Meaning of Market Structure

Market structure refers to the types of markets in which the producers or firms operate and are organized. Thus, market structure indicates how the market is organized and it is based on characteristics or structural variables of the market that affect business or managerial decisions. Various market forms are classified based on the competitiveness of the market structure. Market competitiveness refers to the extent to which individual firms have the power to influence the market price of the product. The lower the power an individual firm has influenced the price of the product, the more competitive is the market structure. One of the intense forms of market structure is perfect competition in which a firm has no power to influence the price of the commodity. The other extreme form of market is a monopoly, in which there is only one producer of a good who enjoys considerable power to influence the market price of the commodity. In between these two extreme forms of market, there are several forms of the market where the individual producer has the lower power to influence the price. Monopolistic competition, oligopoly, etc. are two such market forms that are neither fully competitive nor fully monopolistic.

Characteristics of Market Structures or Factors Affecting Determining Market Forms

There are different characteristic features of the market forms that differentiate one market from others. The number of sellers of a commodity, the nature of the product, the number of buyers of the product, degree of restrictions on the entry into the industry, the knowledge and information about the market, and the extent of advertisement are some of the important characteristics based on which it can distinguish between different forms of market. These different features or characteristics of the market structure are listed below.

Number of firms

Nature of the product

Price elasticity of demand

Firm's control over price

Non-price competition

Potential of entry

Size of the firm

1. Perfect Competition Market Structure

It is the market structure in which there is a very large number of buyers and many sellers of a homogeneous product. In this market, many sellers or producers offer a homogeneous product, to a very large number of buyers at a uniform price. The price of the product under this market is determined in the industry and the sellers and buyers accept that price, so the price is fixed. this market is characterized by a complete absence of rivalry among the individual firms. An individual seller or buyer does not affect the price of the product.

According to Dominick Salvatore, "A market where no buyers or seller can affect the price of the product, all units of the product are homogeneous, resources are mobile and knowledge of the market is perfect is called perfect competition or perfectly competitive market."

1.1 Characteristics of Perfect Competition Market

Major features of a perfect competition market are explained below.

Many Sellers and Buyers

In a perfectly competitive market structure, the number of sellers and buyers is very large, so that each buyer and seller have no effect on market price and contributes only a small part of the total quantity on the market. They are like a drop of water in an ocean.

Homogeneous Products

Products produced by firms are homogeneous or almost identical means similar in quality, size, weight, taste, packing, etc. The product of each firm is a perfect substitute for the product of other firms. The buyers can not differentiate among the products of different firms. So, no firm can gain any competitive advantage over other firms.

Free Entry and Exit of the Firms

There is no barrier to enter the industry and exit from it for a new firm. Therefore, several firms are operating under the industry in the short run.

Perfect Information

Under the perfect competition market, there is perfect information or knowledge about the market, market price, market demand, supply, etc. to all the buyers and sellers. They have full information of prevailing and future prices, and quantities of the commodities.

Perfect Mobility of Factors

In the case of perfect competition, all the factor inputs move freely between the business firms within the economy. It means factors of production should have perfect mobility between industries. They should be free to move to those places where they can get the highest price.

Absence of Price Control

There should be complete openness in buying and selling goods. Here prices are liable to change freely in response to demand and supply conditions. There is no government control in pricing in the form of tariffs, subsidies, licensing, sales tax, or any other types of direct as well as indirect measures of control.

Absence of Transport Cost

There must be an absence of transport cost. Having less or negligible transport costs will help the market in maintaining uniformity in price.

Independent Relationship between Buyers and Sellers

There should not be any connection between sellers and purchasers in the market.

Profit Maximization Objective

The objective of the firm under a perfectly competitive market is to generate maximum profit.

2. Monopoly Market

A market structure illustrated by a single seller, selling a unique product in the market is known as a monopoly market. In a monopoly market, the seller faces no competition, as he is the sole seller of goods with no close substitute. Different special factors like government license, ownership of resources, copyright and patent, and high starting cost make an entity a single seller of goods or give power to a firm and make it a single seller. All these factors restrict the entry of other sellers into the market.

2.1 Characteristics of a Monopoly Market

A monopoly can be distinguished by certain characteristics that set it aside from the other market structures.

Single Seller

Under a monopoly market, a firm itself is the industry and is a single seller of a unique product in the market.

Profit Maximiser

A monopoly maximizes profits. Due to the lack of competition a firm can charge a set price above what would be charged in a competitive market, thereby maximizing its revenue.

Price Maker

The monopoly decides the price of the good or product being sold. The price is set by determining the quantity to demand the price desired by the firm (maximizes revenue).

High Barriers to Entry

Other sellers are unable to enter the market of the monopoly.

Single Seller

In a monopoly, one seller produces all the output for a good or service. The entire market is served by a single firm. For practical purposes, the firm is the same as the industry.

Price Discrimination

In a monopoly, the firm can change the price and quantity of the good or service. In an elastic market, the firm will sell a high quantity of the good if the price is less. If the price is high, the firm will sell a reduced quantity in an elastic market.

2.2 Sources of Monopoly Power

In a monopoly, specific sources generate individual control of the market. Sources of power include.

Patent over a new product

Economies of scale

Capital requirements

Control over raw materials and natural resources

Technological superiority

No substitute goods

Control of natural resources

Network externalities

Deliberate actions

Market franchises

3. Monopolistic Competition Market

Monopolistic competition is a market in which many firms offer products or services that are similar, but not perfect substitutes called differentiated. Barriers to entry and exit in a monopolistic competitive industry are low, and the decisions of anyone firm do not directly affect those of its competitors. Monopolistic competition is closely related to the business strategy of brand differentiation.

So, it is a market structure that combines elements of monopoly and competitive markets. Essentially a monopolistic competitive market is one with freedom of entry and exit, but firms can differentiate their products. Therefore, they have an inelastic demand curve and so they can set prices. However, because there is freedom of entry, supernormal profits will encourage more firms to enter the market leading to normal profits in the long term.

Markets of products like soap, toothpaste AC, etc. are examples of monopolistic competition.

So, Monopoly + Competition = Monopolistic Competition

3.1 Features of Monopolistic Competition

Major features of a monopolistic competition market are explained below.

Many Sellers

There are large numbers of firms selling closely related, but not homogeneous products. Each firm acts independently and has a limited share of the market. So, an individual firm has limited control over the market price. Many firms lead to competition in the market.

Product Differentiation

In the case of this market, every firm can exercise some degree of monopoly (despite many sellers) through product differentiation. Product differentiation refers to differentiating the products based on brand, size, color, shape, etc. The product of a firm is close, but not a perfect substitute for other firms. Product differentiation ensures that buyers of a product differentiate between the same (not identical) products produced by different firms. Therefore, they are also willing to pay different prices for the same product produced by different firms. This gives some monopoly power to an individual firm to influence the market price of its product.

Product differentiation creates a monopoly position for a firm and a higher degree of product differentiation (i.e. better brand image) makes the demand for the product less elastic and enables the firm to charge a price higher than its competitor’s products. For example, Wai Wai is superior to any other brand of noodles.

High Selling Costs

Under monopolistic competition, products are differentiated, and these differences are made known to the buyers through selling costs. Selling costs refer to the expenses incurred on marketing, sales promotion, and advertisement of the product. Such costs are incurred to persuade the buyers to buy a particular brand of the product in preference to the competitor's brand. Due to this reason, selling costs constitute a substantial part of the total cost under monopolistic competition. [*Note: It must be noted that there are no selling costs in perfect competition as there is perfect knowledge among buyers and sellers. Similarly, under monopoly, selling costs are of a small amount (only for informative purposes) as the firm does not face competition from any other firm.*]

Freedom of Entry and Exit

Under monopolistic competition, firms are free to enter or exit from the industry at any time they wish. It ensures that there are neither abnormal profits nor any abnormal losses to a firm in the long run. However, it must be noted that entry under monopolistic competition is not as easy and free as under perfect competition.

Pricing Decision

A firm under monopolistic competition is neither a price-taker nor a price-maker. However, by producing a unique product or establishing a particular reputation, each firm has partial control over the price. The extent of power to control price depends upon how strongly the buyers are attached to his brand.

Non-Price Competition

In addition to price competition, the non-price competition also exists under monopolistic competition. Non-Price Competition refers to competing with other firms by offering gifts, making favorable credit terms, etc., without changing the prices of their products.

Firms under monopolistic competition compete in several ways to attract customers. They use both Price Competition (competing with other firms by reducing the price of the product) and Non-Price Competition to promote their sales.

Relatively Elastic Demand Curve

Under monopolistic competition, many firms selling closely related but differentiated products make the demand curve downward sloping and more elastic. It implies that a firm can sell more output only by reducing the price of its product and demand is more affected by the change in the price, unlike monopoly. [*Note: As products are differentiated so we cannot derive the market demand curve and market supply curve like perfect competition.]*

Heroic Assumption

Edward Chamberlin makes the heroic assumption that both demand and cost curves for all products are uniform throughout the group. This assumption ensures that the ability of a firm to influence a consumer is not due to the difference in cost and demand structure of the firm. So, the influence over consumers' demand comes only due to differentiated products. Moreover, Chamberlin makes these assumptions to be able to show the equilibrium of the firm and the group on the same diagram.

Profit Maximization Objective

The goal of the firms under monopolistic competition is to maximize profit.

4. Oligopoly Market

The term oligopoly was derived from the Greek word 'Oligos' indicates a few and 'Pollien' denotes sellers. Thus, an oligopoly is a market structure in which a few firms are selling homogeneous or differentiated products. The oligopoly industry selling homogeneous products is known as pure or perfect oligopoly and that which is selling differentiated products is known as an imperfect or differentiated oligopoly. Pure oligopoly is found in capital goods such as cement, steel, aluminum, zinc, etc., and consumer goods like automobiles, detergents, televisions, refrigerators, shampoo, etc.

It is the most prevailing market structure in the manufacturing sector. It is specifically found in science-based and technologically advanced industries.

4.1 Characteristics of Oligopoly Market

Major features of an oligopoly market are explained below.

Few Sellers

There is a small number of sellers under the oligopoly market. The number of sellers largely based on the size of the market. Since the number of sellers is small that the market share of each firm is so large that a single seller can influence the market price and business strategy of its rival firms.

Monopoly Power

There is a presence of monopoly power in oligopoly. Since there are only a few firms and every firm has a large share of the market. In its share of the market, it controls the price and output. Thus, an oligopoly has some monopoly power.

The Interdependence of Firms

In the case of an oligopoly market, there are only a few firms, each producing a homogeneous or slightly differentiated product. Since the number of firms is small, each firm enjoys a large share of the market and has a significant influence on the price and output decisions. Thus, firms are interdependent. No firm can ignore the actions and reactions of rival firms under oligopoly. This means that the price and output decision of a firm depends on the price and output decision of the rival firms.

Conflicting Attitude of Firms

Under oligopoly, two types of conflicting attitudes are found in the firms. On the one hand, firms recognize the disadvantages of mutual competition and desire to combine to maximize their joint profits. This tendency leads to the formation of collusion. On the other hand, the desire to maximize one's profit may lead to conflict and antagonism, the firms come into clash with one another on the question of distribution of profits and allocation of markets. Thus, there is an existence of two opposing attitudes among the firms.

Nature of Product

If the firm's product homogeneous product, it becomes a pure oligopoly. The firms with product differentiation constitute impure oligopoly. So oligopolist firms can compete on homogenous as well as heterogeneous products.

Barriers to Entry

The requirement of huge investment, economies of scale enjoyed by existing firms, consumer's loyalty to old products, etc. creates barriers to entry into the market for new firms. So, there are barriers to entry for new firms but those who can cross these barriers can enter the industry.

Indeterminate Price and Output

The demand curve under oligopoly is indeterminate and uncertain because any step taken by his rivals may change the demand curve. Due to the feature of fewness and interdependence of oligopoly firms, the derivation of the demand curve is a difficult task and thus price and output are said to be indeterminate.

Advertisement and Selling Cost

There is a high significance of advertisement and selling costs. Under this, an advertisement can become a life and death matter according to Professor Baumol. Advertisement can be an effective tool to attract consumers from rival firms. The firms which cannot keep up with the advertisement budget of the competitors, cannot survive in the market.

Price Rigidity

Under it, the price is said to be rigid. If any firm reduces price, it is immediately followed by rival firms and this creates a price war in the market. Similarly, if any firm increases the price, the rival firm will not follow the same and that firm may have to lose consumers of the product. So, the price remains rigid in an oligopoly market.

4.2 Classification of Oligopoly Market

The oligopoly market is classified mainly into two types. Namely, they are collusive oligopoly and non-collusive oligopoly. The following table shows the classification of the oligopoly market.

<table>
<tr><th colspan="2">Oligopoly Market-Types</th></tr>
<tr><th>1. Collusive Oligopoly</th><th>2. Non-collusive Oligopoly</th></tr>
<tr><td>a. Cartels
1. Cartel Aiming Joint Profit Maximization
2. Market Sharing Cartel
a. Non-price Competition
b. Determination of Quota
b. Price Leadership Model
1. Price Leadership by Low-Cost Firm
2. Price Leadership by Dominant Firm
3. Barometric Price Leadership</td><td>a. Kinked Demand Curve Model</td></tr>
</table>

Table: Classification of Oligopoly Market

4.2.1 Collusive Oligopoly

It is a situation in which firms have been to be in collusion or agreement. Such agreement can be open or tacit, explicit, or secret, legal, or illegal with one another for the following reasons.

1. To reduce the uncertainty that arises due to the interdependence of the collusive firms
2. To narrow down the degree of competition between the firms and give some monopolist power in their pricing and other decisions
3. To create barriers to entry of new firms

Collusive oligopoly is also of two types as cartel and price leadership. A cartel is a type of collusion where firms or sellers of a product are formally organized to restrict competition and maximize profit. Similarly, price leadership is another form of collusion in an oligopolistic market where the firm serves as the price leader and initiates a price change, and other firms in the industry soon match it.

4.2.2 Non-collusive Oligopoly

It is a type of oligopoly market in which oligopoly firms act independently, they are competitors of one another and there is no collusion between the firms. In this firms do not engage in collusive practices rather they compete to promote their self-interest. However, they are interdependent in decision-making. They calculate the optimal moves of rival firms and develop their strategy.

The Summary Table

<table>
<tr><th>Types of Market</th><th>No. of Firms</th><th>Nature of Product</th><th>Price Elasticity of Demand for Individual Firm</th><th>Nature of Demand Curve</th><th>Firm's Control Over Price</th><th>Examples</th></tr>
<tr><td>Perfect Competition</td><td>Very Large</td><td>Homogeneous (Gold, petrol, wheat, etc.)</td><td>Perfectly elastic</td><td>Horizontal demand curve</td><td>None</td><td>Stock Market, Agricultural Market</td></tr>
<tr><td colspan="7">Imperfect Competition</td></tr>
<tr><td>a. Monopoly</td><td>Single</td><td>Unique and no close substitutes (gas, electricity, telephone)</td><td>More inelastic</td><td>Steeper</td><td>Full but regulated</td><td>Public utilities</td></tr>
<tr><td>b. Monopolistic Competition</td><td>Many</td><td>Differentiated</td><td>Relatively Elastic</td><td>Flatter</td><td>Some</td><td>Tea, cigarette, garments etc.</td></tr>
<tr><td>c. Pure Oligopoly</td><td rowspan="2">Few</td><td>Homogeneous (steel, bread, sugar, etc)</td><td rowspan="2">Relatively inelastic</td><td rowspan="2">Steeper</td><td rowspan="2">Some</td><td rowspan="2">Steel, cement, car, etc. d</td></tr>
<tr><td>d. Impure Oligopoly</td><td>Differentiated (tea, toothpaste, soaps, etc.)</td></tr>
</table>

Table: Summary table of market structures and their features

References and Suggested Readings

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