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FORMS OF MARKET

You are familiar with the term market. Market is the major source of distribution of goods and services. The purpose of producing goods is to sell them to the consumers who demand them. To sell the goods (and services) we need the medium of market. In today's world a buyer can get so many types of goods in the market. What are the different forms of market? As students of economics you must know the forms of market. This lesson is denoted for towards this.

OBJECTIVES

After completing this lesson, you will be able to:

- understand the concept of market;
- know the meaning of perfect competition and its features;
- explain the meaning of monopoly and its features;
- understand the meaning of monopolistic competition and its features;
- understand the meaning of oligopoly and its features; and
- draw a comparison among different forms of market.

21.1 WHAT IS A MARKET

Market is the heart and soul of modern economic life. Without market, producers' and consumers' activities hardly make any sense. In common parlance, market is assumed to be a place where goods are bought and sold. But in economics, the term 'market' does not refer to a specific place. Rather, it is a mechanism through which buyers and sellers come into contact with each other and buy and/or sell goods at mutually agreed prices.

Main features of a market include:

(a) **Buyers and Sellers:** Buyers and sellers must come into contact with each other for a market to exist. It is only after the contact between the buyer and the seller, that a transaction takes place.

(b) **Area:** You can easily find a market place nearer to a human settlement. But in today's world, the market is not limited to a particular place. Today, in the age of Internet, we have a rapidly growing online market which is not limited to any geographical area. A buyer can place order to buy a good online. So modern Market exists physically and virtually.

(c) **Commodity:** The transaction between buyer and seller has to be over some good or service. So a commodity becomes the integral part of a market.

(d) **Different forms of Competition:** Forms of market depends on the degree of competition among the sellers selling the goods, where the degree of competition it self is determined by the inter relationship of among the goods and services sold by different sellers as well on number of sellers present in the market.

(e) **Money transaction:** Money is the mediums of exchange in the modern day world. Consumers pay money to the seller to buy goods as services in the market. So money and market are inseparable.

21.2 BASIS OF DIFFERENT MARKET FORMS

Different forms of market can exist on the basis of some distinguished characteristics. Some of these characteristics are:

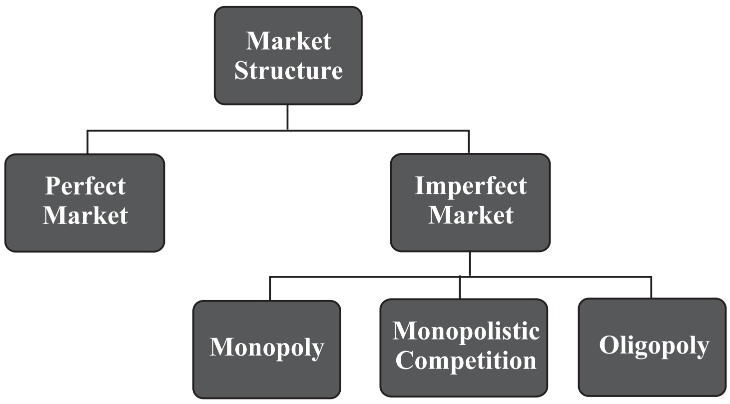
(a) **Number of Firms:** Number of firms in a market indicates the degree of control of a firm on the price of a commodity. For example, if there is a large number of firms competing against each other, a single firm supplies just a miniscule part of market supply and hence cannot influence the market supply and consequently the price significantly. Similarly, if there is only one firm in the market, it becomes the sole determinant of the market supply and therefore, exercises a great degree of control over the price.

(b) **Ease of Entry and Exit of the Firms:** If the firms can easily enter a particular market or can leave the market without much loss, the price will be stable and profits will be just normal in the long run. In case there are restrictions on entry of new firms, the degree of control of existing firms increases and the possibility of earning higher profits also increases as the firms have a lesser degree of competition in such a case.

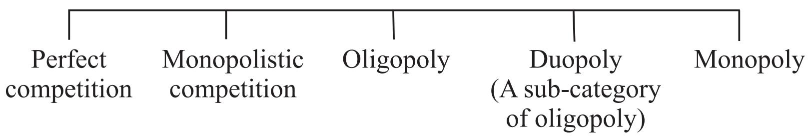
(c) **Degree of Product Differentiation:** It simply means how unique the product offered by a particular firm is. The greater the degree of uniqueness (or higher degree of product differentiation), the greater is the control exercised by that firm over its pricing decisions. In case, the goods offered by different firms are homogeneous, the individual firms lose their control over the market in price determination.

21.3 DIFFERENT FORMS OF MARKET STRUCTURE

Based on the above mentioned characteristics, we can classify different markets in the way as shown in the following chart



On the basis of degree of competition among sellers, we can say that while monopoly does not have any competition, on the otherhand perfect competition has maximum degree of competition. Oligopoly and monopolistic competition lie between these two extreme market forms.



INTEXT QUESTIONS 21.1

1. What is a market? Explain its salient features.
2. Define market structure?
3. Bring out main features of a market.
4. On what basis, can different market structures be distinguished from one another?
5. Which is the most competitive market structure?
6. Which is the least competitive market structure?
7. Is it necessary for a market to be some specific place?

21.3.1 Perfect Competition

Like any other market structure, Perfect Competition is defined on the basis of its features. Perfect Competition is a market structure in which there is a large number of buyers and sellers who transact homogeneous or similar goods at a price fixed by the market or industry. Here, industry is a group of firms producing similar goods.

Features of Perfect Competition: Perfect Competition is characterized by:

1. **Very Large number of buyers and sellers:** In a perfectly competitive market, there is a very large number of buyers and sellers. For instance, if a single seller tries to raise the price, there is a large number of other sellers selling identical product at a lower price. Therefore, the demand for this particular firm decreases forcing it to come in line again with the industry determined price.
2. **Homogeneous Product:** The products offered by different firms are homogeneous in every respect so that the buyer does not have any basis to prefer the goods of one seller over the goods of another seller. The goods are identical in terms of quality, size, packing, and other terms of deal etc. This feature ensures the uniformity of the price throughout the market.
3. **Firm is a Price Taker:** The firm has to sell the goods at a price determined by the industry as the firm has no control over the price. The market or industry determines this price on the basis of market demand and market supply as shown in the figure. So industry is the price maker and firm is the price taker.
4. **Free Entry and Exit:** Under perfect competition firms are free to enter into the market or exit from the market at any point of time. This means that there is no obstruction from any where for a new firm to produce the same product produced by the existing firms in the market; similarly if a firm wishes to exit then it is free to do so.
5. **Perfect Knowledge:** This feature implies that both sellers and buyers have perfect knowledge about the goods and their prices so that it is not possible for a firm to charge a different price. It also ensures uniform price for the buyers and uniform cost function for the producers.
6. **Perfect Mobility:** The goods as well as the factors of production are perfectly mobile so that there is no restriction- legal or monetary (involving expenditure in movement of goods). This feature ensures that the price throughout the market tends to be uniform.
7. **No Selling Costs:** Selling costs are the costs aimed at promotion of sales of product of a firm, e.g. expenditure on advertisement of a product. In perfect competition, there is no need to incur selling cost because of assumption of

perfect knowledge and homogeneous goods. This implies that if people have complete knowledge about the product, the seller does not find it necessary to educate consumers through advertisements. Similarly, when goods are homogeneous, there is no basis on which the seller can claim superiority of his products over the products of its rivals.

8. **Shape of Demand Curve:** Under perfect competition, the demand curve for the firm is horizontal and perfectly elastic. It means that the firm can sell any amount of the product at the price determined by the industry, but the firm cannot vary the price.

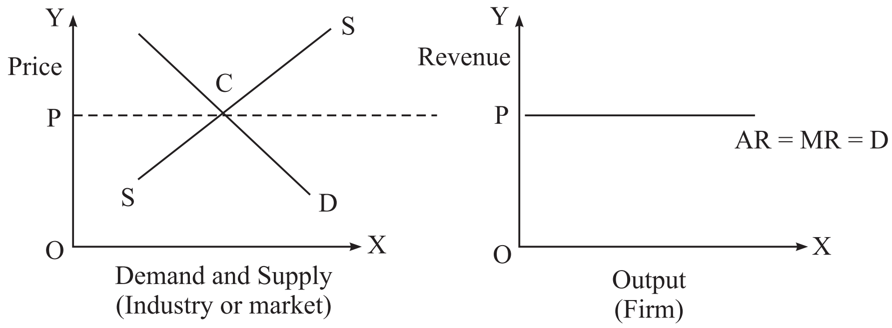


Fig. 21.1

INTEXT QUESTIONS 21.2

1. What is perfect competition? Explain its various features.
2. What is the relevance of the feature of 'large number of buyers and sellers' in perfect competition?
3. Why is there no need of selling cost in perfect competition?
4. What is the shape of demand curve for a product under perfect competition?
5. Why do firms earn only normal profits under perfect competition in the long run?
6. Under perfect competition, firm is a price-taker and not price maker. Explain.
7. Under perfect competition, all the firms sell their goods at the same price. (True/False)

21.3.2 Monopoly

Monopoly is a market structure in which there is a single seller, there are no close substitutes for the commodity produced by the firm and there are barriers to entry.

Example: Indian Railways which is operated under government of India.

Monopoly also implies absence of competition.

Features of Monopoly: Monopoly is characterized by:

1. **Single Seller:** In monopoly, there is only one firm producing the product. The whole industry consists of this single firm. Thus, under monopoly, there is no distinction between firm and industry. Being the only firm, there is significant control of the firm over supply and price. Thus under monopoly, buyers do not have the option of buying the commodity from any other seller. They have to buy the product from the firm or they can go without the commodity. This fact gives immense control to the monopolist over the market.
2. **No Close Substitute:** There are no close substitutes of the product produced by the monopolist firm. If there are close substitutes of the product in the market, it implies presence of more than one firm and hence no nonopoly. In order to ensure a total of control over the market by the monopolist firm, it is assumed that there are no close substitutes of the product.
3. **No to Entry:** Monopoly can only exist when there is strong barriers before a new firm to enter the market. In fact once a monopoly firm starts producing the produt, no other firm can produce the same. One reason for this is the ability of the monopolist to produce the product at a lower cost than any new firm who thinks to enter the market. If a new firm who knows that it can not produce at a lower cost than the monopolist, then the that firm will never enter the market for fear of loosing out in competition. Similarly the monopolist who is operating for a long time may be enjoying reputation among its customers and is in a better position to use the situation in its own benefit. A new firm has to take long time to achieve this and so may not be interested to enter the market.
4. **Price Maker:** Being the single seller of the product, the monopolist has full control over the pricing of the product. On the other hand, if there is a large number of buyers in the market, so no single buyer exercises any significant influence over price determination. Thus, it is a seller's market. So monopoly firm is a price maker.
5. **Price Discrimination:** Having considerable control over the market on account of being single seller with no entry of other firms, the monopolist can exercise policy of price discrimination, it means that the monopolist can sell different quantities of the same product to a consumer at different price or same quantity to different consumers at different prices by adjudging the standard of living of the consumer.

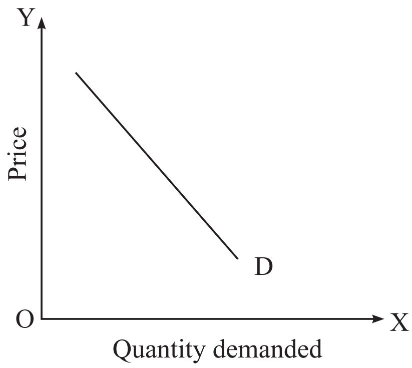


Fig. 21.2

6. **Shape of Demand Curve:** Since a monopolist has full control over the price, therefore, he can sell more by lowering the price. This makes the demand curve downward sloping. As there is no competition of the firm in the market, demand curve is in elastic. See figure 2.

INTEXT QUESTIONS 21.3

1. What is monopoly? Explain its features.
2. Draw a comparison between perfect competition and monopoly.
3. In what forms, can there be barriers to entry of other firms? What role do these barriers play?
4. Why do we assume that there are no close substitutes of the goods produced by a monopolist?
5. What kind of profits are earned by a monopolist in the long run and why?
6. Define price discrimination.
7. Under monopoly, firm is price taker. (True/False)

21.3.3 Monopolistic Competition

Monopolistic Competition is a market structure in which there is a large number of sellers in the market of a commodity, but the product of each seller differs in some respect from the product of the other sellers. Thus, product differentiation is the cornerstone of Monopolistic Competition. Monopolistic competition is like an amalgam of monopoly and perfect competition, and hence the name Monopolistic Competition. According to J.S. Bains, "Monopolistic Competition is a market structure where there is a large number of sellers, selling differentiated but close substitute products."

Example: Restaurants, Market for Toothpaste etc.

Features of Monopolistic Competition

Monopolistic Competition is characterized by:

1. **Large number of firms:** Under monopolistic competition, there is a large number of firms selling closely related products. Thus the control of a particular firm is somewhat diminished when compared to that of monopoly.
2. **Product Differentiation:** Product Differentiation is a very important feature of Monopolistic Competition. This differentiation could be on the basis of quality, packaging, colour etc. or this differentiation could also be just a matter of perception.

   For example: You must have seen different brands of tooth paste. Even if they look different having different taste, the produt it has same use.

3. **Selling Costs:** Under monopolistic competition firms spend a lot on advertisement of their product in order to attract the customers and sell their product. Every firm tries to promote its product through advertisement for which it bears some extra cost ove and above its cost of production. This is calle selling cost.

4. **Non-Price Competition:** Under Monopolistic Competition, sometimes, firms compete with each other without changing price. They may start various promotion schemes, gift schemes or compete in terms of advertisement etc. Thus, firms compete under in every possible way to attract consumers and gain maximum possible market share.

5. **Nature of Demand Curve:** Like monopoly, Monopolistic Competition also has a downward sloping demand curve. However due to the existence of competitors in the market, the degree of steepness of the curve is little less, reflecting greater price elasticity of demand and less control of the firm than that of monopoly. (see figure 21.3).

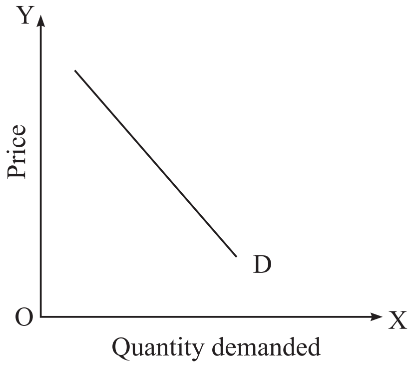


Fig. 21.3

INTEXT QUESTIONS 23.4

1. Define monopolistic competition. Explain its features
2. Draw comparison between perfect competition and Monopolistic competition.
3. Draw comparison between monopoly and monopolistic competition.
4. Explain product differentiation under monopolistic competition.
5. Monopolistic competition is an amalgam of monopoly and perfect competition. Explain.
6. Explain 'Non-price competition'.
7. Fill in the blanks with appropriate words:
   (i) Under monopolistic competition, the number of firms is ....
   (ii) Demand curve under monopolistic competition is .... sloping.
   (iii) Product differentiation is the cornerstone of ....

21.3.4 Oligopoly

Oligopoly is an important form of imperfect competition. Oligopoly exists when there are few firms selling the product. W.H. Fellner wrote a book on oligopoly with the title, "Competition among the Few". This title aptly summarizes what oligopoly is. Oligopoly can simply be defined as the competition among the few firms. The products of these firms may either be close substitutes or homogeneous.

Example: Mobile service providers, car industry, airlines etc.

A. Features of Oligopoly

Oligopoly is characterized by following features:

1. **Interdependence:** Interdependence is a very significant feature of Oligopoly. When the number of firms is small, any strategy regarding change in price, output or quality of a product, will depend on the rival's reaction for its success. Thus, the success of price reduction policy by one company (say, Pepsi) will depend on reaction by its rival (say, Coke). For example, if Pepsi lowers the price per bottle from Rs 10 to Rs 8, the effect of this step on demand for Pepsi will depend on the counter-strategy of Coke. If Coke decides to follow price war strategy and lowers price from Rs 10 per bottle to Rs 7 per bottle, demand for Pepsi may decrease even below its initial level.

2. **Indeterminate Demand Curve:** Demand curve presents different quantities of a product demanded at various prices. However, demand for a product at different prices can be known only when rivals' counter strategies can be predicted with certainty. This being not possible, we cannot draw the usual demand curve for the firm's product in case of oligopoly.

3. **Selling Costs:** Oligopoly firms bear selling cost such as advertisement, sales promotion etc. to sale the product.

4. **Group Behaviour:** Since there are a few firms under oligopoly, there is a tendency among them to come together in order to avoid competition. They may meet secretly to negotiate price and quantity in the market. The aim is to maximise profit in the same manner as a monopolist does. Obviously when they come together it looks as if all firms have become a single entity like a monopolist. But such groupism is done secretly as the government may take action if it comes to know about this type of group behaviours of firm where in firms are trying to reduce competition among them selves. Note that when firms form a group secretly to share profit or quantity etc. it is called collusive oligopoly. When firms work independently and compete with each other, it is called non-collusive oligopoly.

5. **Price Rigidity:** In oligopoly market, once the price of the produt is fixed by the firms, it is normally not changiable. So price is rigid. The reasons for this is that firms face different types of consumers having different elasticities of

demand. So response of change in quantity due to change in price many vary from one firm to another creating uncertainty about future sales. So fearing this firms do not change price once its is fixed.

B. Types of Oligopoly

Oligopoly may further be classified into collusive oligopoly and non-collusive oligopoly.

(a) Collusive oligopoly

The firms under oligopoly may decide to co-operate with each other and make common policies for all the firms. Thus, firms may collude with each other work on common pricing policies and make common output decisions. In such an environment, the group of firms can behave like a monopolist and earn supernormal profits. This group of colluding firms is called 'cartel'. One prominent example of cartel is 'the Organization of Petroleum Exporting Countries (PEC)'.

(b) Non-collusive oligopoly

When firms do not co-operate with each other and engage in fierce competition with each other, the market is called non-collusive oligopoly. Under such environment, while competing with each other, firms drive price levels, and profit levels down to the level of normal profit only.

INTEXT QUESTIONS 21.5

1. What is oligopoly? Explain its features.
2. Define oligopoly. Give example.
3. Explain nature of demand curve under oligopoly.
4. 'Interdependence' and 'Group Behaviour' are two very important features of oligopoly. Comment.
5. What is collusive oligopoly?
6. What is non-collusive oligopoly?

TERMINAL EXERCISE

1. Define a market. What are different types of market?
2. What is Perfect Competition ? Explain its features briefly.
3. What is Monopoly ? Explain its features briefly.
4. What is Monopolistic Competition ? Explain its features briefly.

5. Fill in the blanks:
   - (a) Price determination by industry is a feature of ....
   - (b) Under Oligopoly, price tends to be ....
   - (c) In Monopoly, the number of firms is ....
   - (d) Product Differentiation is the corner stone of ....
   - (e) Interdependence is the most important feature of
   - (f) Market is a place, a particular geographical location. (True/False)

ANSWERS TO INTEXT QUESTIONS

21.1

1. Refer to 21.2
2. Refer to 21.3
3. Refer to 21.2
4. Refer to 21.3
5. Perfect competition
6. Monopoly
7. No

21.2

1. Refer to 21.3.1
2. Refer to 21.3.1 pt. 1
3. Refer to 21.3.1 pt. 7
4. Refer to 21.3.1 pt. 2
5. Refer to 21.3.1 pt. 4
6. Refer to 21.3.1 pt. 2
7. True

21.3

1. Refer to 21.3.2
2. Refer to 21.3.1 and 21.3.2
3. Refer to 21.3.2 point No. 3
4. Refer to 21.3.2 point No. 2
5. Refer to 21.3.2 point No. 3

6. Refer to 21.3.2 point No. 6
7. False

21.4

1. Refer to 21.3.3
2. Refer to 21.3.1 and 21.3.3
3. Refer to 21.2 and 21.3
4. Refer to 21.3.3 point No. 2
5. Refer to 21.3.3
6. Refer to 21.3.3 point No. 4
7. (i) large
   (ii) downward
   (iii) monopolistic competition

21.5

1. Refer to 21.3.4 and 21.4.4 (A)
2. Refer to 21.3.4 (A)
3. Refer to 21.3.4 (A) point No. 2 and 6
4. Refer to 21.3.4 (A) point No. 1 and 4
5. Refer to 21.3.4 (B) part (a)
6. Refer to 21.3.4 (B) part (b)