CHAPTER 8

MARKET STRUCTURE

- This chapter covers the types of market such as perfect competition, monopoly, oligopoly and monopolistic competition, in which business firms operate.

Market Structure

- Basically, when we hear the word **market**, we think of a place where goods are being bought and sold.

- In economics, market is a place where buyers and sellers are exchanging goods and services with the following considerations such as:
  - Types of goods and services being traded
  - The number and size of buyers and sellers in the market
  - The degree to which information can flow freely

Two Types of Market Structure

- Perfect or Pure Market
- Imperfect Market

Perfect Market

Perfect Market is a market situation which consists of a very large number of buyers and sellers offering a homogeneous product. Under such condition, no firm can affect the market price. Price is determined through the market demand and supply of the particular product, since no single buyer or seller has any control over the price.

Perfect Competition is built on two critical assumptions:

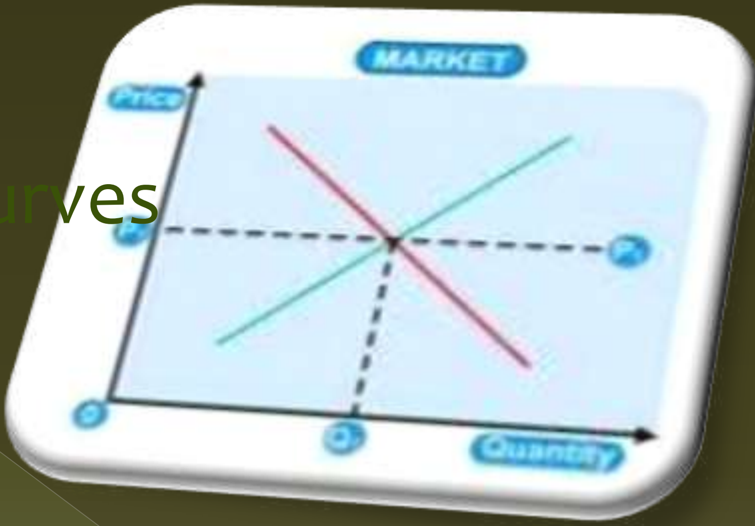
- The behavior of an individual firm
- The nature of the industry in which it operates

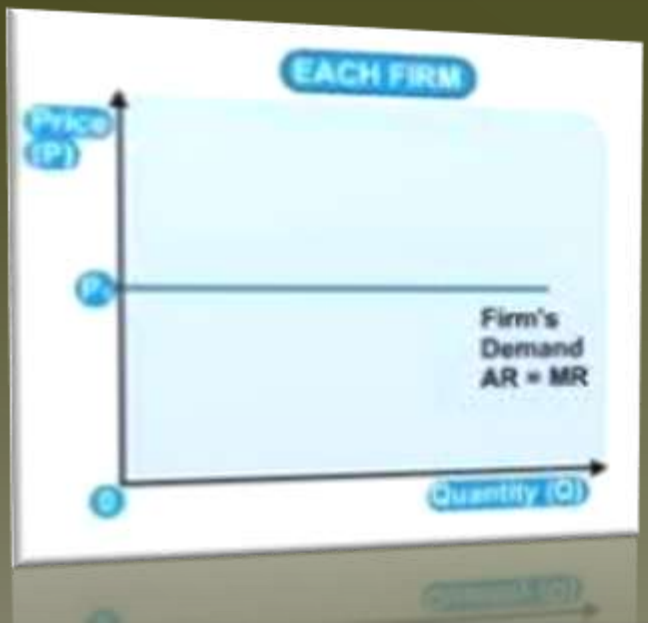
- The firm is assumed to be a price taker
- The industry is characterized by freedom of entry and exit

Demand curves for industry and firm in perfect competition

Industry

- Normal demand and supply curves
- More supply at higher price





Firm

- Price takers
- Have to accept the industry price

Perfect Competition cannot be found in the real world. For such to exist, the following conditions must be observed and required:

- A large number of sellers
- Selling a homogenous product
- No artificial restrictions placed upon price or quantity
- Easy entry and exit
- All buyers and sellers have perfect knowledge of market conditions and of any changes that occur in the market
- Firms are "price takers"

Characteristics of Perfect Competition

- There are very many small firms
- All producers of a good sell the same product
- There are no barriers to enter the market
- All consumers and producers have ‘perfect information’
- Firms sell all they produce, but they cannot set a price.

Short-run Analysis of Perfect Competition

- The firm's objective is to produce the level of output that will maximize profit
- Some inputs are variable and therefore fixed costs arise regardless whether the firm is operating or not
- Since the firm is a price taker, it has no control on the price of a product

Short-run equilibrium under a Perfect Competition Market

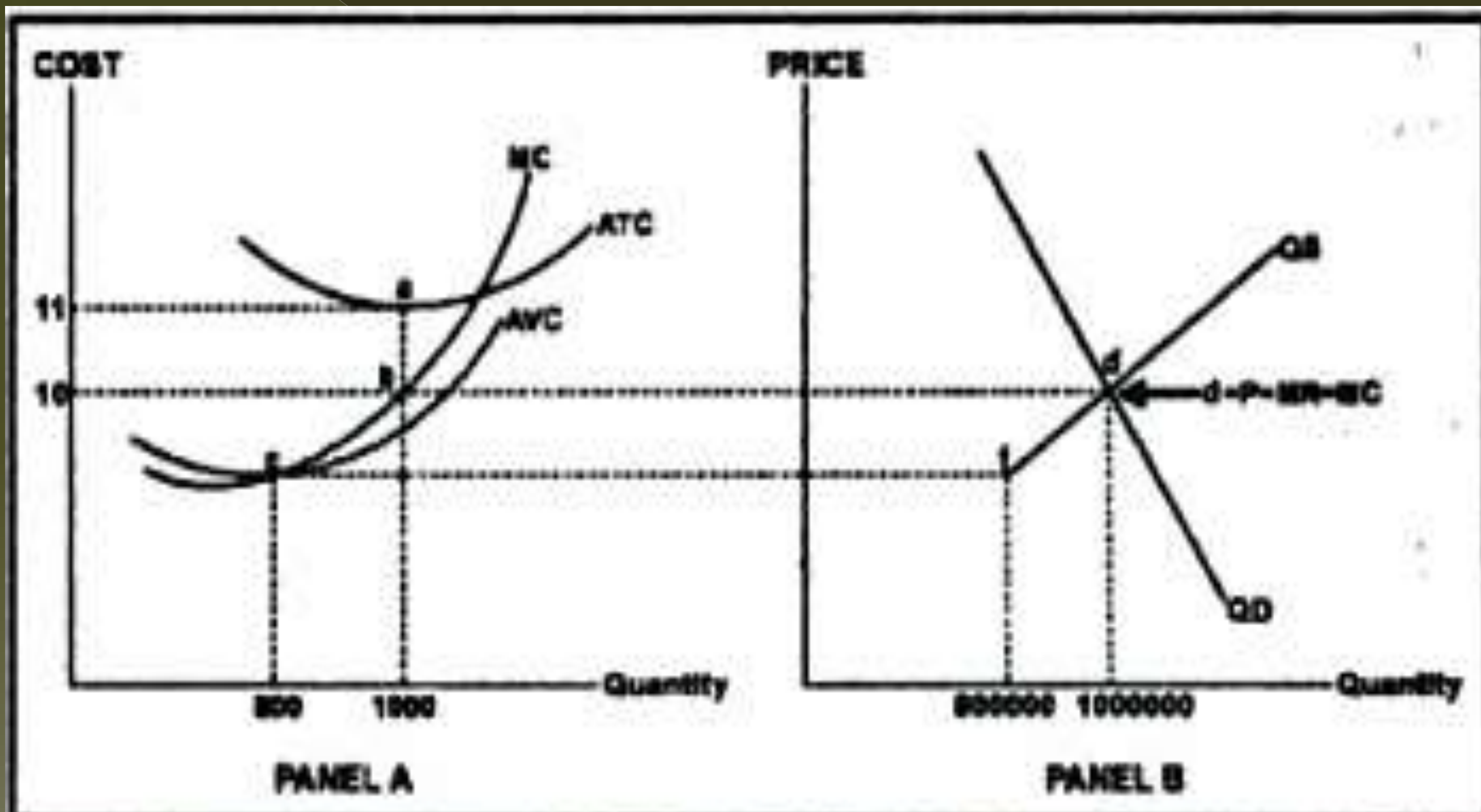


Figure 82. Short-run Equilibrium under Perfect Competition

Long-run Analysis of Perfect Competition

- All inputs and costs of production are variable
- The firm can build most appropriate scale of plant to produce the optimum level of output

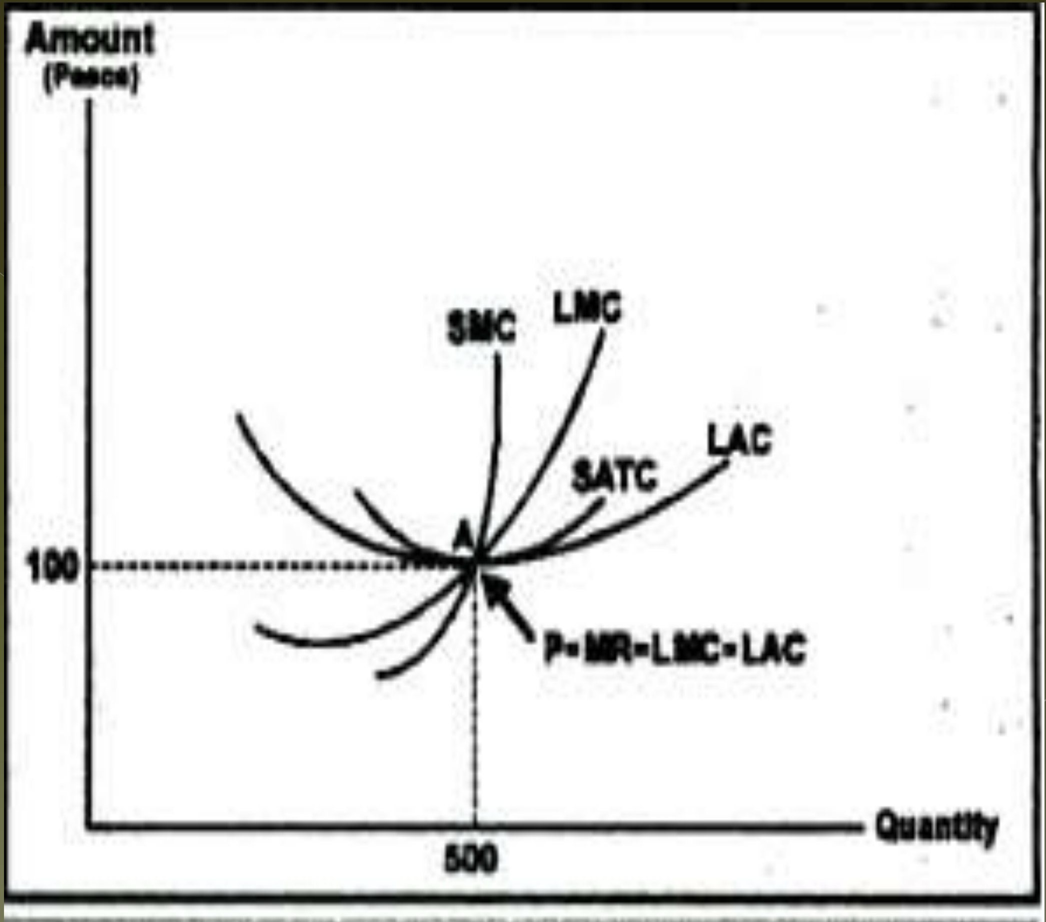


Figure 83. Long-run Analysis of Perfect Competition

Imperfect Market

In economic theory, *imperfect competition* is a type of market structure showing some but not all features of competitive markets.

Forms of imperfect competition include:

- Monopoly
- Oligopoly
- Monopolistic competition

Monopoly

- comes from a Greek word 'monos' which means 'one' and 'polein' means to 'sell'
- There is only one seller of goods or services

A monopoly should be distinguished from a *cartel*.

(Cartel refers to a market situation in which firms agree to cooperate with one another to behave as if they were a single firm and thus eliminate competitive behavior among them.)

Sources of Monopoly

- ✓ There is only one producer or seller of goods and only one provider of services in the market.
- ✓ New firms find extreme difficulty in entering the market. The existing monopolist is considered giant in its field or industry.
- ✓ There are no available substitute goods or services so that it is considered unique.
- ✓ It controls the total supply of raw materials in the industry and has no control over price.
- ✓ It owns a patent or copyright.
- ✓ Its operations are under economies of scale.

Classifications of Monopoly

Monopolies are classified according to circumstances they arise from, that is, cost structure of the industry, possibly the result of law, or by other means.

Natural Monopoly

- is a market situation where is a single firm can supply the entire market due to the fundamental cost structure of the industry.

Legal Monopoly

- is sometimes called as de jure monopoly, a form of monopoly which the government grants to a private individual or firm over the product or services.

Coercive Monopoly

- is a form of monopoly whose existence as the sole producer and distributor of goods and services is by means of coercion (legal or illegal), so that most of the time it violates the principle of free market just to avoid competition.

Short-run Analysis of Monopoly

A monopolist is considered a price maker, since he is the sole seller of a product that has no close substitute in the market.

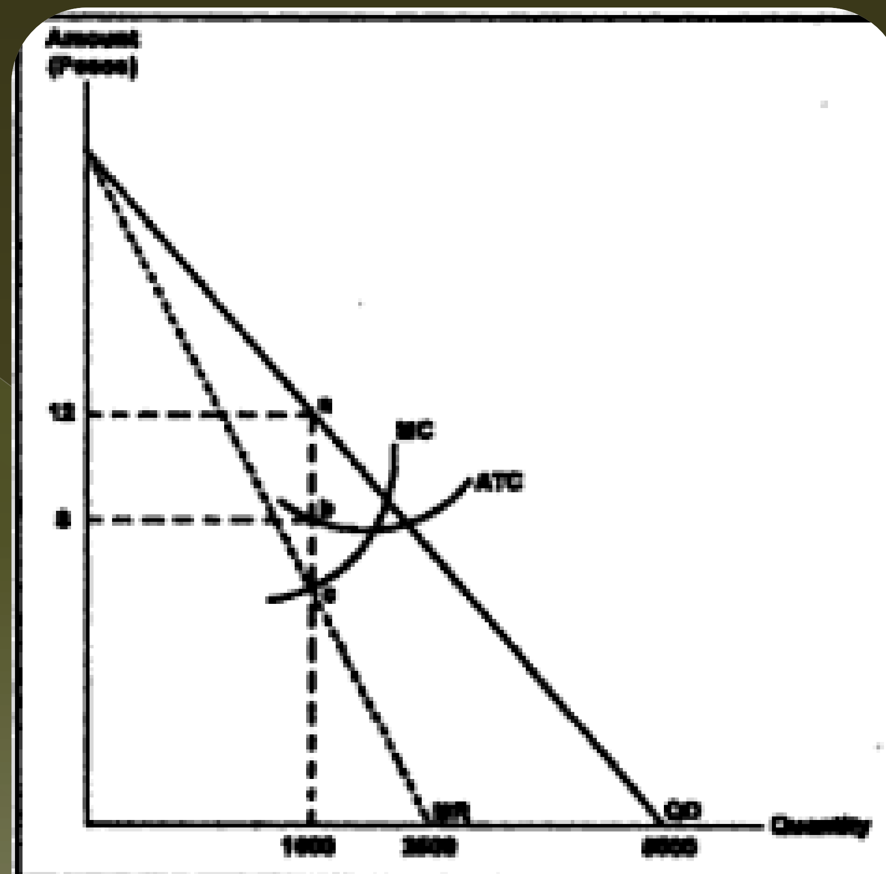


Figure 04. Short-run Analysis of Monopoly

Long-run Analysis of Monopoly

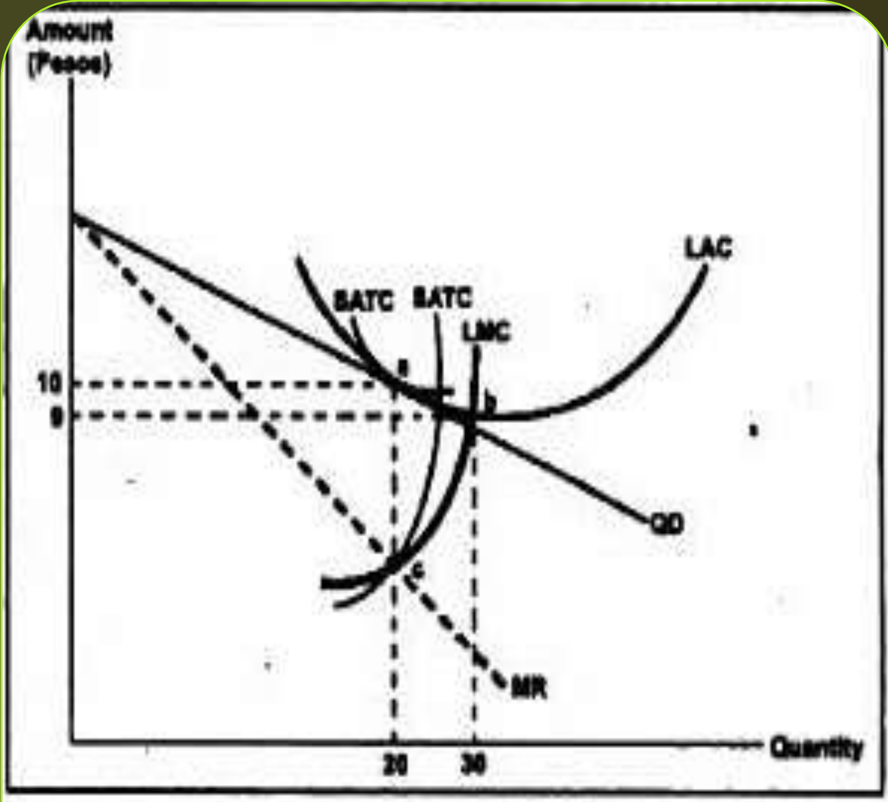


Figure 68
Long-run Analysis of Monopolistic Competition

In the long-run, all inputs and costs are variable, and the monopolist can make his optimal scale of plant to make the best level of output.

Oligopoly

- comes from the Greek word "oligo" which means 'few' and "polein" means 'to sell'.
- small number of sellers, each aware of the action of others
- All decisions depend on how the firms behave in relation to each other

- In oligopoly, *conjectural interdependence* is present, that is, the decision of one firm influences and are influenced by the decision of other firms in the market.

Characteristics of an Oligopoly

- ✓ There are a small number of firms in the market selling differentiated or identical products.
- ✓ The firm has control over price because of the small number of firms providing the entire supply of a certain product.
- ✓ There is an extreme difficulty for new competitors to enter the market.

Types of Oligopoly

1. Pure or Perfect Oligopoly
   - If the firms produce homogeneous products
2. Imperfect or Differentiated Oligopoly
   - If the firms produce differentiated products
3. Collusive Oligopoly
   - If the firms cooperate with each other in determining price or output or both
4. Non-collusive Oligopoly
   - If firms in an oligopoly market compete with each other

Types of Organization of Oligopoly

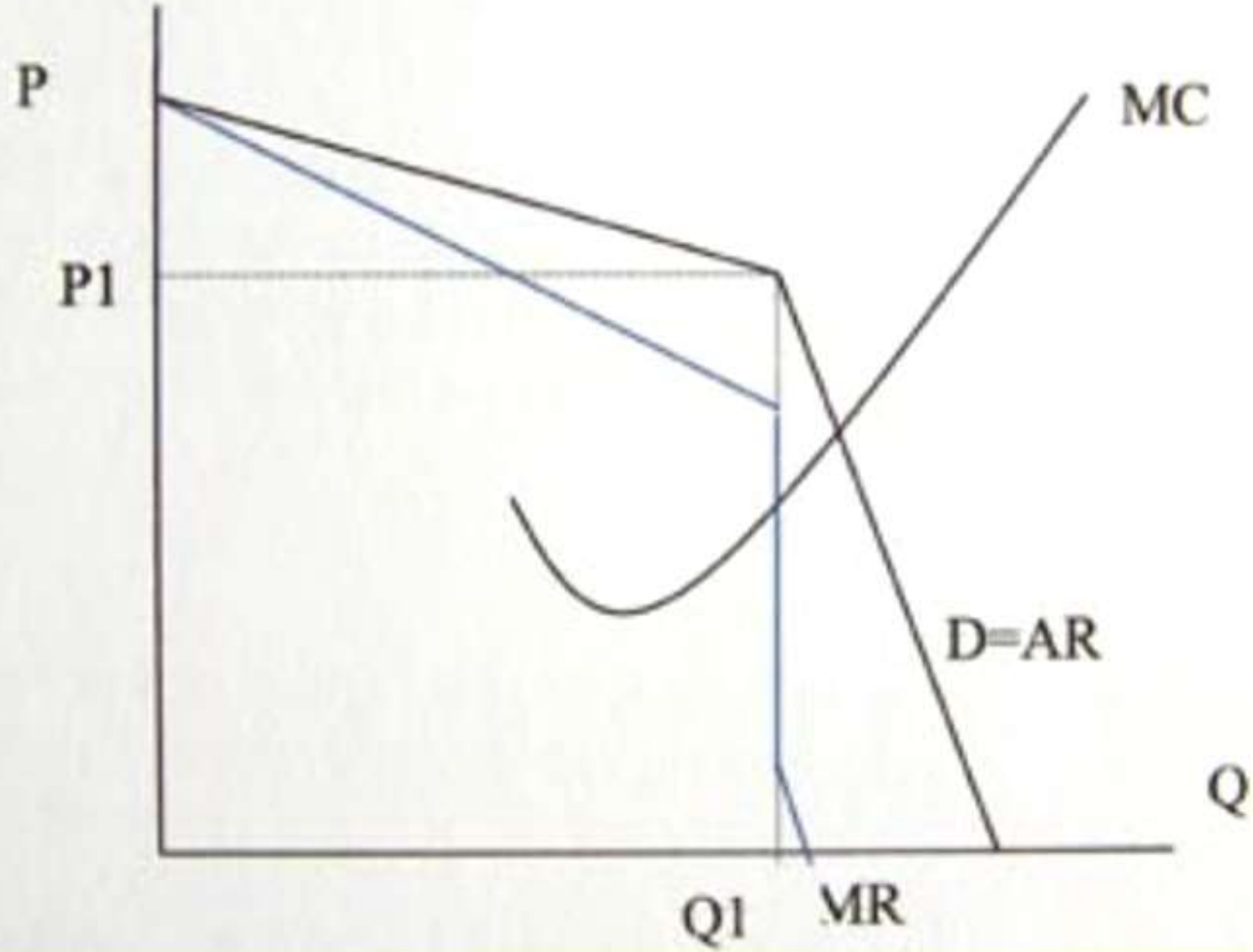
Cartel is a formal agreement among oligopolists to set-up a monopoly price, allocate output, and share profit among members.

Collusion is a formal or an informal agreement among oligopolists to adopt policies that will restrict or reduce the level of competition in the market.

Analyzing Oligopoly using Kinked Demand Curve

- Kinked demand curve is defined as the demand curve of the individual firm in oligopolistic market. It has a "kink" at the existing price caused by the firm's expectation of the actions its rivals are likely to take if the firm changes its price.

The Kinked Demand curve



Monopolistic Competition

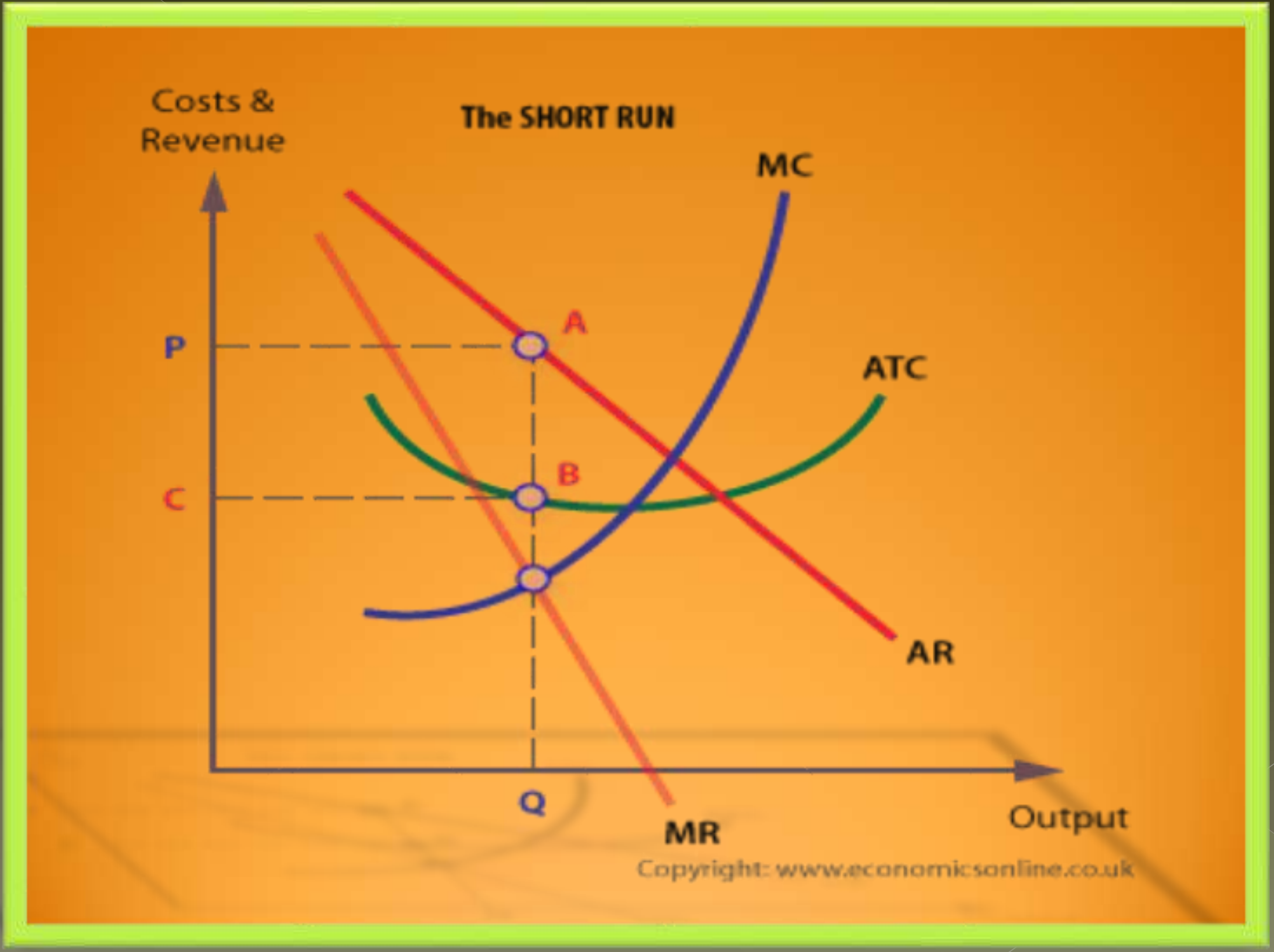
- Market situation in which there are many sellers producing highly differentiated products.
- Monopolistic competition is also perfect competition plus product differentiation.

- Product differentiation gives each monopolistic competitor some market power, since each competitor can raise price slightly without losing all its customers.

Characteristics of Monopolistic Competition

- A large number of buyers and sellers in a given market act independently.
- There is a limited control of price because of product differentiation.
- Sellers offer differentiated products or similar but not identical products.
- New firms can enter the market easily. However, there is a greater competition in the sense that new firms have to offer better features of their products.
- Economic rivalry centers not only upon price but also upon product variation and product promotion.

Short-run Analysis of Monopolistic Competition



Long-run Analysis of Monopolistic Competition

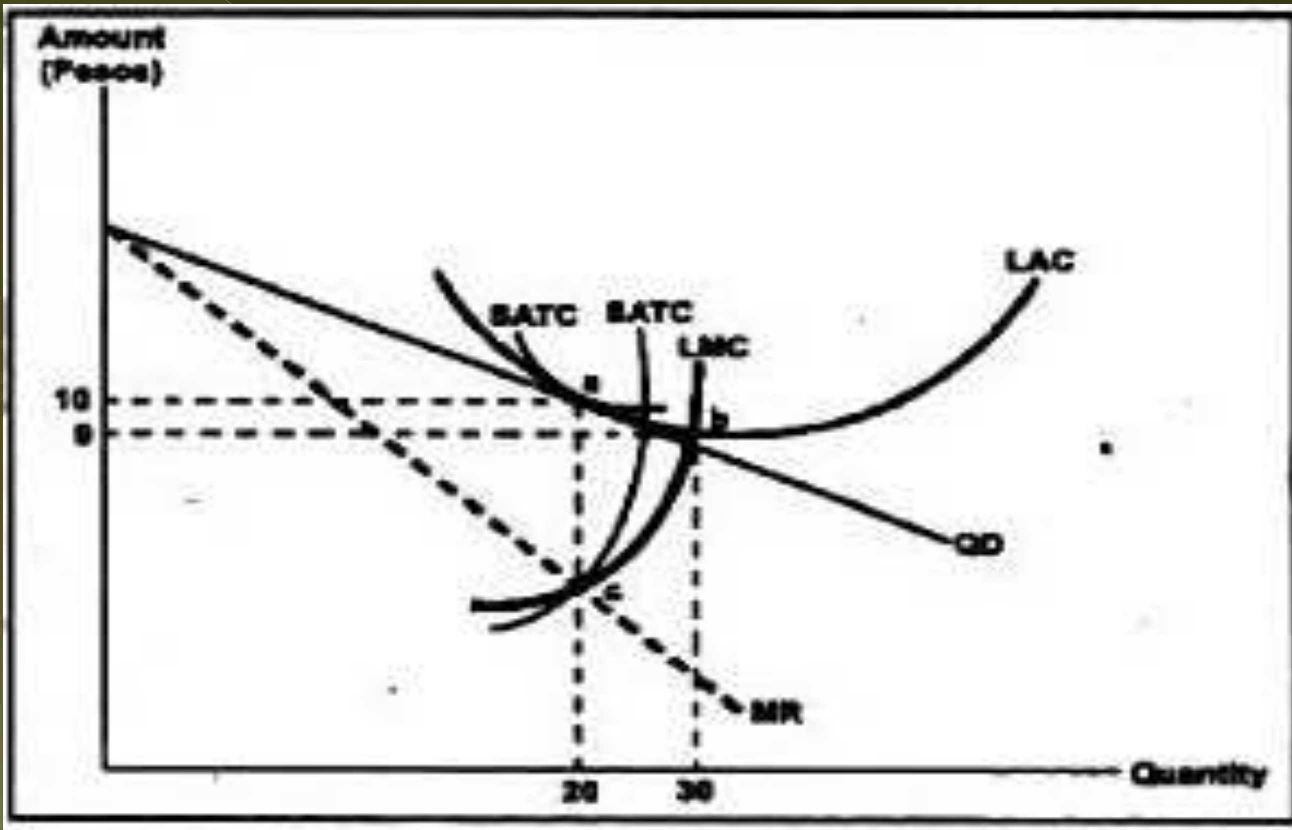


Figure 68
Long-run Analysis of Monopolistic Competition

Monopsony

A market situation in which there is only one buyer of goods and services in the market. It is sometimes considered analogous to monopoly in which there is only one seller of goods and services in the market.

Monopsony power gives them the ability to control their unit cost for an input which is similar to the way the monopoly controls their price.

Oligopsony

A market situation where there are a small number of buyers. This is usually with a small number of firms competing to obtain the factors of production.

Under this market situation, firms are buyers and not sellers. This is sometimes analogous to oligopoly, where there are few sellers.

Summary of Different Market Structure

Market Characteristics	Perfect Competition	Monopolitic Competition	Oligopoly	Monopoly
Product Differentiation (brand name)	No	Yes	Yes, but less so if oligopoly supply raw materials	Yes
Price Competition	Intense: must meet price of other firms	Intense	Occasional but cooperative behavior often present	Occasional with producers of substitute goods and services. Price of natural monopolies is subject to regulation.
Non-price competition (Advertising)	No	Intense	Intense	Often, to promote public good will
Barrier to Entry	No	Low	High	High
Information Cost	No	Low	High	High
Opportunities to earn and keep economic profits	No	Few	Many	Many, though often regulated
Number of sellers	Large number of seller	Numerous buyer and seller	Small number of firm	Only one seller
Degree of control over price	Price taker	Limited control	Has control over price	Price dictator
Type of product	Homogeneous product	Differentiated products or similar but not identical	Differentiated or identical products	Highly standardized

THANK YOU FOR LISTENING!