

MARKET STRUCTURE

The term **market structure** describes the way in which goods and services are supplied by firms in a particular market or industry. More specifically, it relates a market in terms of the number of firms and the **barriers to entry** for new firms wishing to join the market.

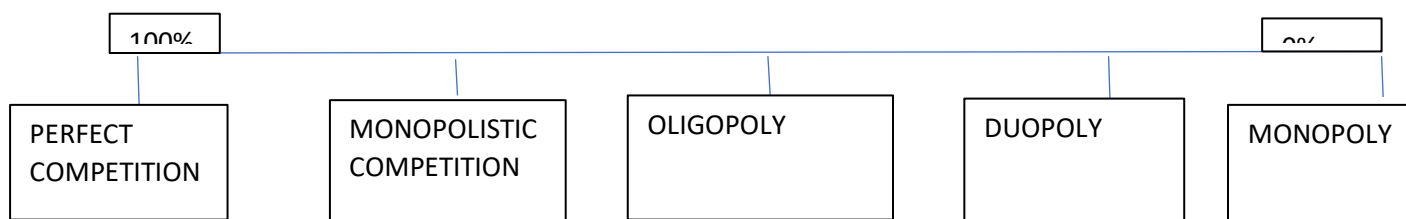
There are different types of market structure and the criteria used for the classification are:

- Number of firms
- Concentration ratio
- Number of customers
- Importance of economies of scale

The different market structures are:

1. Perfect competition
2. Monopolistic competition
3. Oligopoly market
4. Monopoly market

DEGREE OF COMPETITION





DD curve is horizontal

$DD=AR=P=MR$



Normal profit= $AR=AC$

Abnormal loss= $AR<AC$

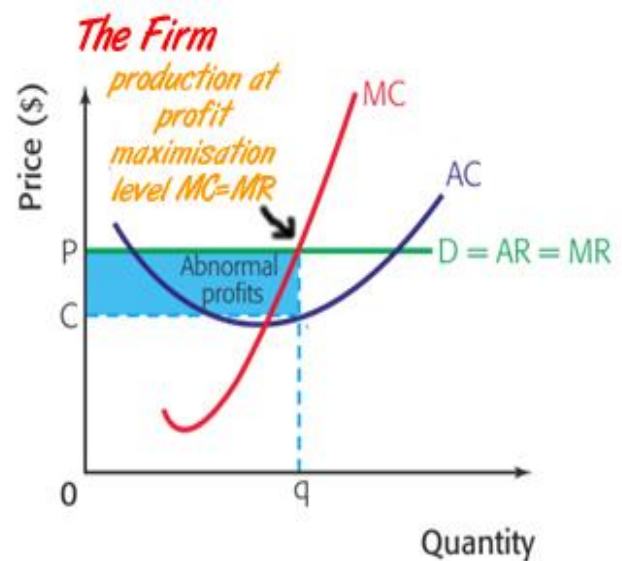
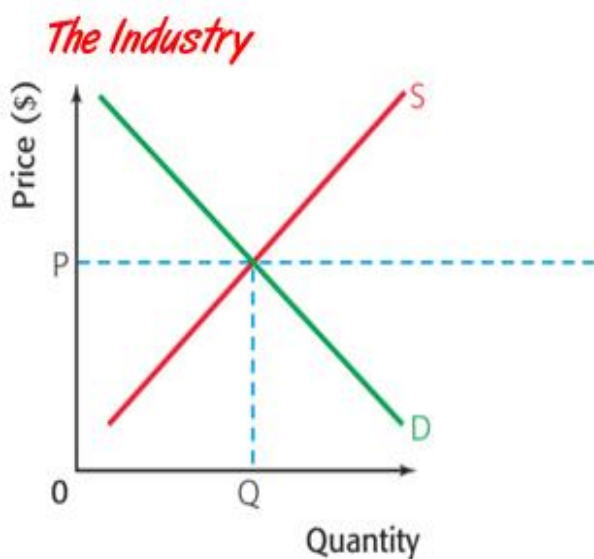
Abnormal profit= $AR>AC$

EQUILIBRIUM OF A FIRM

A firm is said to be in equilibrium at the point where he is deriving **maximum level of profit**. The condition necessary for equilibrium is **$MC=MR$** , and **MC must be rising**

SHORT RUN EQUILIBRIUM: In the short run, the firm can have abnormal profit or abnormal loss.

Supernormal profit ($AC > AR$):



Short run abnormal profits in perfect competition

Preview from Notesale.co.uk
Page 4 of 49

commodity and charge a low price to its marginal customers. By following such a system, the customers who pay the high price are subsidizing the losses that the monopoly firm incurs by selling its commodity at a low price.



As shown in the figure above, the regulatory authority has set a price of P_1 for some customers at which quantity Q_1 is demanded. The profit from the sale of a good too high price customers will be P_1ACB . The customers who are unwilling to buy the good at the price P_1 are charged a lower price P_2 (this price is decided by following marginal cost pricing). At P_2 , the quantity demanded is Q_2 . The loss incurred by charging a price of P_2 will be given by the area $DFEP_2$. Under this system, the profit from high price customers balances the losses incurred from low price customers.

Alternatively, Govt may use **AC PRICING**. Govt may require some nationalized businesses to set a price which is equal to AC. HERE ($AC=AR$)

AC PRICING leads to normal profit for the business.

MONOPOLY SHUTDOWN CONDITION:

		higher incomes more for the same drugs, so that the less well-off can also access the drugs at a lower price. This can yield positive externalities
Producers	If it is used as a predatory pricing method, the firm could face investigation by the Competition and Markets Authority. It might cost the firm to divide the market, which limits the benefits they could gain	Producers make better use of spare capacity. The higher supernormal profits, which result from price discrimination, could help stimulate investment. If more profits are made in one market, a different market which makes losses could be cross subsidised, especially if it yields social benefits. This will limit or prevent job losses, which might result from the closure of the loss-making market.

MONOPOLISTIC COMPETITION:

The monopolistic competition is one which combines the features of the monopoly as well as the perfect competition. It describes an industry in which each firm can influence market share to some extent by changing its price

- Firms in an oligopoly have a strong incentive to collude. By making agreements, they can maximise their own benefits and restrict their output, to cause the market price to increase. This deters new entrants and is anti-competitive.
- Collusion is more likely to happen where there are only a few firms, they face similar costs, there are high entry barriers, it is not easy to be caught and there is an ineffective competition policy. Moreover, there should be consumer inertia. All of these factors make the market stable.
- **Collusion can be overt or tacit. Overt collusion** is when a formal agreement is made between firms. It works best when there are only a few dominant firms, so one does not refuse. It is illegal in the EU, US and several other countries. For example, it is often suspected that fuel companies partake in overt collusion. This could be in the form of price fixing, which maximises their joint profits, cuts the cost of competition, such as by preventing firms using wasteful advertising, and reduces uncertainty.
- **Tacit collusion** occurs when there is no formal agreement, but collusion is implied. For example, in the UK supermarket industry, firms are competing in a price war. Price wars are harmful to supermarkets and their suppliers.
- **The difference between cooperation and collusion** Cooperation is allowed in the market, whilst collusion is not. Collusion is usually with poor intentions, whilst cooperation will be beneficial. Collusion generally refers to market variables, such as quantity produced, price per unit and marketing expenditure. Cooperation might refer to how a firm is organised and how production is managed.

EQUILIBRIUM USING COLLUSIVE MODEL:

- Firms break even when $TR = TC$. A firm's profit is the difference between its total revenue (TR) and total costs (TC). A firm profit maximises when they are operating at the price and output which derives the greatest profit. Profit maximisation occurs where marginal cost (MC) = marginal revenue (MR). In other words, each extra unit produced gives no extra loss or no extra revenue.

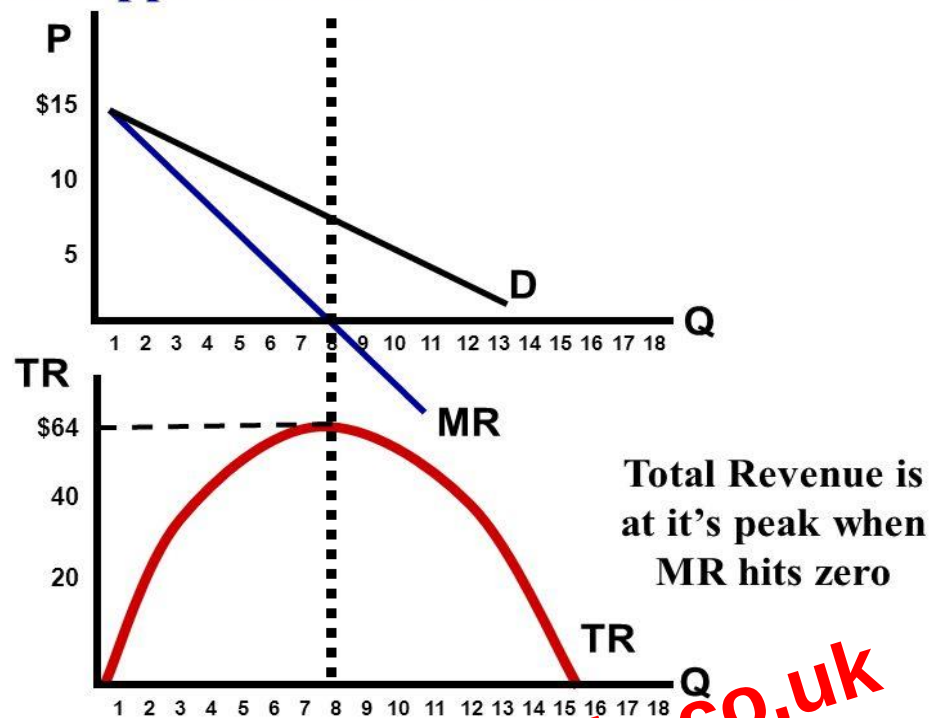


- Profits increase when $MR > MC$.
- Profits decrease when $MC > MR$. Some firms choose to profit maximise because: It provides greater wages and dividends for entrepreneurs
- Retained profits are a cheap source of finance, which saves paying high interest rates on loans
- In the short run, the interests of the owners or shareholders are most important, since they aim to maximise their gain from the company.

- **Growth:** Some firms might aim to increase the size of their firm. This could be to take advantage of economies of scale, such as risk-bearing or technological. This would lower their average costs in the long run, and make them more profitable. Firms might grow by expanding their product range or by merging or taking over existing firms. Large firms are also more able to participate in research and development, which might make them more competitive and efficient in the long run.
- **Increasing their market share:** This helps increase the chance of surviving in the market, and it can be achieved by maximising sales. For example, Amazon aimed to increase their market share in the e-reader market, by trying to sell as many Kindles as possible. They did this at a loss in the short run, but they gained customer loyalty and now they are a leading e-reader producer.
- **Quality:** Firms might aim to increase their competitiveness by improving their quality. Firms might consider improving their customer service or the quality of the good they produce. This could be achieved through innovation. If firms can gain a reputation for high quality goods, they could potentially charge higher prices, since consumers might be willing to pay more for them.
- **Maximising their sales revenue:** Revenue maximisation occurs when $MR = 0$. In other words, each extra unit sold generates no extra revenue.

Demand and Marginal Revenue Curves

What happens to TR when MR hits zero?



Sales maximisation: This is when the firm aims to sell as much of their goods and services as possible without making a loss. Not-for-profit organisations might work at this output and price. On a diagram this is where average costs (AC) = average revenue (AR).

An example of sales maximising is Amazon's Kindle launch. They sold as many Kindles as possible to gain market share, so they can earn more profits in the long run. It helps keep out and deter competitors. **The diagram below summarises each objective.**