CHAPTER 3

Market Structures

INTRODUCTION

The composition of the market is usually determined by the different characteristics of that market. The market may not necessarily be limited to a place, but can also involve any transaction between buyers and sellers at different points. In this chapter, we shall discuss the composition and types of market such as perfect competition and imperfect markets.

OBJECTIVES

At the end of this chapter, students should be able to:

◆ Explain the concept of the market and distinguish it from the marketplace;
◆ Distinguish between perfect and imperfect markets by identifying their factors;
◆ Draw graphs to illustrate price and quantity determination under:
➢ Perfect competition;
➢ Monopoly;
➢ Oligopoly.

3.1 Concept of Market/Market Structure

To the layman, the term 'market' means a fixed place where people meet to buy and sell goods, i.e. a marketplace, for example Balogun market in Lagos and Ekeonunwa market in Owerri. In economics, the term 'market' has a wider meaning than just a marketplace. It means any arrangement, system or organization, where buyers and sellers of goods and services are brought in to contact with one another for the purpose of transacting business. The contact could be through different types of communication systems, for example, telephones, letters and telegrams. Buyers and sellers could also be in contact with fixed places, such as an office, shop, street and even a village market square.

The purpose of a market is to enable buyers and sellers of goods and services to strike a bargain for an exchange to take place.

3.1.1 Definition of Market Structure

The term 'market structure' is defined as those characteristics of a market organization that affect the behaviour and performance of firms, number of sellers and the nature of the product are the most significant dimensions of market structure. Others include the ease of entering the industry, and the nature and size of the purchase of the firms' product.

3.1.2 Types of Markets

Markets could be classified on different bases like the types of commodities bought and sold, and price determination of channel movement of finished products from the producer to the consumer.

3.1.3 Market-Based Type of Commodities

a. **Consumer goods market:** This is made up of buyers and sellers of consumer goods, which may be manufactured goods such as beverages, pens, maltina, cement and so on. They may also be agricultural products such as yam, beans, garri, rice and plantain.

b. **Labour market:** This is made up of employers, employees and workers. It deals with the recruitment of skilled, unskilled, semiskilled and professional workers.
c. **Capital market or money market:** Capital market is a financial market which deals in long-term loans. Money market is a financial market that deals with short-term loans.
d. **Stock exchange market:** This is a market where stocks, shares, bond and other securities are traded. It constitutes of sellers and buyers of second hand securities (sellers of old stocks and shares).
e. **Foreign exchange market:** This is a market that deals with foreign exchange transactions. It is a type of market where foreign currencies are bought and sold.
f. **Market based on the channel of distribution:** Most goods pass from the producer to wholesaler and to the retailer before they reach the final consumers. This type of distribution is divided into wholesale markets and retail markets.
g. **Markets based on price determination:** This is a market that is determined by the forces of demand and supply. It can be classified into perfect and imperfect markets.

3.2 Perfect Competition

This is a type of market that has strong competition between sellers and buyers when the prices of the commodities traded in the market are about the same. Th e perfect market is a theoretical economic model.

3.2.1 Characteristics of a Perfect Competition

a. **Homogenous commodity:** The commodities bought and sold must be identical. All sellers must be selling exactly the same kind of product.
b. **Large number of buyers and sellers:** There is large number of buyers and sellers and hence no one producer or seller can influence the price of his product by increasing or reducing the quantity supplied.
c. **Perfect knowledge of market transactions:** All buyers and sellers must have perfect knowledge of market transactions. There must be perfect flow of information to all sellers and buyers in the market. They must know the goods and services that are demanded. They must be aware of the ruling market prices. Costs and profits of other producers and sellers are not hidden.
d. **Free entry and exit of buyers and sellers:** There must be no restriction of any kind. There must be a perfect mobility of factors of production. Buyers should be free to buy from any seller of their choice. They must be allowed to enter and leave the market when they wish.
e. **No preferential treatment:** All buyers must be treated equally. The seller must not reduce prices for Mr. A because he is his relation or his customer and charge higher prices for Mrs. Y who is not his customer.
f. **Portable goods:** The goods must be easy to carry from place to place. If the goods are not portable, they would be sold at different prices and at different places, for example land.
g. **Identical cost and price structure:** All the firms in the market have identical cost structure. They incur the same costs in producing a commodity. There is a uniform price of commodity for all sellers.
   Example of a near perfect market is the stock exchange and world commodity market such as those of cocoa, coffee and wool.
   It is graphically represented as follows:

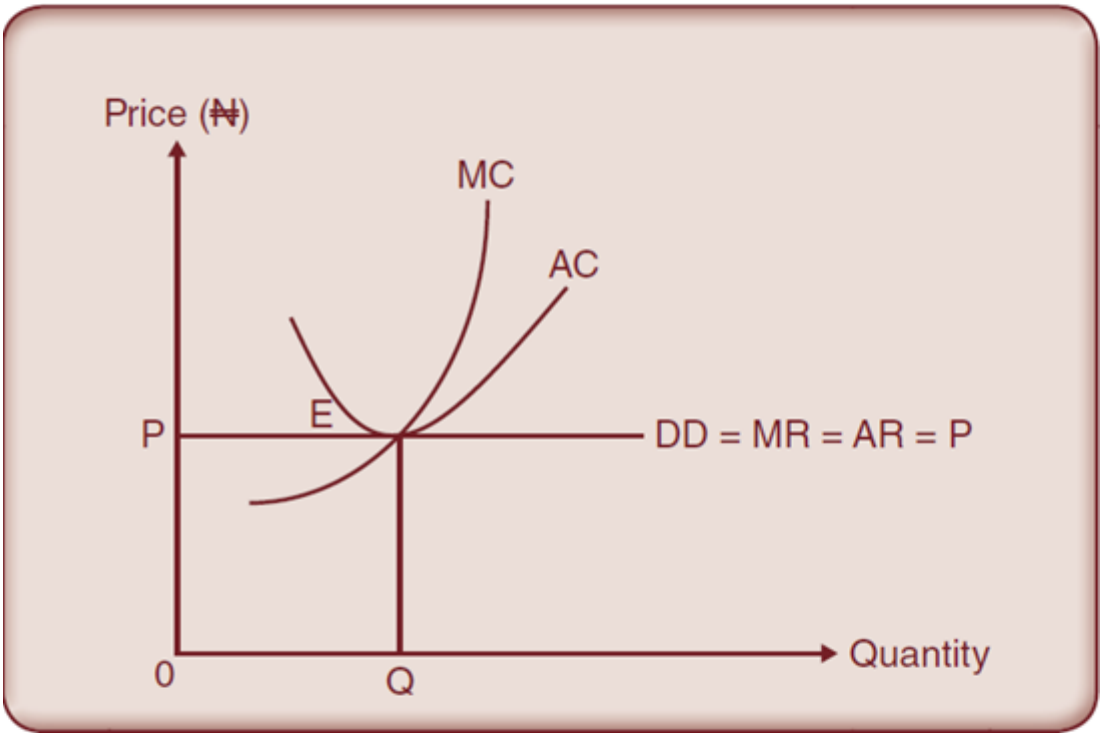

FIG. 3.1 Graph of the Perfect Competitive Market

3.3 Imperfect Competition

When market structures display varying degrees of imperfections, it is called an imperfect market. A market is described as imperfect when a commodity or service is sold in such a way that free competition does not exist. There are different degrees of imperfection. The imperfect markets commonly dealt with are as discussed below.

3.3.1 Monopoly

This is a single seller of a commodity or service. It is a market situation in which an individual or a group of persons, acting as a unit, control the total output or the supply of a particular good or service which have no total close substitutes in the market. In real life, pure monopolists do not exist since there are hardly any goods or services that do not have substitutes.

3.3.1.1 Features of Monopoly

- **a.** **Th**e monopolist faces no competition.
- **b.** As a single seller or producer of a product, he faces no competition. He can vary his supply to change the price as he likes.
- **c.** The monopolist is known to make abnormal profits and exploits consumers.
- **d.** There is no close substitute for his goods and services.
- **e.** Entry into the market is highly restricted. Other firms or producers are not allowed to enter the trade when they wish.
- **f.** The cost structure is unique: He does not have an identical cost structure with any other seller or producer.

3.3.1.2 Advantages of Monopoly

- **a.** **It avoids waste:** The type of wastages experienced in competitive market is greatly avoided under a monopoly market situation because production is tailored according to demand.
- **b.** **Invention:** It leads to invention. People carry out researches that may lead to the discovery of new products in order to enjoy patent laws.
- **c.** **Uses of resources:** Raw materials, equipment and factors of production are used effectively and efficiently.

d. **Expansion:** More profits lead to expansion.

3.3.1.3 Disadvantages of Monopoly

a. **Increase in the cost of goods:** The monopolist sells his goods at exorbitant prices in order to make extra profits.
b. **Reduction in supply:** Some monopolists reduce supply of their product to create artificial scarcity and make profit.
c. **Consumers bear the brunt:** The consumers are usually cheated by the monopolist.

Monopoly can be graphically presented as shown in Fig. 3.1.

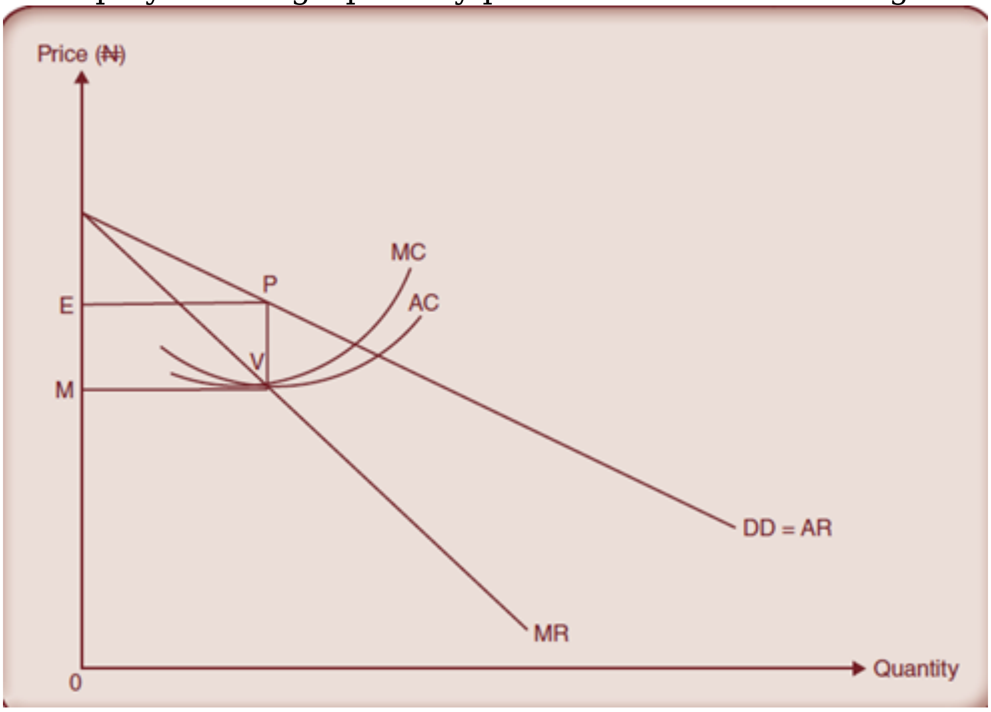

FIG. 3.2 Graph of the Monopolist

3.3.2 Duopoly

This is a market situation involving two producers of the same commodity.

3.3.3 Oligopoly

This is a market situation where a few large firms control the industry.

3.3.4 Monopolistic Competition

This is a market structure in which there are many sellers of the same kind of commodity. The sellers practice product differentiation where they try to make their products different from those of their rivals in terms of packaging, colour, size, quality, quantity, location and so on.

However, there is a basic similarity between the brands. There are some degrees of competition among the sellers of the unique but basically similar products.

3.3.4.1 Features of Monopolistic Competition

- There are many sellers but no single seller dominates in order to affect the price or output level.
- There are some degrees of free entry and exit from the market through entry permits and licenses to operate.
- Products are not homogenous. They have brand names and are priced differently.

Summary

This chapter has discussed:

❖ The market as an arrangement system or organization where buyers and sellers of goods and services are brought into contact with one another for the purpose of transacting business.

❖ The different types of markets which are as follows:
- Market based on types of commodities
- Labour market
- Capital market and money market
- Stock exchange market
- Foreign exchange market
- Markets based on the demand of distribution
- Markets based on price determination

❖ The features of a perfect market which are as follows:
a. Homogenous commodity
b. Large numbers of buyers and sellers
c. Perfect knowledge of market transactions
d. Free entry and exit of buyers and sellers
e. No preferential treatment
f. Portable goods
g. Identical cost structure

- Imperfect competition which is a market structure that displays some varying degrees of imperfections.
- Types of imperfect competition which include the following:
i. Monopoly
ii. Monopolistic competition
iii. Duopoly
iv. Oligopoly
- Features of monopoly:

i. Abnormal profits: There are no close substitutes for the goods and services.
ii. Entry into the market is highly restricted.
iii. Cost structure is unique.

Class Activity

Students should practice the drawing of graphs of the different markets treated in this chapter.

Revision Questions

Objective Questions

1. If a monopolist is attempting to maximize profi t, which of the following should he attempt to do?
(a) Equate average cost to average revenue
(b) Equate marginal cost to marginal revenue
(c) Equate marginal cost to average revenue
(d) Fixed price and output
(e) Equate price to total cost **(SSCE 1995)**
2. An imperfect competitor is in equilibrium when:
(a) Marginal cost is equal to marginal revenue
(b) Marginal revenue is equal to price
(c) Average cost is equal to average revenue
(d) Output is equal to average revenue
(e) Average revenue is equal to marginal revenue **(SSCE 1998)**
3. In a perfect market price and quantity to be bought are determined by the:
(a) Consumer and retailer
(b) Producers and wholesaler
(c) Forces of demand and supply
(d) Interest of government and producers **(SSCE 1999)**
4. Commodity market can best be described as a market in which:
(a) Goods are sold

(b) Labour is bought and sold
(c) Short term loans are obtained
(d) Quoted stocks are bought **(SSCE 1999)**
5. The charging of different prices to different groups of buyers for the same goods or services is called:
(a) Monopolistic competition
(b) Price determination
(c) Monopoly
(d) Oligopoly **(SSCE 2000)**

Essay Questions
1. (a) Define a market.
(b) Explain four characteristics of a perfect market. **(SSCE 1991)**
2. (a) Explain the advantages and disadvantages of monopoly. **(SSCE 1999)**
(b) Write on the following:
(i) oligopoly
(ii) duopoly
(iii) monopolistic competition
3. (a) Outline any **two** differences between monopoly and perfect competition.
(b) State any **four** entry barriers that can prevent the emergence of competitive firms. **(SSCE 2005)**
4. (a) Why would a producer (i) enter a competitive market? (ii) leave a competitive market?
(b) In what ways do consumers benefit from perfect competition?
(c) Give the two conditions necessary for profit maximization for a perfectly competitive firm. **(SSCE 2006)**

Glossary
Market: This is any arrangement, system or organization where buyers and sellers of goods and services are brought in contact with one another for the purpose of transacting business.
Perfect Competition: A type of market that has strong competition among sellers and buyers when the prices of the commodities traded in the market are about the same.
Monopolistic Competition: This is a market structure in which there are many sellers of the same kinds of commodity.