Market Structure Analysis

Concept

- An **arrangement** through which buyers and sellers come into contact to buy and sell various goods and services.
- Any mode of communication- direct face to face or through mails, internet, websites, telephone, etc.
- Market Structure comprises of different forms of markets.

Characteristics

S. no.	features	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
1.	No. of Sellers/Producers	Large	Many	Few	Single/One
2.	Nature of the product	Homogeneous	Heterogeneous/ Differentiated	Homogeneous & Heterogeneous/ Differentiated	Unique/ Single
3.	Competition	Consumer is the king.	Higher degree of competition.	Dominance of seller.	No competition, seller controls market.
4.	Barriers to entry	Nil	Low	High	Very high
5.	Pricing Decisions/ Power to influence price	Price takers No influence	Price makers Some	Price makers Some	Price makers Considerable
6.	Non-price Competition	None	Selling cost/ Advertising	Selling cost/ Advertising	Advertising
7.	Demand Curve	Horizontal	Downward Sloping (Flatter)	Kinked	Downward Sloping (Steeper)
8.	Equilibrium: Short Run Long Run	Excess profit, Normal profit, loss (sub-normal) Normal profit	Excess profit, Normal profit, loss (sub-normal) Normal profit	Excess profit, Normal profit, loss (sub-normal) Excess profit	Excess profit, Normal profit, loss (sub-normal) Excess profit

Perfect Competition

Demand and MR curve in Perfect Competition

- Firms under perfect competition market structure are price taker.
- The demand curve is horizontal.
- Condition for Equilibrium

i. MR = MC

ii. MC curve cuts the MR curve from below

- Normal profit—P=AC
- Excess profit—P>AC
- Subnormal profit (loss)—P<AC
- Shut down point—P=AVC
- Loss—P<AVC

Long Run Equilibrium of a Firm in Perfect Competition

- The firms in long run which remains in the market earns only normal profit.
- Industry is in equilibrium when all firms are in equilibrium with normal profit.
- There is no entry and exit
- Condition: LMC=SMC=P=AR=MR=LAC

Monopoly

Source of Power

- Monopoly is a market structure in which there is a single seller, there are no close substitutes for the commodity it produces and there is barrier to entry.
- Source:
  1) Natural monopoly—high infrastructure or start up cost
  2) Geographic monopoly--
  3) Technology
  4) Legal Protection—granted by government
  5) Cartel Formation
  6) Barriers to New Competition

Firms Equilibrium in Short Run

- In equilibrium, MR=MC and MC cuts the MR from below.
- In short-run, a monopolist due to monopoly power can earns excess profit.
- As the demand for the product produced by the monopolist depends on the market, the monopolist may even incur loss.

Firms Equilibrium in Long Run

- In long run, the monopoly makes all the necessary adjustments to earn supernormal profit.
- However, insufficient demand for the product may compel the monopolist to settle down with normal profit.
- In equilibrium, MC=MR and MC cuts the MR from below.

1) Price Discrimination

- Exist in Monopoly market structure
- Price discrimination refers to the act of selling the same product, produced under single control at different prices to different buyers.
- Types:

i. Personal price discrimination
ii. Local discrimination
iii. Age discrimination
iv. Gender discrimination
v. Size discrimination
vi. Quality wise price discrimination
vii. Use discrimination
viii. Discrimination based on the nature of the product
ix. Time discrimination

Price Discrimination

- Price discrimination exists in a monopoly market.
- It implies the practice of selling the same product at different prices to different buyers.
- Degrees of Price Discrimination- this classification was given to us by Piguo.
    1. First Degree of Price Discrimination
    2. Second Degree of Price Discrimination
    3. Third Degree of Price Discrimination

Monopolistic Competition

Selling Cost

- Selling cost is the advertisement expenditure that influences the consumer's desire to purchase commodity.
  - If the selling cost becomes effective, it shifts the demand curve to the right.
  - Selling cost enables the producer to sell more at the same prices.
  - The selling cost makes the demand more elastic.
  - After incurring the selling cost if the firm reduces the price and the sales increases.
- Selling cost increases profits.
- SC ↑TC→TR ↑>TC ↑

Oligopoly

Evaluation of Kinked Demand Curve Model

- Does not explain the determination of price
- Does not apply to cartel and price leadership
- Not valid during the prosperity period

Collusive Oligopoly

- Firms join together to reduce uncertainty in the market.
- They decide the price, output and mechanism to share profit.
- Forms: 1) Cartel

  2) Price Leadership

Cartel

- Cartel is formed to avoid the price war due to the dependency behavior amongst the firms and to tackle the uncertainty.
- Cartel can be explicit or implicit.
- OPEC is an **explicit cartel**.
  - Homogeneous product –Petroleum
  - Few producers and they charge same price.
  - Each producer is allotted a certain quota of output.
  - Profit earned varies.
  - Two forms—i) market sharing cartels—geographical area

    ii) centralized cartels—cartel (Central Administrative Agency) decides the price, allocates output and determines the norms of profit sharing.(OPEC)
- **Implicit cartel**-cartel formed in secrecy, agreement may be in written or oral form.
  - Loose type of cartel
  - The decisions regarding the sharing of output and profit takes place in two different methods:

  i) Non-price method

  ii) Quotas

Non-price Competition

- **Covert Cheating**—secret discounts, additional facilities, or any other secret benefit to the retailers and or the final consumer.
- Monopoly price to earn maximum price.
- Low cost firms charge lower price—cartel breaks.

Quotas

- Quota of output and price
- Quota of output depends on past record and negotiating skills.
- Division of market region-wise.

Price leadership

- Lead firms influences or decides the price.
- Types:

  i) Dominant Firm Leadership

  ii) Low Cost firm leadership

  iii) Barometric Price leadership

  iv) Aggressive Price Leadership

Limitations of Price Leadership

- Non-price Competition
- Product Differentiation
- Difference in Cost of Production