, which is price

OF = QE, which is the Average cost

OQ = FE, which is the equilibrium output.

Average profit = price − Average cost.

Here, DE is the average profit and the area CDEF is the total profits, which constitutes the 'supernormal' or 'abnormal' profits.

Based on it's cost function and market condition, the firm may make profits, losses or just break even in the short-run.

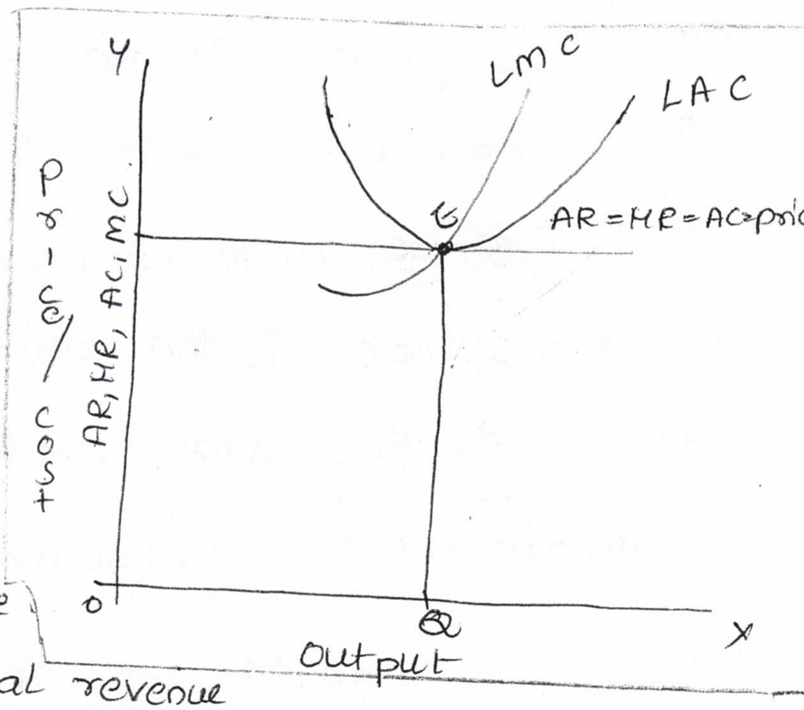
(ii) ~~sho~~ Long run :- In the short run firms may attain supernormal profits but in the longrun more firms enter the industry with the result the firms will be in a position to enjoy only normal profits. Normally profits are the profits that are just sufficient for the firms to stay in the business.

If firm want to get equilibrium under long run it should satisfy following conditions.

ⓐ MR = MC

ⓑ AR = AC & AC must be tangential to AR at it's lower point.

QE is the price and also long run avg cost. long run marginal cost (LMC) curve. Passes through the minimum point of the long run avg cost curve (LAC) at 'E' while passing through the marginal revenue curve.



'E' is the equilibrium point & the firm Produces OQ units of output it can be noted that normal profits are not visible to the naked eye since normal profits are included in the average cost. If the market price is below long-run average. Average cost of the firm, the firm will have to quit the industry since in the long-run. The firm have to recover avg costs

Monopoly

The word monopoly is made up of two syllables, mono & 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.

Features of monopoly:-

(a) Single person or a firm:- The total supply of the commodity is controlled by a single person or a firm. There will be no competition for monopoly firm. The monopolist firm is the only firm in the whole industry.

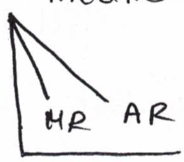
(b) No close substitutes:- The product sold by the monopolist shall not have closely competing substitues. Even if the price of the monopoly product increases people will not go in for substitute, Ex: if price of electric bulb increase slightly, consumers will not go in for kerosene lamp.

(c) Large number of buyers:- Under monopoly, There may be a large number of buyers in the market. who compete among them selves.

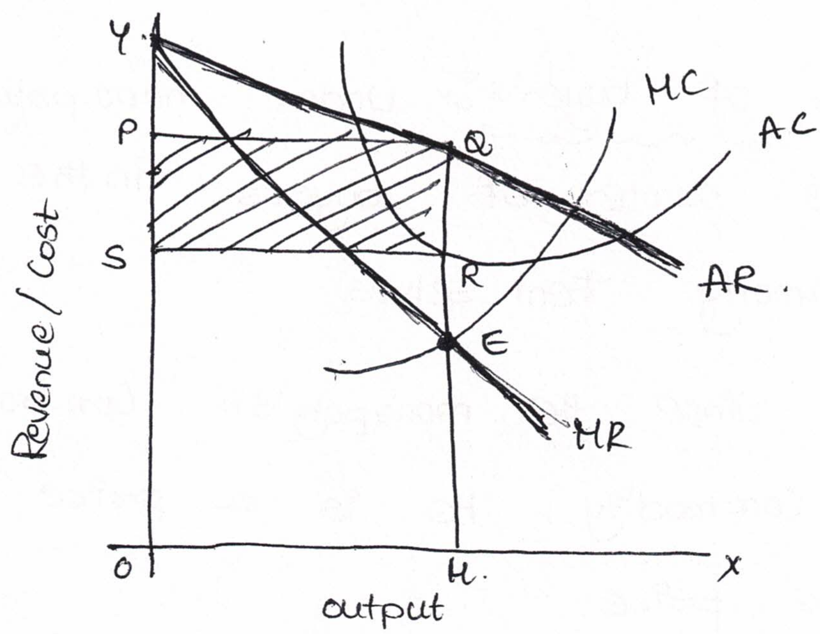
(d) Price Maker:- Since the monopolist controls the whole supply of a commodity, he is a price maker. he can alter the price.

(e) Supply and price :- The monopolist can fix either the Supply or the price. ~~The~~ He can not fix both. if he charges a very high price, he can sell a Small amount If he want to sell more, he has to charge low ~~pri~~ Price. He can not sell as much as he wishes for any Price.

(f) Down ward Sloping demand curve :- The demand curve of mono-polist slopes downward from left to right. It means that he can sell More only by lowering price.



Price output determination (Equilibrium point) :- The monopolistic firm attains equilibrium when it's marginal cost equl to marginal revenue (MC = MR) He makes maximum Profits at this point. The monopolist produces goods up to that point where additional cost is equal to the additional revenue (AC = AR)



The quantity supplied or demand is shown along 'x' -axis. The cost or revenue are shows along 'y'- axis

The monopolistic firm attain equilibrium when it's marginal cost is equal to marginal revenue (MC = MR) Under monopoly the MC curve may cut the MR curve from below or from a side. In the diagram the, above condition is satisfied at point 'E'. The firm is equalibrium The output is 'OM'. In the above diagram,

Avg revenue = MQ = OP

Avg cost = MR.

Profit permit = Avg revenue - Avg cost.

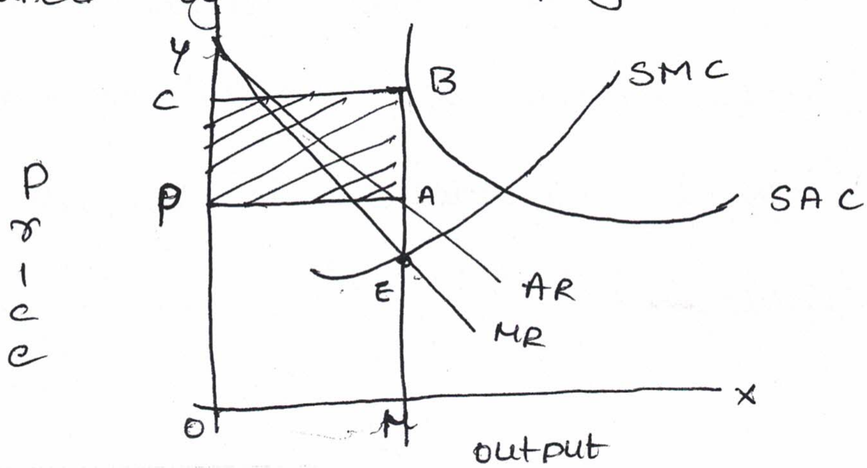
= MQ - MR = QR.

Total profit = profit persuit x Quantity.

= QR x SR

= PQRS.

The area 'PQRS' represents the maximum Profit earned by the monopoly firm.



But it is not always possible for a monopolist to earn super-normal profits. If the demand and cost situations are not favourable. The monopolist may realise short run losses.

Though monopolist is a price maker. due to weak demand and high costs, he suffered a loss equal to 'PABC'

If AR > AC → Abnormal profits

If AR = AC → Normal profits.

If AR < AC → loss.

In the long run the firm has time to adjust his plant size or to use existing plant so as to maximise profits.

PRICE DISCRIMINATION:

Price discrimination is also called as " ~~difference~~. differential pricing". It maybe defined as " changing different price for the same product or service. from different consumers on the basis of personal, situational and trade considerations is termed as. " price discrimination".

The basis of price discrimination:-

(a) Purchasing power:- The firm is likely to charge a high price from a customer who has the ability to pay a higher price. urgency, quality, of the product may leads the price discrimination.

(b) Quantity brought:- A customer buying large number of units is relatively charged a lower rate per unit.

(c) Customer from different market Condition:- If the goods are bought for ~~future~~. further processing resale, the buyer maybe charged a lower price. If goods are brought for ultimate consumption, the buyer may be charged relatively higher.

How can Markets be Separated:- The customers can be separated into different markets based on a ~~marked~~ number of factors. Such as, time factor, geographical boundaries, income and wealth levels, sex, Age, education level etc., Ex: ① Most of airliners such as Air india, Gulf Air, British Airways, and so forth, charge cheaper rates for Journey during off - season periods.

② Electricity charges are different for domestic house hold as compared to commercial and industrials users.

MONOPOLISTIC COMPETITION

Perfect competition & pure monopoly are rare phenomena in the real world. But in the real world the futures of both Markets are apper. (Edward H. Chamberlin developed the theory of monopolistic competitions which presents a more ~~relationst~~ realistic picture of the actual market structure and nature of competition)

①. Existance of many firms :- Industry consists of a large number of sellers, each one of whome does not feel dependent upon others. Every firm acts independently with out bothering about the reactions of it's rivals) the size is so large that an individual firm has only a relative small part in the total market. so that each firm has very limited control over the Price of the product.

② Product differentiation :- Product differentiation means that Products are deferent in some ways, but not altogether so) The products are not identical but at the same time they will not be entirely different from each other. (An example of monopolistic competition and product.

defferentiation is the ~~koethpa~~ toothpast produced by Various firms like colgate, close-up, etc,

③ Large number of buyers :- There are a Large number of buyer in the market. But the buyers have their own brand preferences. so the seller are able to exercise a certain degree of monopoly) over them. Each seller has to plan various incentive schemes to retain the customers, who patronised his products.

④ Free entry & exit of firm :- . As in the perfect competition, in the monopolistic competition too. there is freedom of entry and exit. That is ~~the~~ there is no barrier as as found under monopoly.

⑤ Selling cost :- Since the product s are close substitutes much effort is needed to retain the existing customer and to create new demond. so each firm has to spend a lot on selling cost, which includes on advertising & other sales promotion activities.

⑥ Imperfect knowledge :- Imperfect knowledge ~~amoun~~ about the product leads to monopolistic competition If the business are fully aware of the quality of the product they can not be influenced much by advertisement or other sales promotion technology.

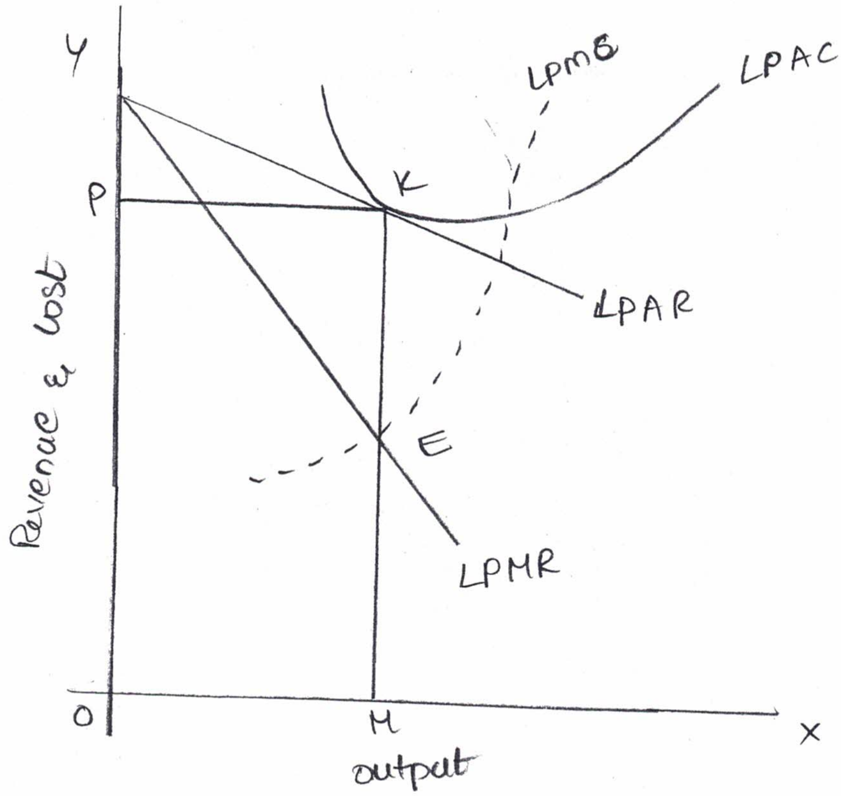
(4) The Group :- under perfect competition the term industry reference to the collection of firms producing a homogeneous products But) under monopolistic the Products of various firms are not identical through, there are close substitutis (Prof. chamberlin calls the collection of firm producing close substitute products as a group).

Price output determination

I. Short-run

[Like Monopoly market]

II Long-run :- The abnormal profits earned inshort Period will attract new comers to the group. The new comers will fix lower prices than the price charged by the existing firms. This will compel the existing firms to reduce prices. As a result of such a keen compe-tition, price will fall. consequently the AR curve will shift to a lower position. The AC curve will shift to a higher position. due to increased demand on factors of production. Thus, the distance between AR & AC will be narrowed down and the abnormal profits will be removed. ultimately the firm will earn only normal profits.


Y
LPMC
LPAC
P
K
LPAR
Revenue & Cost
E
LPMR
O
M
X
output

Oligopoly :-

Oligopoly is a term derived from two Greek words 'Oligos' meaning a few, and 'Pollein' meaning to sell. Thus oligopoly refers to that form of imperfect competation where there will be only a few sellers producing either a homogeneous products or products which are close substitutes but not perfect substitutes.

Oligopoly is of two kinds :

a. Homogeneous oligopoly
b. Differentiated oligopoly

- Homogeneous oligopoly consists of mostly agricultural products, such as oil and wheat. Homogeneous oligopoly is called Pure oligopoly
- Differentiated oligopoly found in case of manufactured and durable products.

CHARACTERISTICS OR FEATURES OF Oligopoly :-

1) Only a few sellers :- The number of sellers in an oligopoly industry is only a few

2) Interdependence :- Each firm ~~is~~ in an oligopoly industry is interdependent, on the others whether it is a decision regarding price on one pertaining to advertising or any other.

3) Price rigidity :- Generally in an oligopoly industry, Prices once established remain relatively stable unlike in the case of Perfect competation.

4) Price leadership :- one of the firms in the industry, [Prices once] has the highest market share and is, therefore, called dominant price leader.

5) Advertising and selling costs :- Firms in an oligopoly market, like in monopolistic competition incur heavy expenditure on advertising and other promotional activities.

6) Brand Proliferations :- Oligopoly firms can earn profits in the long run when they can create entry barriers such as brands.

7) Non-Price competation :- oligopoly firms may introduce excellent after sales service that is essential for creating confidence in the minds of customers escepecially in the case of consumer durables.. Firms complete in proving the best service to the customers.

8) Innovations :- Oligo poly firms innovate and improve all the time the quality of their products, reduce production and management costs, improve the brand image, customer care, and so on, and try to have an edge over the rival firms in all these aspects.

9) collusion :- To protect the business interests at large, oligopoly firms may have a tacit collusion among themselves to fix price and quotas for each of them. For example, Cartels or syndicates

10) Indeterminate demand curve :- It is impossible to determine equilibrium price and output under oligopoly because demand is indeterminate.

11) Conflicting attitudes of firms :- oligo poly firms in the industry face a dilemma whether to cooperate or compete.

The cause of oligopoly is :

a) Economies of scale : Due to economies of scale, big firms have a greater advantage when compared to small firms.
b) Mergers and acquisitions : Firms may grow by buying out rivals or merging with them or by hounding out rivals through questionable competative Practices such as Predatory Pricing, hoodwinking the law in the Process. Mergers and acquistions result in economies of scale.
c) Entrepreneurial genius : Sometimes, oligopoly may emerge because of extraordinary genius of an entreprenur.
d) Patent rights : Patent rights acquired by a firm or franchise rights exclosively acquired by a firm give rise to oligopoly.
e) Exclusive control of a factor input : A firm may become an oligopoly due to exclusive control of a input, such as raw materials,,

KINKED DEMAND THEORY OF OLIGOPOLY :-

Paul Sweezy explained very convincingly the reasons for Price rigidity in an oligopoly industry through his 'kinked demand curve model', Sweezy's model became very Popular. The model is based on two assumptions :
a) If an oligopoly firm increases the Price, its rivals will not increase the Price because they believe that they can gain more customers by keeping status quo, especially the customers of the firm which has increased the Price

b) if an oligopoly firm reduces the Price with an intention of increasing the Volume of its sales, other rival firms also follow suit so that their customers will not be lost to the rival firm, which has resorted to the Price cut.

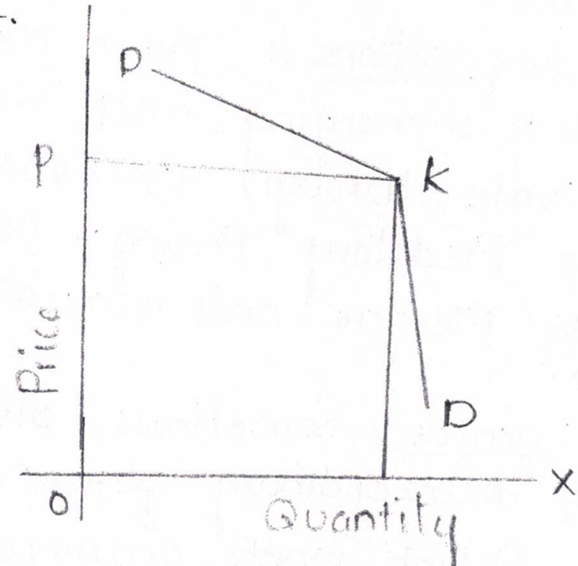


Fig : kinked demand curve.

Explaination:

The equilibrium Price and output remain stable at the kink 'k' on the demand curve. The Price has neither increased above the kink nor decreased below the kink. The Price remains rigid or sticky at the kink. It is to be noted that the 'kinked demand curve' model explains why Prices are rigid or sticky in an oligopoly industry. It will not explain how Price is originally determined.

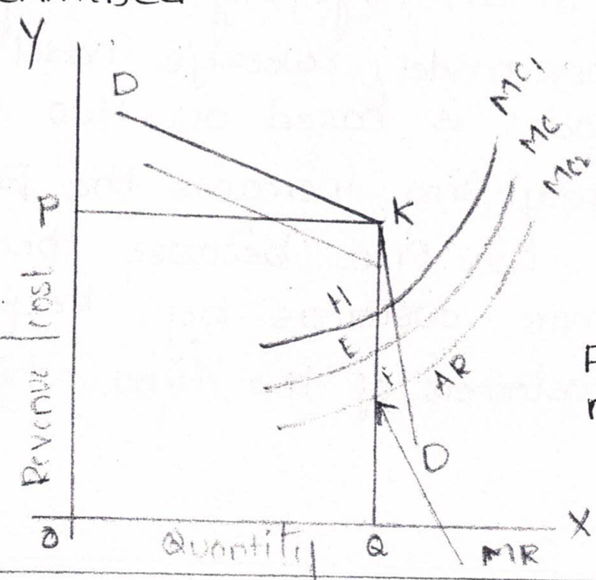


Fig: The average revenue curve

The marginal revenue curve will be a discontinuous one because of the kink in the AR curve. The length of the discontinuity of the MR curve depends upon the relative elasticities of the two parts or segments of the kinked demand curve. The greater the diffe-rence in the elasticity of the two segments, the greter the length of the discontinuity.

If the marginal cost curve of the oligopoly firm passes anywhere through the discontinuous portion of the marginal revenue curve, the oligopoly firm will maximise its profits at the prevailing price level, OP. Thus, the firm will be in equilibrium either at point E or F or H where MR is equal to MC.

PRICING :-

* Price is a market value of the product/service in a particular market at a particular period of time.

*Pricing objectives:-

a) To maximize profits

b) To increase sales

c) To increase the market share

d) To satisfy the customer

e) To Meet the competition.

Pricing Methods

- Cost Based Pricing
  - Cost plus pricing
  - Marginal cost pricing
- Competition based pricing
  - (a) Sealed bid Pricing
  - (b) going rate Pricing
- Demand oriented Pricing
  - (a) Price discrimination
  - (b) Perceived value Pricing
- Strategy Based Pricing
  - (a) Market skimming
  - (b) Market Penetration
  - (c) Peak load pricing
  - (d) Bundling pricing
  - (e) Limit pricing

Ex 2:- the car can provide cars with air-condition power steering, automatic tranxmission and soon sell them at a special price.

© **Limit pricing**:- A firm may also try to establish a price that reduces/eliminates that threat of entry of new firms into industry. This is called "limit pricing". for limit price to be effective some sort of collusion is necessary among "Existing" firms".

thus if the existing firms set their price closer to average cost. there will be less incentive for the new contrants.

* Cost - Base Pricing Methods :-

(a) Cost plus pricing :- this is also called "Full cort / Mark up" pricing. Some mark is added to the average cost in arriving at the price. in other words, find out the product limit's total cort and add the percentage of profit to arrive at the selling price.

Suitability :- it is commonly followed by departmental store and other retail shopes

* Evaluation :-

Advantages :-

it is simple, acceptable and consitency with a target rate of return on investement

Disadvantages :-

in some industries it is difficult to get the averag cost exactly

(b) Marginal Cost pricing :- Selling price is fixed in suc a way that is covers fully the variable / marginal cost and contributes towards recovery of fixed cost & fully or partly, depending up the market suitations it is also called "Target Profit pricing" or "Break even pricing".

* suitability:- in times of stiff competition marginal cost offers a guide line as to how for the selling price is lowered

II. Competition oriented pricing:-

ⓐ sealed bid Pricing:-

in this method the proper sellers (buyers) are asked to quote their prices through a sealed covered, all the offers are opened at a pre-annonced time in the presence of all the competitors and the one who quoted the least in awarded the contract

sutability:- Tendered and contracts

ⓑ Going rate pricing:- Here the price charged by the firm is in time with price charged in the industry as a whole. in other words, the prevailing market price at a given point of time is the guiding factor.

* sutability:- When one want to buy / sell gold, the prevailing market rate at a given point of time is taken as the basis to determine the price.

* DEMAND - ORIENTED PRICING

ⓐ Price Discrimination :- Refers to the Practice of charging different prices to customers for the same good. the firm uses its discreation to charge differently the different customers. it is also called as " Differential pricing."

Ex :- Bulk and low gas supply to industrial and household consumers etc. government hospital the pateints are charged after based on their income governers etc.

ⓑ Preceived value pricing :- Preceived value pricing refers to where the price is fixed on the basis of perception of the buyer of the value of the product.

* IV Strategy - based Pricing :-

ⓐ Market skimming :- Under this method the company fixes a very high price of the product. The main idea is to charge the customer maximum possible. as the time passes by the price comes down and more people can affected to buy.

Sutability :- Technological products.

Example :- Sony introduces TV at a higher price.

(b) Market Penetration :- Under this method the price of production is fixed so low that the can increase its market share. The company attains profits with increasing volumes and increase in the market share.

Sutability :- When market is high price sensitive.

Ex :- RIN soap, Hamam soap etc

(c) Peak Load Pricing :-

During seasonal period when demand is likely to be higher a firm may enhance the profits by peak load pricing. the firm's philosophy is to charge a higher price during peak times. The price is fixed in such a way that the business is not lost to the competatiors.

* Sutability :- When demand flueturate.

Example :- Airlines such as air india, indian airlines Jet air and so on, keep revising their fares every three months to charge higher fares during festivals / holiday seasons.