Micro Economics Notes PDF

On

Non-competitive Markets

(Class – 11)

INTRODUCTION

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

MONOPOLY

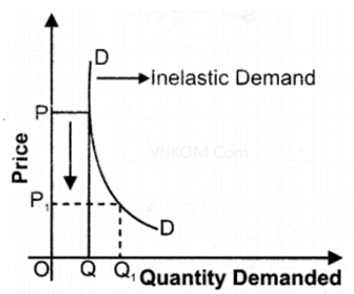
(a) 'Mono' means single and 'poly' means seller, i.e., single seller.
(b) Monopoly is a market situation where there is a single firm selling the commodity and there is no close substitute of the commodity sold by the monopolist.

Some Features of the Monopoly Market:

- A single seller with a large number of potential buyers.
- Barriers to new firms entering the market.
- There are no close substitutes available.
- Complete price control.
- Discrimination based on price.
- It is a price maker.
- A demand curve with a downward slant that is less elastic.

SHAPE OF DEMAND CURVE UNDER MONOPOLY:

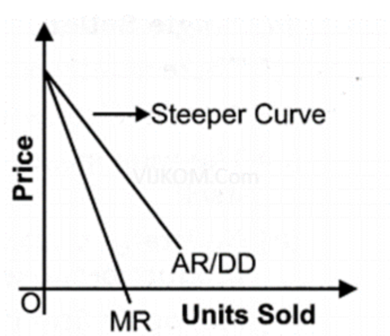
(a) As we know in a monopoly there is a single seller or firm, that is why like an industry, a single seller constitutes the entire market for the product which has no substitutes.
(b) So, a monopolist has full freedom and power to fix the price for the product.



(c) However, demand for the product is not in the control of monopoly firms. In order to increase the output to be sold, monopolist will have to reduce the price because of price discrimination.
(d) Therefore, a monopoly firm faces a downward sloping demand curve.
(e) The elasticity of the demand curve is inelastic because of no close substitute of a commodity.

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 falls, then marginal revenue also falls but at a much faster rate. So, Marginal Revenue (MR) is less than Average Revenue (AR).

MONOPOLISTIC COMPETITION

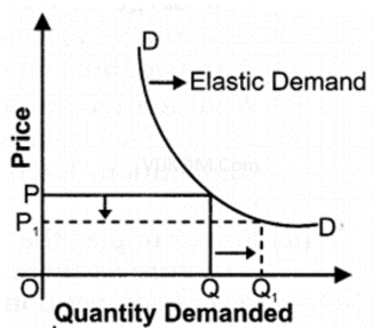
It is a market in which a large number of buyers and sellers are present. The sellers offer a variety of products, not all of which are identical. The products are nearly identical to one another.

Some Features of Monopolistic Competition:

1. A large number of potential buyers and sellers
2. Differentiation of products based on colour, flavour, packaging, trademark, and size.
3. The cost of advertising and sales promotion.
4. Unrestricted entry and exit of businesses.
5. Price control, but only in parts.
6. A lack of complete knowledge.
7. A demand curve that is elastic and slopes downward.
8. Production factors and products are not perfectly mobile.

SHAPE OF DEMAND CURVE UNDER MONOPOLISTIC COMPETITION:

(a) 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.



(b) The demand curve in monopolistic competition is highly elastic due to availability of close substitutes as a result, the AR curve becomes flatter.

SHAPE OF AVERAGE REVENUE AND MARGINAL REVENUE CURVE UNDER MONOPOLISTIC COMPETITION:

(a) Like a monopoly firm, the firm under monopolistic competition also fixes the price itself subject to certain limitations.

(b) No doubt, the producer has control over a price, but he knows very well that to maximize the profit, price has to be reduced. Price reduction means Average Revenue reduces and average revenue reduces marginal revenue but at a much faster rate. So, under monopolistic competition MR < AR.

OLIGOPOLY

It is a market structure in which only a few firms can prevent the others from exerting significant influence.

Important Characteristics of Oligopoly Market:

- There are only a few sellers who control all or most of the industry's sales
- Each firm creates a product that is either homogeneous or differentiated.

- The demand curve in an oligopoly cannot be determined. In terms of price determination, all firms are interdependent.

Oligopoly Can Be Categorised Into Two Categories on the Basis of Production:
- Collusive oligopoly is a type of oligopoly in which all firms agree to avoid competition and set prices and output quantities through cooperative behaviour.
- Non-collusive oligopoly is a type of oligopoly in which all firms set their prices and output quantities in response to rival firms' actions and reactions.

Oligopoly Can Be Categorised Into Two Categories on the Basis of Differentiation:
- When firms deal with homogeneous products, they form a type of oligopoly known as a perfect oligopoly.
- When there is product differentiation, an imperfect oligopoly occurs. It deals with heterogeneous products.

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 a 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.

Price Elasticity and Marginal Revenue:
Price elasticity and marginal revenue have a direct relationship. The more elastic a good's demand is, the more it is affected by supply changes. Marginal revenue and price are equal in a competitive market. As a result, price elasticity and marginal revenue have a direct relationship in a competitive market. Marginal revenue is less than price in a natural monopoly. Because low prices are a primary driver of monopoly, this is the case. As a result, price elasticity has a direct relationship with marginal revenue in a monopoly.

Price and cost, both of which are a function of demand, drive marginal revenue. Higher revenues are generated by higher prices and lower costs. Higher volume generates more revenue and lowers costs due to economies of scale. The effect is cyclical, with the cost-cutting benefit offset by the revenue loss from lower prices. Changes in price will have no effect on demand if the good is price inelastic. Because price has no effect on demand, raising the price will increase revenue. Furthermore, the cost savings from increased volume do not need to be passed on to the customer. Marginal Revenue is expressed as:
MR = P1 − (1/Ep)
Where MR = Marginal Revenue,
P = Product's market price
Ep = The price elasticity of demand for the product.