

Markets – definition, essentials of market, classification of market structure – perfect and imperfect markets

MARKET

The word market has been derived from the Latin word ‘marcatus’ which means merchandise or trade.

Definitions:

- A market is any place where the sellers of a particular good or service can meet with the buyers of that goods and service where there is a potential for a transaction to take place. The buyers must have something they can offer in exchange for there to be a potential transaction.
- A market is the sphere within which price determining forces operate.
- A market is the area within which the forces of demand and supply converge to establish a single price.
- Economists understand by the market not any particular market place in which things are bought and sold but the whole of any region in which buyers and sellers are in such free contact with one another that the prices of the same goods tend to equality easily and quickly.

Essentials of a Market :

They may also be termed as the components of a market.

1. The existence of a good or commodity for transactions.
2. The existence of buyers and sellers
3. Business relationship or intercourse between buyers and sellers
4. Demarcation of area such as place, region, country or the whole world.

Market Structure : It refers to the size and design of the market. It relates to those organizational characteristics of a market which influence the nature of competition and pricing and affect the conduct of business firms.

Monopsony is a market structure in which there is only one buyer instead of one seller.

Oligopsony is a market structure in which there are only few buyers.

Bilateral monopoly is a market structure in which a single seller faces a single buyers

Markets are classified based on the degree of competition as perfect and imperfect market

Perfect market : A market is said to be perfect when all the potential sellers and buyers are promptly aware of the prices at which transaction take place and all the offers made by other sellers, and buyers, and when any buyer can purchase from any seller and conversely. Under such a condition, the price of a commodity will tend to be the same (after allowing for cost of transport including import duties) all over the market.

Imperfect market : A market is said to be imperfect when some buyers or sellers or both are not aware of the offers being made by others. Different prices prevail for the same commodity at the same time.

Comparative Characteristics of Markets

	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Number & Nature of Sellers	<ul style="list-style-type: none"> • Many (small sellers) • Independent 	Many (small to medium)	<ul style="list-style-type: none"> • Few (large) • Inter - dependent 	One
Price	No control	Some control	Considerable control	Absolute control
Nature of Product	Homogeneous (no differentiation)	Some differentiation	Sometimes but not always	No substitutes
Barriers to entry	None	Low	Considerable	Entry is blocked
Profit Potential	Normal Profits in LR	Some profits in SR & LR	Considerable Profits in SR & LR	Large Profits in SR & LR
Product Promotion & Advertising	None or minimal	Considerable	Heavy	Some but not directed to competition, but to increase sales

PERFECT COMPETITIVE MARKET

Perfect competition market is the world of price-takers. A perfectly competitive firm sells a homogeneous product [one identical to the product sold by others in the industry]. It is so small relative to its market that it cannot affect the market price; it simply takes the price as given.

Perfect competition market is a market under which no buyer or seller can affect unilaterally

Characteristics of Perfect Competition Market:

The main characteristics of perfect competition market are as follows:

01. Large Number of Buyers and sellers:

One condition of perfect competition is that there should be operating in the market a large number of buyers and sellers. If that is so, no single seller or purchaser will be able to influence the market price, because the output of any single firm is only a small proportion of the total output and of the total demand.

02. Homogeneous Product:

The second condition is that the commodity produced by all firms should be standardized or identical

03. Free Entry or Exit:

There should be no restrictions, legal or otherwise, on the firms' entry into, or exit from, the industry. In this situation, all the firms will be making just normal profit. If the profit is more than normal, new firms will enter and extra profit will be competed away; and if, on the other hand, profit is less than normal, some firms will quit, raising the profits for the remaining firms. But if there are restrictions on the entry of new firms, the existing firms may continue to enjoy supernormal profit. Only when there are no restrictions on entry or exit, the firms will earn normal profit.

04. Perfect Knowledge: Another assumption of perfect competition is that the purchasers and sellers should be fully aware of the prices that are being offered and accepted. In case there is ignorance among the dealers, the same price cannot rule in the market for the same commodity. When the producers and the customers have full knowledge of the prevailing price, nobody will offer more and none will accept less, and the same price will rule throughout the market. The producers can sell at that price as much as they like and the buyers also can buy as much as they like

05. Absence of Transport Costs: If the same price is to rule in a market, it is necessary that no cost of transport has to be incurred. If the cost of transport is there, the prices must differ to that extent in different sectors of the market.

06. Demand Curve of Perfect Competition Market is Completely Horizontal:

Figure-01: Demand curve looks horizontal to a perfect competitor.

The industry demand curve has inelastic demand at the market equilibrium. However, the demand curve for the perfectly competitive firm is horizontal (i.e. completely elastic).

07. No Government Regulation: Government does not intervene in the marketing functions.

Pure competition differs from perfect competition in the sense that it excludes the features of Perfect mobility of resources and Perfect knowledge.

Characteristics of monopolistic competition, monopoly, oligopoly

Monopolistic Competition, Monopoly and Oligopoly

Chamberlin is associated with Monopolistic Competition

Characteristic features of Monopolistic Competition:

i) Large Number of firms: The number of firms operating under monopolistic competition is sufficiently large. Moreover there is freedom of entry. There are no quantitative restrictions or differences in market conditions. However, each firm differs from its rivals in some qualitative respect.

ii) Close Substitutes: Under monopolistic competition firms produce very close substitutes. Chocolates of one company may serve a similar purpose as that of some other firm. The only difference may be of some variation in the quality of the product.

iii) Group: Firms under monopolistic competition together form a group. They cannot be called an industry. This is because their products are somewhat dissimilar and not homogenous as under competitive industry.

iv) Product Differentiation: Under monopolistic competition products are differentiated. This is the outstanding feature of this form of market. Otherwise monopolistic competition closely resembles perfect competition. The fundamental difference between the two is that products are no more homogenous. Goods produced are deliberately differentiated by trade name or brand name or salesmanship or quality etc.

(v) Selling (Advertising) Cost: Selling Cost i.e., advertisement expenditure and Product Differentiation together enable the producer to maintain some control over market conditions and influence the shape of the demand curve. Whenever a *product* is *differentiated* it is necessary to inform buyers; and advertisement is the only medium through which buyers can be told about superiority of that product.

Features of Monopoly: Monopoly is another traditional form of market. It is an extreme form, opposed to a competitive market structure. As against this, a competitive market is one with a large number of firms or producers.

1. Monopoly is a case where there is only a single seller in the market. This, however, is a theoretical concept.

2. Absence of substitutes: for the goods produced and sold by the monopolists. Buyers have no other option except to purchase goods from the monopolist at whatever price he charges. This results in a situation in which the monopolist has complete control over market conditions. He can decide his own price and earn profits without any fear of

competition from his rivals. The Cross Elasticity of Demand is negligible or very low. Yet a monopolist has certain constraints arising out of demand and technical conditions.

3. There is no distinction between the firm and industry in monopoly market situation.

4. There is complete negation of competition.

Oligopoly

The word **OLIGOPOLY** is derived from the Greek words 'olig' means a few and 'poly' which means sellers.

Oligopolistic Market refers to a market characterized by the presence of a small number of producers who often act together to control the supply of a particular good and its market price.

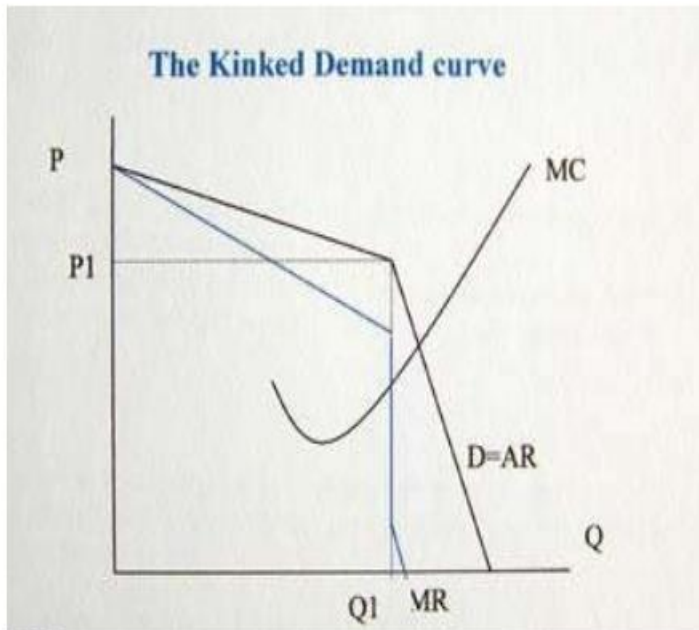
It is dominated by a few large suppliers who are interdependent on each other, before making any pricing and investment decisions. It is also explained as a market condition in which sellers are so few that an action of any one of them will materially affect price and have a measurable impact on competitors; in other words; since there are few participants in this type of market, each Oligopolist is aware of the actions of the other.

OPEC is an example of Oligopoly since few countries control the production of oil, the steel and the automobile industry in United States of America is another example.

The Key characteristics of an Oligopolistic Market are as follows: -

- It is a market dominated by a small number of participants who are able to collectively exert control over supply and market prices.
- Few firms sell branded products which are close substitutes of each other.
- Entry barriers for the other firms are high; the barriers can be due to patents, copyrights, government rules / regulations or ownership of scarce resources.
- Firms are interdependent for decision making.
- Products can be homogenous (standardized) or heterogeneous (differentiated).
- The sellers are the price makers and not price takers, since the few sellers mutually dominate the pricing decisions.
- The sellers can achieve supernormal profits in the long run.
- The sellers can achieve economies of scale; since for the large producers as the level of production rises, the cost per unit of products decreases; thus ensuring higher profits.
- There is high degree of market concentration, since the four-firm concentration ratio is often used, where the market shares of four largest firms are measured (as a percentage) since they form the major portion of the market share.

An Oligopolist faces a downward sloping demand curve; however; the price elasticity depends on the rival's reaction to change its price, investment and output.



The Kinked Demand Curve Graph

- This assumes that firms seek to maximise profits
- If they increase price, then they will lose a large share of the market because they become uncompetitive compared to other firms, therefore demand is elastic for price increases.
- If firms cut price then they would gain a big increase in Market share, however it is unlikely that firms will allow this. Therefore other firms follow suit and cut price as well. Therefore demand will only increase by a small amount: Demand is inelastic for a price cut
- Therefore this suggests that prices will be rigid in Oligopoly

The below diagram suggests that a change in Marginal Cost still leads to the same price, because of the kinked demand curve (profit maximization occurs where $MR = MC$)