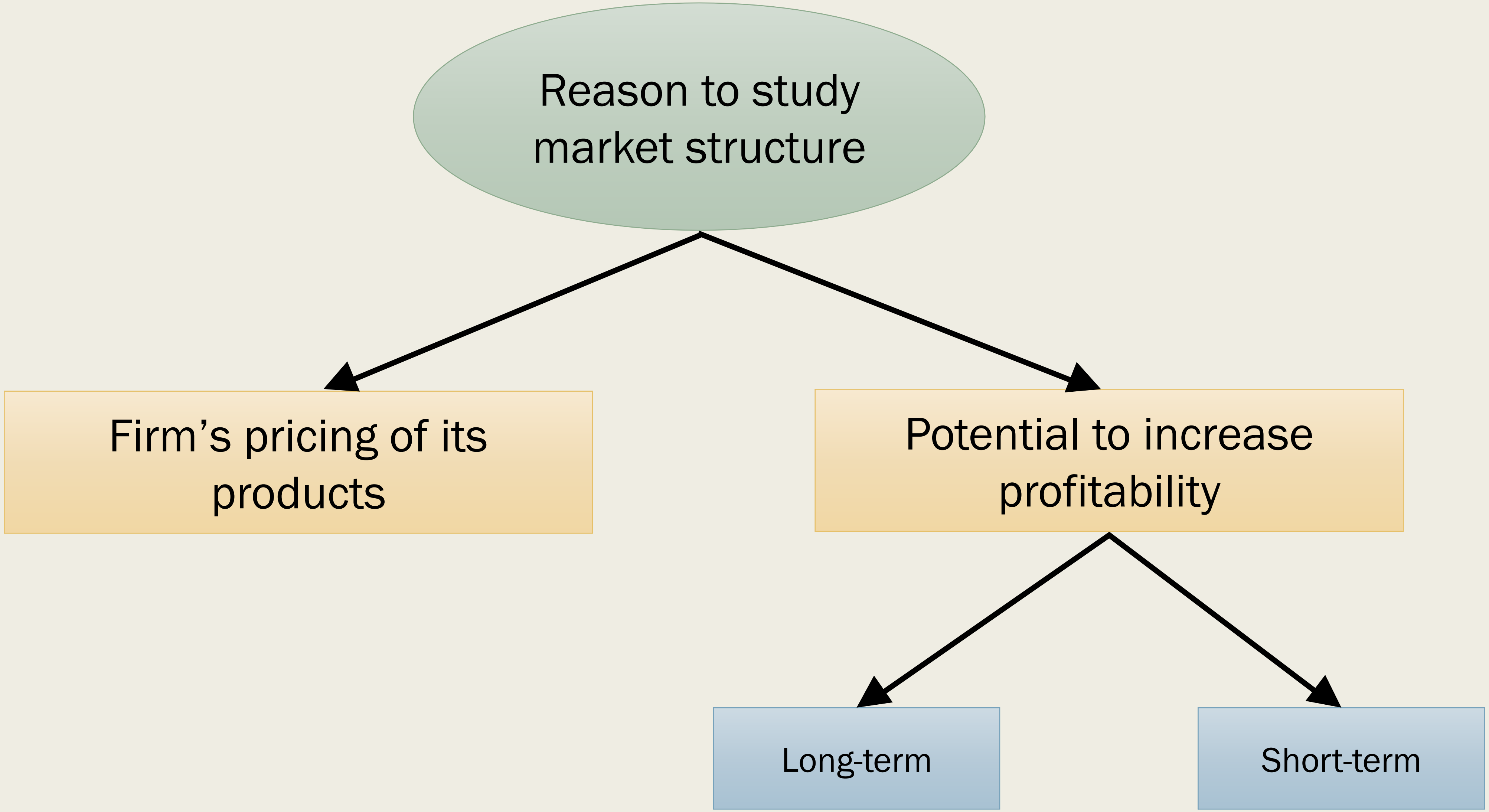
MARKET STRUCTURES

-Yesoda Bhargava

Why study market structure?



In the long run, a firm's profitability will be determined by the forces associated with the market structure within which it operates.

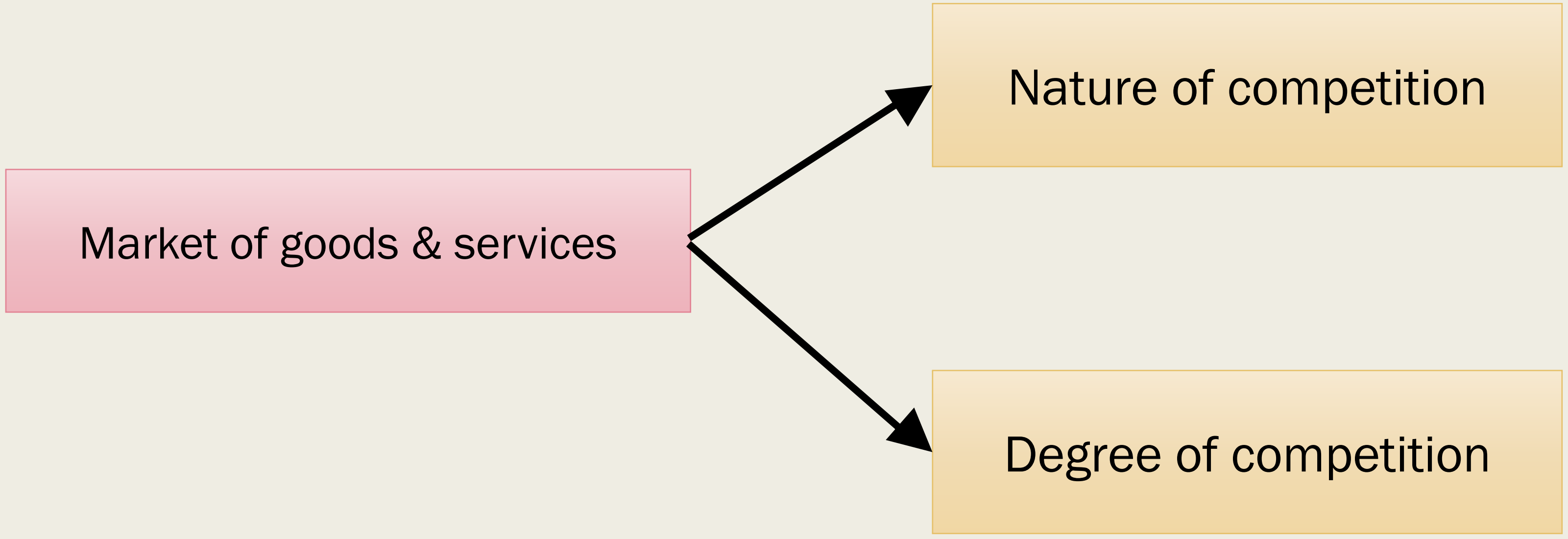
What is a market?

- Ordinarily, its a place where goods are purchased and sold.
- But in **economics,** market is used in a wider perspective.
- The whole area where the buyers and sellers of a product are spread.
- Why so?
- The sellers and buyers of a particular commodity are spread over a large area.
- The transactions for commodities may be also through letters, telegrams, telephones, internet, etc.

THE TERM MARKET REFERS NOT NECESSARILY TO A PLACE BUT ALWAYS TO A COMMODITY AND THE BUYERS AND SELLERS WHO ARE IN DIRECT COMPETITION WITH ONE ANOTHER.

Prof. R. Chapman

What is a market structure?



Determinants of market structure

- Number and nature of sellers.
- Number and nature of buyers.
- The nature of product.
- The conditions of entry into and exit from the market.
- Economies of scale.

Number and Nature of sellers

- Large number of sellers in perfect competition.
- A single seller in pure monopoly.
- Two sellers in duopoly.
- A few sellers in oligopoly.
- Many sellers of differentiated products.

Number and Nature of buyers

- 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.
- Two buyers who act jointly in the market. This is called **duopsony** market.
- They may also be a few organised buyers of a product. This is known as **oligopsony**.
- Examples of Duopsony and Oligopsony market: Cash crops.

Nature of Product

Product Differentiation

The process of distinguishing a product or service from others to make it more appealing to a specific target market.


Chex
Crispix
WHEATIES
Cracklin' Oat Bran
Rice Chex
Rice Squares
Cheerios
Oat Crunch
Maple Cheerios
Toasted
Corn Chex
Corn Squares
Multi-Grain Cheerios
Rice Krispies
Life


VS
PRODUCT DIFFERENTIATION IS THE
SECRET INGREDIENT (PEPSI VS. COCA-COLA)


MIXED FRUIT
MUSHROOMS
Sweet CORN
CHICKEN NOODLE SOUP
SALMON
CHILI
BAKED BEANS

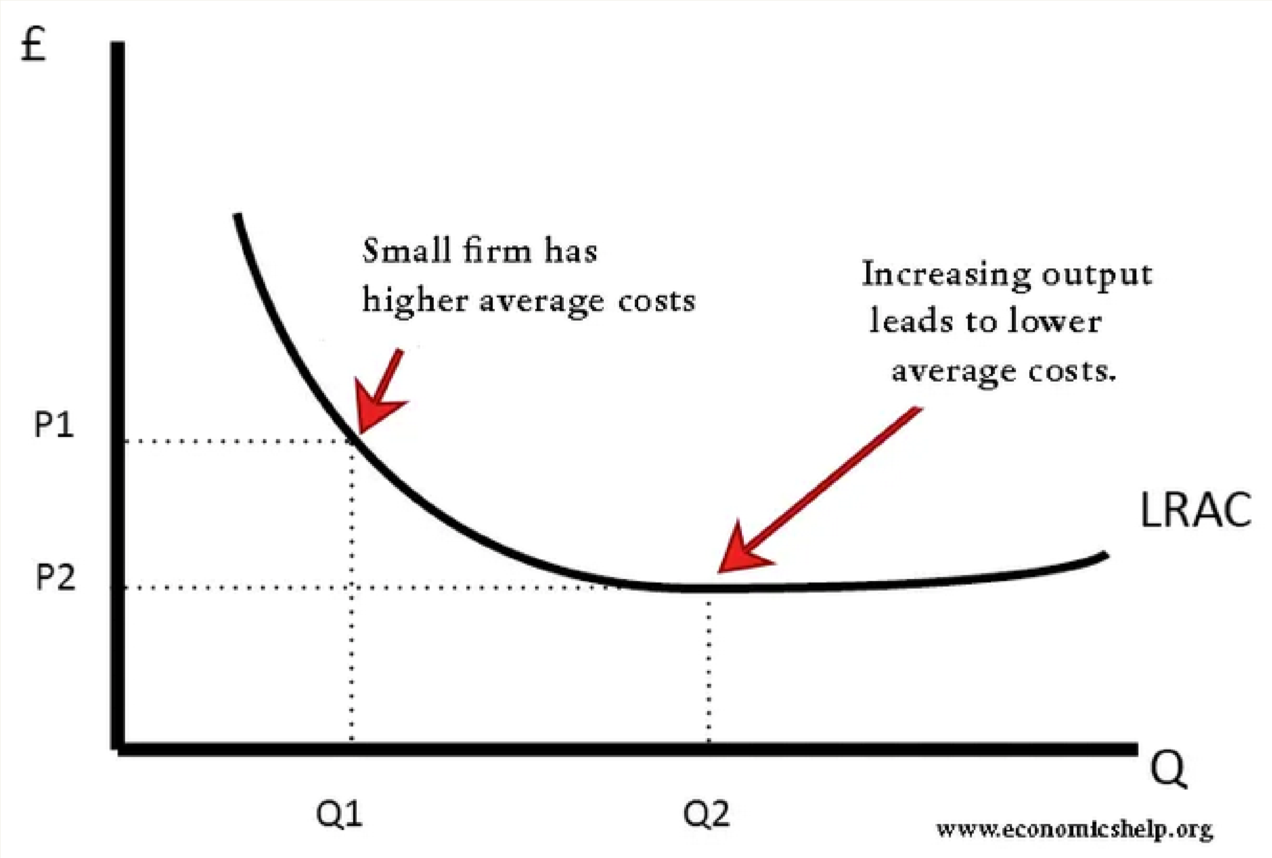
- If *there is product differentiation*, products are close substitutes and the market is characterised by **monopolistic competition.**
- On the other hand, in case of *no product differentiation*, the market is characterised by **perfect competition**. Eg. Agricultural markets, Internet related industries (e-bay, Amazon, flipkart, purchasing books online, ebooks)
- If *a product is completely different from other products*, it has no close substitutes and there is **pure monopoly** in the market. Eg. Town specific airline, Gas connection company in an area, Electricity company, Water supplier, Cable TV, Postal, Air Transport.

Entry and Exit conditions

- The conditions for entry and exit of firms in a market depend upon profitability or loss in a particular market.
- In a perfect competition market, there is freedom of entry or exit of firms.
- In Monopolistic competition?
- In Pure Monopoly?
- In Oligopoly?

Economies of scale

- Economies of scale occur when increasing output leads to lower **long-run average costs (LRAC)**.
- It means that as firms increase in size, they become more efficient.
- Think why a smaller business charges more for a similar product sold by a larger company.
- Cost per unit.
- Larger companies are able to produce more by spreading the cost of production over a larger amount of goods.



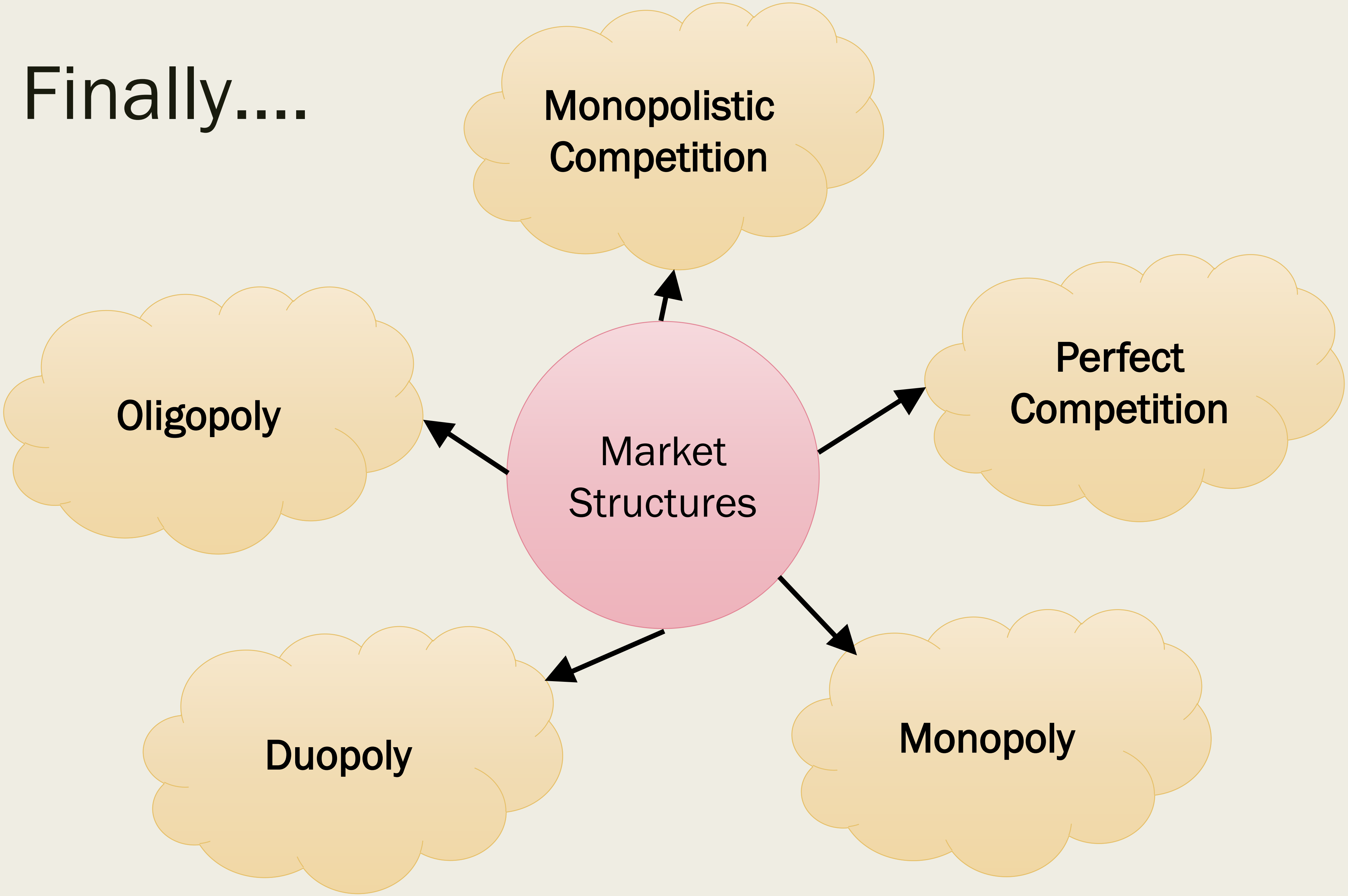
Why Economies of Scale leads to lower per-unit cost?

- Specialization of labor.
- Integrated technology.
- Lower cost of capital (the weighted average of a firm's cost of debt and cost of equity blended together).
- Operational efficiencies (Information Technology, Marketing, Accounting)

How Economies of Scale affects Market Structure?

- 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 emergency 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.**

Finally….


Monopolistic Competition
Oligopoly
Market Structures
Perfect Competition
Duopoly
Monopoly

Essential Reading for the Week

- Warren Buffett 1997 Email Exchange on Microsoft

Perfect Competition Market

- 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.
- There is freedom of entry into, and exit from, industry.
- Characteristics of Perfect Competition:
  - *Large number of buyers and sellers.*
  - *Freedom of Entry or Exit of Firms*
  - *Homogeneous product*
  - *Absence of artificial restrictions*
  - *Profit maximization goal*
  - *Perfect Mobility of Goods and Factors*
  - *Perfect knowledge of market conditions*
  - *Absence of transportation cost*

Agricultural Market

Monopoly Market

- Only one seller of a product with barriers to entry of others.
- The product has no close substitutes.
- No other firms produce a similar product.
- There are restrictions on the entry of other firms in the area of monopoly product.
- A monopolist can influence the price of a product. He is a price-maker, not a price-taker.
- Pure monopoly is not found in the real world.
- Eg. Microsoft and Windows, DeBeers and Diamonds. Watch Diamonds documentary on Netflix, Explained Series, Season 2.

Monopolistic Competition

- Many firms selling a differentiated product.
- Competition among a large number of sellers producing close but not perfect substitutes for each other.
- Features:
  - *Large number of sellers.*
  - *Product differentiation*
  - *Differentiation based on certain characteristics (quality, design, color, style)*
  - *Freedom of entry and exit of firms.*
  - *Independent behaviour*
  - *Product Groups*

Dairy/Yoghurt market

Oligopoly

- Market situation in which there are a few firms selling homogeneous or differentiated products.
- 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. (Pure Oligopoly)
- Example: Producers of aluminium, cement, steel, copper, zinc etc.
- An oligopoly industry produces either a homogeneous product or heterogeneous products. (Differentiated Oligopoly)
- Example: Producers of consumer goods such as automobiles, TV, refrigerators, rubber tyres etc.
- Characteristics:
  - *Interdependence*
  - *Advertisement*
  - *Competition*
  - *Barriers to entry of firms.*

Oligopoly Examples

Duopoly

- Special case of oligopoly in which there are only two sellers.
- Both the sellers are completely independent and no agreement exists between them.
- Despite independence, a change in the price and output of one will affect the other.
- 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.
- Duopoly problem can be considered as either ignoring mutual dependence or recognising it.

Duopolies in Indian Market

Essential Reading for the Week

- How competitive forces shape strategy : Harvard Business Review Article
- Sustainable Competitive Advantage Video

Assignment: State of Competition

- For the project in Innovation identified do the following and submit as a report. This is a team project.
  - *Who are buyers? Justify. 100 words*
  - *Who are the sellers? Justify. 100 words*
  - *What is the nature of your product? Is it differentiated from others existing in the market? Justify. 200 words*
  - *What kind of market structure exists for your proposed idea? Explain with reason and logic. 200 words*
  - *Which current market players in India/globally provide the same/differentiated solution as yours. 200 words*