Economics

(Micro-economics)

Chapter 6: NON-COMPETITIVE MARKETS

NON-COMPETITIVE MARKETS

Introduction

This chapter explains non competitive market forms (monopoly, monopolistic competition and oligopoly), their features and differences.

Monopoly

1. Meaning

(a) 'Mono' means single and 'poly' means seller, i.e., single seller.

(b) Monopoly is a market situation where there is a single firm selling the commodity and there is no close substitute of the commodity sold by the monopolist.

2. Reasons of Monopoly:

(a) Grant of patent rights:

i. When a company introduces a new product or new technology it applies to the government to grant it patent certificate by which it gets exclusive rights to produce new product or use new technology.

ii. Patent rights prevent others to produce the same product or use the same technology without obtaining license from the concerned company. Patent rights are granted by the government for a certain number of years.

iii. For example, Patent certificate was granted to Xerox company for copying machines invented by it, thereby giving rights to monopoly.

(b) Licensing by Government:

i. A monopoly market emerges when government gives a firm license, i.e. exclusive legal rights to produce a given product or service in a particular area or region.

ii. For example Previously Delhi Vidyut Board (Govt. Board) had the exclusive right to distribute electricity in Delhi. Now after privatization the same rights have been given to two private companies with exclusive areas to serve.

(c) Forming a Cartel:

i. A Cartel is a group of firms which jointly set output and prices so as to exercise monopoly power.

ii. For example, In 1960, some oil producing companies formed a cartel, called OPEC (Organisation of Petroleum Exporting Countries).

3. **Features of Monopoly**

a. Single Seller

i. There is only one seller or producer of a commodity in the market.
ii. As a result, the monopoly firm has full control over the supply of the commodity.
iii. The monopolist may be an individual, a firm, a group of firms or a government itself.
iv. Naturally, a monopoly firm can exploit buyers by charging almost any price for its product because of exclusive control over the product.
v. Monopoly firm itself is the price maker and not the price taker.

b. Absence of close substitutes of product

i. The product sold by the monopolist has no close substitute.
ii. Though, some substitutes of the product may be available, yet they are not close substitutes in the sense that such substitutes are not identical products.

c. Difficult entry of a new firm

i. The monopolist controls the situation in such a way that it becomes very difficult for a new firm to enter the monopoly market and compete with the monopolist by producing the same product.
ii. The monopolist tries his utmost to block entry of a new firm.

d. Price Discrimination

Price discrimination refers to the practice of charging different prices from different buyers at the same time for the same product.

e. Price Maker

i. A monopoly firm has market power and is itself a price-maker. It can choose any price, it likes.
ii. Unlike perfect competition where as output increases, price remains unchanged.
iii. In monopoly as output increases or decreases, price changes according to what consumers are willing to pay along the demand curve. It produces and supplies a product to satisfy the entire market.
iv. It is because a monopoly firm faces the entire demand of the market, that market demand curve is said to be a constraint facing a monopoly firm.

4. Shape of demand curve under monopoly

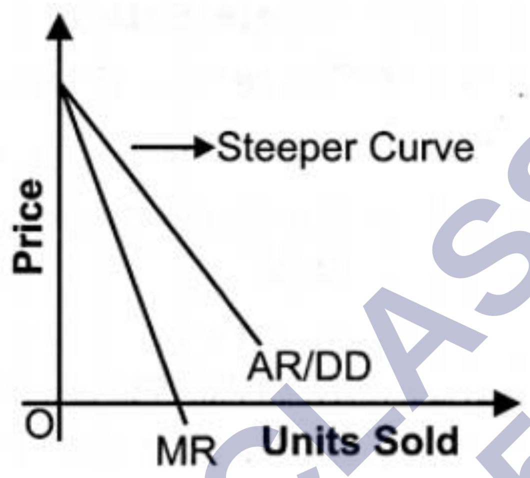
i. As we know in monopoly there is a single seller or firm, that is why like an industry, single seller constitutes the entire market for the product, which has no close substitutes.
ii. So, a monopolist has full freedom and power to fix price for the product.

iii. However, demand of the product is not in the control of monopoly firm. In order to increase the output to be sold, monopolist will have to reduce the price because of price discrimination.

iv. Therefore, a monopoly firm faces a downward sloping demand curve.

v. The elasticity of demand curve is inelastic because of no close substitute of a commodity.

5. Shape of Average revenue and marginal revenue curve under monopoly



(a) A monopoly firm faces a downward sloping demand curve as more output can be sold only by reducing the price because of price discrimination.

(b) As, we know, Price = Average revenue. So, when price falls means Average revenue falls and when Average revenue fall, then marginal revenue also falls but at a much faster rate. So, Marginal Revenue(MR) is less than Average Revenue (AR).

Monopolistic Competition

1. Meaning

(a) It refers to a market situation in which there are many firms which sell closely related but differentiated products.

(b) Market for such products are toothpaste, soap, air conditioners etc.

(c) The market is called monopolistic competition since it contains both the competitive element and monopoly element.

2. Features of monopolistic competition

(a) A large number of firms:

(i) The number of firms selling similar product is fairly large, but not very large as in perfect competition.

(ii) As a result, firms are in a position to influence the price of their product due to their branji names.

(b) Product differentiation:

(i) In this type of market situation a producer can produce different products, but that products should be a close substitute to each other.

(ii) Product differentiation means differentiating the product on the basis of brand, colour, shape etc.

(iii) Due to product differentiation each firm under monopolistic competition is in a position to exercise some degree of monopoly (inspite of large number of sellers) because buyers are willing to pay different prices for the same product produced by different firms.

(iv) No doubt, producer has a control over a price, but he knows it very well to maximize the profit price has to be reduced. So, price falls under monopolistic competition due to product differentiation.

(c) Selling cost:

(i) It is the expenses which are incurred for promoting sales or inducing customers to buy a good of a particular brand.

(ii) This includes the cost of advertisement through newspaper, television and radio, and cost on each other sales promotional activities.

(d) Free entry and exit of firms:

(i) New firms can enter the market, if found profitable. Similarly, inefficient firms already operating in the market are free to quit the market if they incur losses.

(ii) It is because of this feature that like perfect competition, monopolistic competition also gives rise to normal profit.

(iii) No firm receives abnormal profit in the long run as then new firms can emerge and old ones can expand output and adjust supply with changing demand.

3. Shape of Demand Curve Under Monopolistic Competition

(i) The demand curve faced by a firm is negatively slope, (i.e. when price falls, demand rises) because the firm can sell more only by lowering the price of its product because of product differentiation.

Oligopoly

1. Meaning:

i. The term oligopoly is derived from two Greek words: 'oligoi' means few and 'poleein' means 'to sell.'

ii. Oligopoly is a market situation in which an industry has only a few firms (or few large firms producing most of its output) mutually dependent for taking decisions about price and output.

iii. William Fellner defines oligopoly as "Competition among the few".

iv. In India, markets for carbonated beverages, "National Newspapers" market, mobile services provider, washing products, automobiles, cement, aluminium, etc., are the examples of oligopolistic market. In all these markets there are few firms for each particular product.

2. Types of Oligopoly:

(a) Pure or Perfect Oligopoly:

(i) In the case of pure oligopoly, firms produce homogenous products like copper, iron, steel and aluminium.

(ii) So, decisions by consumers to purchase the goods of a particular firm are influenced by the price considerations.

(b) Imperfect or Impure or Differentiated Oligopoly:

(i) In differentiated oligopoly, firms produce differentiated products such as toilet soap, cigarettes or soft drinks.

(ii) The goods produced by different firms have their own distinguishing characteristics, but they are close substitutes of each other.

(c) Collusive Oligopoly: If the firms cooperate with each other in determining price or output or both, it is called collusive oligopoly or cooperative oligopoly.

(d) Non-collusive Oligopoly: If firms in an oligopoly market compete with each other, it is called a non-collusive or non-cooperative oligopoly.

3. Features of Oligopoly

(a) Few Large Sellers:

(i) The number of sellers in an oligopoly market is small – when there are two or more than two, but not many sellers.

(ii) What matters is that these few sellers account for most of the industry's sales.

(iii) These "few" sellers consciously dominate the industry and indulge in intense competition. Each firm is aware of that it possesses a large degree of monopoly power.

(iv) For example, the market for mobile service provider in India is an oligopolist structure as there are only few producers of mobile service provider. There exists severe competition among different firms and each firm tries to manipulate both prices and volume of production to outsmart each other.

(b) Interdependence of Decisions:

(i) Interdependence means that actions of one firm affects the actions of other firms.

(ii) Since the number of sellers is small, each firm has to take into consideration the possible reaction of its competitors, when making decisions.

(iii) The business decision of a single seller will have a substantial impact on the product price, output and profits of the rival firms.

(iv) For example in the "National Newspapers" market, when the "Economic Times" introduced invitation pricing policy—they offered the newspaper at a price of Rs.1.50 on weekdays. The Hindustan Times was forced to reduce its prices from Rs. 2.50 per copy to ? 1.50 per copy on weekdays. When Hindustan Times was celebrating its 75 years of service, they offered the newspaper at Rs. 1/- weekdays. The Times of India responded by matching the price cut.

(c) Non-Price Competition:

(i) Oligopoly firms try to avoid price competition for the fear of price war.

(ii) They use non-price competition methods like better services to customers, advertising, etc. to compete with each other.

(iii) Oligopoly firms are in a position to influence the prices. However, they follow the policy of price stability or price rigidity.

(iv) Price rigidity refers to a situation in which whether there is change in demand and supply the price tends to stay fixed.

(v) If a firm tries to reduce the price the rivals will also react by reducing their prices. Likewise, if it tries to raise the price, other firms will not do so. It will lead to loss of customers for the firm which intended to raise the price.

So, firms prefer non-price competition instead of price competition.

(d) Barriers to the entry of firms:

(i) The main reason why the number of firms is small is that there are barriers which prevent entry of firms into industry.

(ii) Patents, large capital, control over the crucial raw material etc., prevent new firms from entering into industry.

(iii) Only those who are able to cross these barriers are able to enter.

(e) Role of selling costs:

(i) Due to severe competition and interdependence of the firms various sales promotion techniques are used.

(ii) For example, T.V. commercials war between pepsi and coke.

(iii) It relies more on non-price competition.

(f) Oligopoly firms may produce either a homogeneous or a differentiated product.

(i) Oligopoly firms may sell homogeneous products such as steel, aluminium, LPG cylinders etc. They are called pure oligopolies, as the products of the respective firms are indistinguishable.

(ii) Firms producing differentiated products are called impure oligopolies.

(iii) In case of a pure oligopoly market situation rival firms will rely on "price" or "lowercosts" to compete in the market.

(iv) On the other hand, in case of impure oligopolies, with firms producing differentiated products, firms can use "product variations" and "promotional" strategies to compete.

(g) Group Behaviour:

(i) In an oligopoly situation, there are a few firms who control the entire market and each firm recognizes interdependence in their decision-making.

(ii) So, price-output decisions of a particular firm directly influence the competing firms.

(iii) Instead of independent price and output strategy, oligopoly firms prefer group decisions that will protect the interest of all the firms.

(iv) Group Behaviour means that firms tend to behave as if they were a single firm even though individually they retain their independence.

(h) Indeterminate demand curve facing an oligopoly firm:

(i) The most distinguishing feature of oligopoly is the "interdependence in decision making" of the rival firms.

(ii) The consequence of such interdependence is the high degree of uncertainty regarding the reaction pattern of rival oligopolists.

(iii) Interdependence and uncertainly result in "indeterminateness of the demand curve" facing an oligopolist. The firm cannot assume that his rivals will not react to its decision regarding change in its variables.

(iv) The demand curve facing an oligopoly firm keeps shifting as rival firms react to changes made by this firm. The demand curve thus loses its definiteness and determinateness.

Important Questions

Multiple Choice questions:

1. Which of the following is not the feature of an imperfect competition?

(a) Large number of buyers

(b) Single seller

(c) Homogeneous products

(d) Price maker

2. A monopolist is a price

(a) Acceptor

(b) Taker

(c) Giver

(d) Maker

3. The firm and the industry are one and the same in:

(a) Monopolistic competition

(b) Monopoly

(c) Duopoly

(d) Oligopoly

4. Which of the following is not a characteristic feature of imperfect competition?

(a) Prices vary from seller to seller

(b) All the products are homogeneous

(c) Profits of the seller is included in the price

(d) None of above

5. Market which has two firms is known as

(a) Duopoly

(b) Monopolistic Competition

(c) Oligopoly

(d) None of These

6. Under which of the following forms of market structure a firm has no control over the price of its product?

(a) Monopoly

(b) Perfect competition

(c) Oligopoly

(d) Monopolistic competition

7. Oligopoly having identical products is known as

(a) Pure oligopoly

(b) Collusive oligopoly

(c) Independent oligopoly

(d) None of above

8. Price discrimination can take place only in

(a) Perfect competition

(b) Oligopoly

(c) Monopolistic competition

(d) Monopoly

9. Which market have characteristic of product differentiation

(a) Monopolistic competition

(b) Oligopoly

(c) Monopoly

(d) Perfect competition

10. Under monopoly form of market, TR is maximum when

(a) MR is maximum

(b) MR < 0

(c) MR > 0

(d) MR is zero

Very Short:

1. What would be the shape of the demand curve so that the total revenue curve is a positively sloped straight line passing through the origin?

2. What would be the shape of the demand curve so that the total revenue curve is a horizontal line?

3. Will the monopolist firm continue to produce in the short run if a loss is incurred at the best short run level of output?
4. Explain why the demand curve facing a firm under monopolistic competition is negatively sloped.
5. List the three different ways in which oligopoly firms may behave.

Short Questions:

1. Equilibrium price of an essential medicine is too high. What can be done to bring the price down only through market forces? Explain the series of changes that will occur in the market.
2. Market for a necessary good is competitive in which the existing firms are earning supernormal profits. How can the policy of liberalisation by the government help in making the market more competitive in the interest of the consumers? Explain.
3. Explain the effects of a 'price ceiling'.
4. Explain the effects of a 'price floor'.
5. Market for goods is in equilibrium. Demand for the good "increases". Explain the chain effects of this change.

Long Questions:

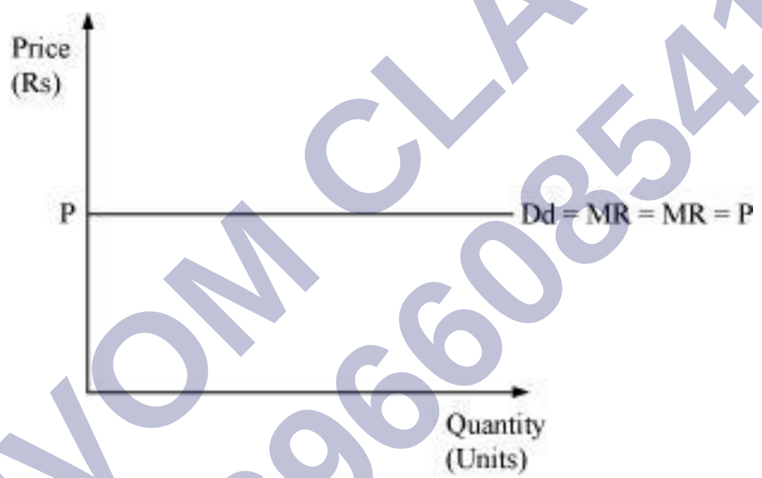
1. Distinguish between collusive and non-collusive oligopoly. Explain how the oligopoly firms are interdependent in taking price and output decisions.
2. Explain the implications of the following features of the oligopoly market.
   (i) Few firms
   (ii) Barriers to the entry of firms
3. Explain the implications of the following:
   (i) Products under monopolistic competition
   (ii) Large number of sellers under perfect competition
4. Distinguish between perfect competition and monopolistic competition
5. Explain the implications of the following features of perfect competition.
   (i) Homogenous products
   (ii) Freedom of entry and exit to firms.

MCQ Answers:

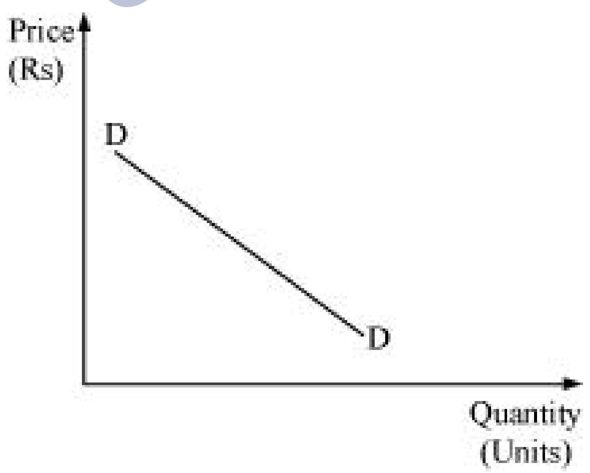
1. (c) Homogeneous products
2. (d) Maker
3. (b) Monopoly
4. (b) All the products are homogeneous
5. (a) Duopoly
6. (b) Perfect competition
7. (a) Pure oligopoly
8. (d) Monopoly
9. (a) Monopolistic competition
10. (d) MR is zero

Very Short Answers:

1. If the total revenue curve is a positively sloped straight line passing through the origin, then the slope of the demand curve will be a horizontal line parallel to the *x*-axis.



2. If the total revenue curve is a horizontal line, then the demand curve will be downward sloping.



3. A monopolist firm can earn losses in the short run if the price is less than the minimum of AC. But if the price falls below the minimum of AVC, then the

monopolist will stop production. The firm will continue to produce when the price is in between the minimum of AVC and the minimum of AC.

4. A monopolistic firm has differentiated products; thus, it has to lower its price in order to increase its sales. Further, the products of different monopolistic firms are close substitutes to each other. Hence, the demand for all the products is elastic. For this reason, the demand curve is negatively sloped.

5. Oligopoly firms may behave in the following three ways:

1) Cartel
2) Informal understanding
3) Advertisement and differentiated product

Short Answers-

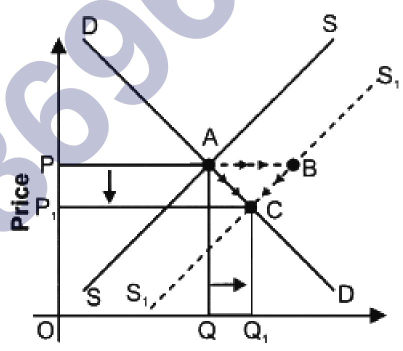
1. Since medicine is a necessary good, its demand will be perfectly elastic.

Following are the possible steps that can be taken to bring down the equilibrium price:

(i) The government should provide subsidy on the production of such medicines.

(ii) The government should cut down or abolish all the taxes on such medicine.

(iii) The government should offer various facilities to industrialists to motivate them for the production of such medicine. These facilities will reduce the cost of inputs used in the production of medicines. The effect of above steps will be that supply of such medicines will increase and as the result of, the equilibrium price of medicines will reduce as shown in the given figure.



In the given figure price is on vertical axis and quantity demanded and supplied is on horizontal axis. But due to increase in supply the supply curve shifts rightward from SS to S_1S_1. With new supply curve S_1S_1, there is excess supply at initial price OP because at price OP, supply is PB and demand is PA, so there is excess supply of AB at price OP. Due to this excess supply competition among the producer will make the price fall. Due to this fall in price there is downward movement along the supply curve (Contraction in supply) from B to C and similarly, there is downward movement along the demand curve (Expansion in demand) from A to C. So, finally, equilibrium price falls from OP to OP_1 and equilibrium quantity rises from OQ to

OQ_1

2. The liberalization strategy promotes new enterprises to enter the industry. This boosts the industry's overall output. The total market demand stays steady, and prices begin to fall. As a result, consumers receive things at significantly lower prices.

Liberalization policies will remove market barriers such as licensing quotas. As a result, new firms will enter the industry. This will increase market supply and make the market more competitive. Inferring a shift to the right in the market supply curve. Other things being equal, a rightward shift in the market supply curve will result in a decrease in equilibrium price and an increase in equilibrium quantity. Extraordinary profits will eventually be wiped out, and consumers can expect to enjoy a greater quantity at a lower price.

3. Black marketing can be defined as a direct result of a price ceiling. It denotes a circumstance in which a commodity subject to the government's control policy is illegally sold at a greater price than that set by the government. It may occur primarily as a result of the presence of consumers who are willing to pay a higher price for the commodity rather than go without it.

4. Buffer stock is an important instrument in the government's arsenal for ensuring a price floor or minimum support price. If the market price is less than what the government believes should be paid to farmers or producers. This will cause them to purchase the product at a higher price from the farmers or producers in order to have stock of the commodity on hand in case of future shortages.

5. 'Given equilibrium, demand rises,' the following are the chain effects of the change:

i. If the price remains constant, excess demand emerges.

ii. As a result of the increased rivalry among purchasers, prices rise.

iii. A price increase produces a decrease or contraction in demand and an increase or expansion in supply.

iv. The price continues to rise until the market returns to equilibrium at a higher price.

Long Answers-

1. The following points focus on the distinction between collusive and non-collusive oligopoly:

There is also a significant degree of interconnectedness between enterprises in an oligopoly. The price and production policy of one firm has a significant impact on the price and output policy of the market's rival enterprises. The reason for this is that there are only a few large corporations. When one company cuts its pricing, competitors may follow suit in order to compete. On the other hand, if one company raises the price of a specific commodity, rival enterprises may make a decision in response. Enterprises always consider the likely reaction of the market's dominant rival companies when making price and output decisions.

2. The implications of the given features of oligopoly market are as follows:

   (i) Oligopoly occurs when there are just a few firms in a market. However, each company is so large that it has a monopoly on a specific customer section of the market. It is so significant that the price or production policy of one firm has a direct impact on the price and output policy of competitors. As a result, drawing a precise demand curve for an oligopoly firm is likewise impossible. We have shown that oligopolistic enterprises seek to form trusts and cartels in order to avoid market pricing competition. They benefit from monopoly earnings in this manner. However, this is a very small proportion of the whole market.

   (ii) It is usually more when there are barriers to firm admission. These restrictions are nearly identical to those seen in monopolistic circumstances. It is highly difficult, but not impossible, for a new firm to enter the market. These barriers might be natural, such as the need for large amounts of cash or the need to operate at the lowest possible cost, or artificial, such as patent rights. They mostly keep new entrants out of the market.

3. (i) When a product is subject to monopolistic competition, this has ramifications. It is a distinguishing trait. A product is frequently differentiated by trade marks or brand name, size, number, and so on. The differentiated products are typically close alternatives for each other. Bagh bakri tea and Tajmahal tea are two examples. Because of product differentiation, each firm can choose its own price policy. As a result, each firm has a limited amount of control on the pricing of its product. This is done to entice buyers from competing companies. Also, because these companies produce in large quantities and their products are unique, they always have some devoted customers who buy these things and just these products.

   (ii) When there are a lot of sellers on the market. In an economy, there are always more consumers and sellers. As a result, the size of each economic agent in comparison to the market is so small that they cannot influence the price through their individual actions.

4. The following are the distinctions between perfect and monopolistic contest:

Basis of Difference	Perfect Competition	Monopolistic Competition
Number of buyers and sellers	In this case, there are a large number of buyers and sellers in the market.	There are many buyers and sellers in this market, but it is not a perfectly competitive market.
Products	In this case, products are homogeneous.	In this case, products are heterogeneous.
Slops of firm's DD curve	In this case, horizontal straight line (AR = MR)is present.	In this case, it slopes downward with significant flexibility (AR > MR)
Mobility	Perfect movement in this case.	Imperfect movement in this case.
Selling cost	In this case, selling cost is not very important.	It is significant in this case because it has monopoly prices.
Degree of price control	In this case, there is no pricing control.	

5. Ans: (i) The ramifications of homogeneous products are significant. This essentially means that the products are the same in terms of nature, quality, size, shape, and color. As a result, no producer is able to demand a different price for the product. The market has consistent pricing. Commodity must always be identical in a totally competitive market. As a result, it gives consumers or buyers no incentive to prefer one seller's product over another.

(ii) Enterprises have the freedom to enter and quit the market. When a company decides to depart or enter a market, it is entirely up to them. In this case, enterprises can only generate regular profits in the long run, with TC=TR, AR=MR, and P=MC. In exceptional circumstances, if typical profits are achieved, new firms will enter the industry, resulting in an increase in market supply. Marek's price will fall, and any extra earnings will be lost. In the event of unusually large losses, some of the existing enterprises will abandon the industry. Marek supply will be reduced, and the commodity's market price will rise. Extraordinary losses will be erased.