

UNIT IV – MARKET STRUCTURE

Introduction

Market structure refers to the nature and organisation of a market. It explains the number of buyers and sellers, the nature of products, the degree of competition, and the control over price. Market structure plays an important role in determining the price of goods and services, the quantity of output, and the behaviour of firms. The major types of market structure are perfect competition, monopoly, monopolistic competition, and oligopoly.

Meaning of Market Structure

Market structure is the arrangement of a market based on the number of firms, the nature of products, the conditions of entry and exit, and the degree of control over price. It helps to understand how firms compete with one another and how prices are determined in the market.

Example: The agricultural market may have many sellers, while a particular public utility may have only one major supplier.

Price and Output Determination under Perfect Competition

Meaning of Perfect Competition

Perfect competition is a market structure in which there are a large number of buyers and sellers dealing in homogeneous products. No individual firm can influence the market price, so each firm acts as a price taker. The market price is determined by the interaction of demand and supply. An individual firm accepts this price and decides its output according to its production costs.

Example: An individual farmer selling wheat generally accepts the prevailing market price rather than fixing a separate price.

Price and Output Determination under Perfect Competition

Perfect competition refers to a market situation where there are a large number of buyers and sellers dealing in homogenous products.

Moreover, under perfect competition, there are no legal, social, or technological barriers on the entry or exit of organizations.

In perfect competition, sellers and buyers are fully aware about the current market price of a product. Therefore, none of them sell or buy at a higher rate. As a result, the same price prevails in the market under perfect competition.

Under perfect competition, the buyers and sellers cannot influence the market price by increasing or decreasing their purchases or output, respectively. The market price of products in perfect competition is determined by the industry. This implies that in perfect competition, the market price of products is determined by taking into account two market forces, namely market demand and market supply.

In the words of Marshall, “Both the elements of demand and supply are required for the determination of price of a commodity in the same manner as both the blades of scissors are required to cut a cloth.” As discussed in the previous chapters, market demand is defined as a sum of the quantity demanded by each individual organizations in the industry.

On the other hand, market supply refers to the sum of the quantity supplied by individual organizations in the industry. In perfect competition, the price of a product is determined at a point at which the demand and supply curve intersect each other. This point is known as equilibrium point as well as the price is known as equilibrium price. In addition, at this point, the quantity demanded and supplied is called equilibrium quantity. Let us discuss price determination under perfect competition in the next sections.

Short Run and Long Run Price Determination under Perfect Competition

Introduction

In a perfectly competitive market, the price of a commodity is determined by the interaction of market demand and market supply. A firm is a price taker, which means it cannot fix the market price. The price is determined by the forces of demand and supply, and each firm accepts that price. Price determination differs between the short run and the long run because the time available for adjusting production, costs, and the number of firms is different.

1. Short Run Price Determination

Meaning of Short Run

The short run is a period in which some factors of production are fixed, while other factors are variable. In this period, firms cannot change the size of their plant or fully adjust their production capacity. The number of firms in the industry also remains fixed.

Example: A bakery can increase the production of bread by using more labour and raw materials, but it cannot immediately construct a larger bakery building.

Market Price Determination

In the short run, the market price is determined by the intersection of the demand curve and the supply curve of the industry. The demand curve represents the quantity demanded by consumers, while the supply curve represents the total quantity supplied by all firms.

The point where the demand curve and supply curve intersect is called the equilibrium point. The price corresponding to this point is the equilibrium price.

Long Run Price Determination

Meaning of Long Run

The long run is a period in which all factors of production are variable. Firms can change their plant size, production capacity, and methods of production. New firms can enter the industry, and existing firms can leave the industry.

Example: A bakery can construct a new building, purchase additional machinery, expand production, or close its business in the long run.

Market Price Determination in the Long Run

In the long run, the market price is influenced by changes in industry supply. If firms earn supernormal profits, new firms enter the industry. This increases supply and tends to reduce the price. If firms suffer losses, some firms leave the industry. This reduces supply and tends to increase the price.

Under perfect competition, in the long-run equilibrium:

$$P=MR=MC=AC$$

The firm earns only normal profit, and there is no tendency for firms to enter or leave the industry.

Pricing Policy

In business, a systematic approach is required in pricing the commodities produced. Decision-making in this respect is very important, as it leads to a permanent source of revenue to the business and also survival in the venture. It is the most important device for the firm to expand its market.

If the price is too high, a seller may have to go out of the market. If the price is too low, the firm may not cover its cost and face loss. Hence, setting prices is a complex problem. There is no cut and dried formula for fixing the prices. It depends upon various situations in the business.

Objectives of Price Policy

1. Prices should aim at maximizing profit for the entire product line i.e. they should stimulate profitable combination sales.
2. Prices should be set to promote the long-range welfare of the firm. eg: to discourage competitors from entering the field.
3. Prices should be adopted and individualized to fit the diverse competitive situations encountered by different product.
4. Pricing policies should be flexible enough to meet changes in economic conditions of the various customer industries.
5. A predetermined and systematic method of [pricing new products](#) should be provided.

Importance of Price Policy

1. To maintain appropriate living standard, price control is essential.
2. To maintain planning process in a fine manner, price should be controlled at all costs.
3. Protect from monetary fluctuations, i.e. fluctuation defects are created, so to remove them appropriate price control is required.
4. Establishment of balance in demand and supply; if not hardship develops with consumer, producer and investor. So balance is needed in a proper way.
5. It is necessary to control the consumer price for well distribution management.

6. The major objective of economic planning is multi faced development of national resources. Thus price policy should be quite independent as price regulation can adjust this motto.

Pricing Methods

Pricing method refers to the technique used by a company to determine the selling price of its products or services. The company must fix a price that covers production expenses, earns profit, attracts customers, and competes effectively with other businesses. Before deciding the price, the company considers production costs, customer demand, market conditions, and competitors' prices. Therefore, selecting a suitable pricing method is essential for the success and profitability of a business.

1. Cost-Oriented Pricing Method

Cost-oriented pricing is a method of fixing the selling price of a product by considering its total production cost and adding a suitable profit margin. The total cost may include fixed costs, such as rent and machinery expenses, and variable costs, such as raw materials and labour. This method helps the company recover its expenses and earn a reasonable profit. For example, if the total cost of producing a school bag is ₹500 and the company adds ₹100 as profit, the selling price will be ₹600.

1.1 Cost-Plus Pricing

Cost-plus pricing is a method in which the manufacturer calculates the total cost of producing a product and adds a fixed percentage of profit, known as mark-up, to determine the selling price. The total cost includes both fixed and variable costs. This method is simple and helps the manufacturer recover production expenses. For example, if the cost of producing a shirt is ₹400 and the company adds a 25% profit margin, the profit will be ₹100 and the selling price will be ₹500.

1.2 Mark-up Pricing

Mark-up pricing is a method in which a fixed amount or percentage is added to the cost price of a product to determine its selling price. This method is commonly used by wholesalers and retailers. The mark-up represents the additional amount added to the cost to earn profit. For example, if a shopkeeper purchases a school bag for ₹800 and adds a mark-up of 20%, the mark-up will be ₹160 and the selling price will be ₹960.

1.3 Target-Return Pricing

Target-return pricing is a method in which a company fixes the selling price of a product to achieve a predetermined rate of return on its investment. The company estimates its total production cost, investment, expected sales, and desired profit before deciding the price. This method helps the business achieve its financial objectives. For example, if a company invests ₹1,00,000 and expects a return of 10%, it aims to earn ₹10,000 as profit from the investment.

2. Market-Oriented Pricing Method

Market-oriented pricing is a method in which the selling price of a product is determined by considering market demand, customer preferences, competitors' prices, and the value of the

product. Under this method, the company conducts market research to understand the needs and purchasing power of customers. The price is fixed according to the prevailing market conditions rather than production cost alone. For example, a smartphone company studies customer demand and competitors' prices before fixing the price of a new smartphone.

2.1 Perceived-Value Pricing

Perceived-value pricing is a method in which the price of a product is fixed according to the value that customers believe the product provides. The company considers product quality, brand image, design, advertising, promotion, and customer satisfaction while deciding the price. Customers may be willing to pay a higher price for a product that they consider valuable or superior. For example, customers may pay ₹60,000 for a branded smartphone because they value its design, camera quality, features, and brand reputation.

2.2 Value Pricing

Value pricing is a method in which a company offers good-quality products at a reasonable or comparatively low price. The main aim of this method is to provide customers with greater value for their money. The company tries to control production costs while maintaining product quality. This method helps attract price-conscious customers and increase sales. For example, a company may sell a durable school bag with good quality for ₹700, while similar products are sold for ₹900.

2.3 Going-Rate Pricing

Going-rate pricing is a method in which a company fixes the price of its product by considering the prevailing prices charged by competitors. The company may charge a price equal to, slightly higher than, or slightly lower than the market price. This method is suitable for products that are similar in quality and features. It helps businesses remain competitive and avoid fixing unrealistic prices. For example, if most shops sell a particular notebook for ₹50, another shop may also sell the same type of notebook for approximately ₹50.

2.4 Auction-Type Pricing

Auction-type pricing is a method in which the price of a product is determined through competitive bidding among buyers. Different customers offer different prices, and the product is generally sold to the highest suitable bidder according to the auction rules. This method is commonly used in online marketplaces and auction platforms. The price depends on demand, the number of bidders, and the condition of the product. For example, a second-hand mobile phone listed on an online auction platform may be sold to the buyer who offers the highest acceptable price.

2.5 Differential Pricing

Differential pricing is a method in which a company charges different prices for the same or similar product or service to different customers or under different conditions. The price may vary according to location, customer group, time, quantity, or market conditions. This method helps companies attract different groups of customers and increase sales. For example, a

cinema may charge ₹150 for a morning show and ₹250 for an evening show. The difference in price is based on the time of the service.

Price Determination under Monopoly

Meaning of Monopoly

Monopoly is a market structure in which there is only one major seller or producer of a particular product or service, and there are no close substitutes for that product. The monopolist has considerable control over the supply and price of the product. However, the seller cannot fix any price without considering consumer demand.

Example: A local water supply authority may be the only supplier of piped water in a particular area.

Features of Monopoly

1. Single Seller

A monopoly market has only one seller who supplies the product or service to the entire market. The firm and the industry are considered to be the same.

2. No Close Substitutes

The product sold by a monopolist has no close substitute. Therefore, consumers may have limited alternative products available.

3. Barriers to Entry

New firms cannot easily enter the market because of legal restrictions, high capital requirements, control over resources, patents, or other barriers.

4. Price Maker

A monopolist has the power to influence the price of its product by controlling its output. However, the price is restricted by the demand of consumers.

5. Downward-Sloping Demand Curve

The monopolist faces a downward-sloping demand curve. To sell more units, the monopolist generally has to reduce the price.

Kinds of Monopoly

Monopoly can be classified into different types according to its origin, ownership, and the nature of the market.

1. Natural Monopoly

A natural monopoly arises when a single firm can supply the entire market at a lower average cost than several competing firms. This usually occurs because of large economies of scale and high infrastructure costs.

Example: Water supply pipelines, electricity distribution networks, and certain railway infrastructure services.

2. Legal Monopoly

A legal monopoly is created or protected by government laws, licences, patents, copyrights, or other legal rights. These restrictions prevent or limit other firms from entering the market.

Example: A pharmaceutical company may have exclusive patent rights to produce a particular medicine for a specified period.

3. Private Monopoly

A private monopoly is owned and controlled by a private individual or private company. The main objective is generally to earn profit.

Example: A private company holding exclusive rights to supply a specialized product in a particular market.

4. Public Monopoly

A public monopoly is owned and controlled by the government. It may be established to provide essential goods and services to the public and to ensure social welfare.

Example: A government-controlled public utility providing essential water or electricity services.

5. Simple Monopoly

A simple monopoly is a situation in which a monopolist charges a single price for its product to all customers, regardless of their individual willingness to pay.

Example: A single seller charging ₹100 for each unit of a product to every buyer.

6. Discriminating Monopoly

A discriminating monopoly is a situation in which a monopolist charges different prices to different customers or groups for the same product or service, based on differences in demand or willingness to pay.

Example: A service provider charging different prices to different customer groups under separate pricing arrangements.

Price Discrimination

Meaning of Price Discrimination

Price discrimination refers to the practice of charging different prices for the same product or service to different customers or groups of customers, when the difference is not fully explained by differences in the cost of supplying them.

The monopolist charges different prices because customers may have different purchasing power, demand, or willingness to pay.

Example: A cinema may charge a lower ticket price for students and a higher price for other customers for the same screening.

Definition

According to economist Joan Robinson, price discrimination occurs when the same commodity is sold at different prices to different buyers, and the price differences are not justified by differences in the cost of supplying the commodity.

Features of Price Discrimination

1. Different Prices

The same product or service is sold at different prices to different customers or groups.

2. Same Product or Service

The product or service is substantially the same, or the differences in price are not primarily due to differences in production cost.

3. Market Segmentation

The seller divides the market into different groups based on factors such as age, location, time, or customer category.

4. Difference in Elasticity of Demand

Price discrimination is more feasible when different customer groups have different price elasticities of demand.

5. Prevention of Resale

The seller must be able to prevent or limit customers from buying at a lower price and reselling to customers who would otherwise pay a higher price.

Monopolistic Competition

Meaning of Monopolistic Competition

Monopolistic competition is a market structure in which there are many sellers offering products that are similar but differentiated in terms of quality, design, brand, packaging, features, or services.

Each firm has some control over the price of its product because its product is differentiated from those of competitors. However, competition remains strong because many substitute products are available.

Example: Restaurants, clothing shops, beauty salons, and toothpaste brands operate in markets that often have characteristics of monopolistic competition.

Features of Monopolistic Competition

1. Large Number of Sellers

There are many firms selling similar products. Each firm has a relatively small share of the total market.

Example: Many restaurants operate in a city and compete for customers.

2. Product Differentiation

Products are differentiated through quality, design, brand name, packaging, location, and customer service.

Example: Two restaurants may sell similar meals but differ in taste, ambience, service, and brand image.

3. Freedom of Entry and Exit

Firms can generally enter or leave the industry with relatively few barriers compared with monopoly.

Example: A new clothing shop can enter the market if it can obtain the required capital, premises, and permissions.

4. Some Control over Price

A firm has limited control over the price of its product because its product is different from competing products. However, it cannot charge an excessively high price because customers can switch to substitutes.

5. Selling Costs

Firms spend money on advertising, sales promotion, attractive packaging, and other methods to increase demand for their products.

Example: A restaurant advertises its special dishes through social media to attract customers.

6. Non-Price Competition

Firms compete not only through price but also through product quality, service, brand image, design, and customer experience.

7. Downward-Sloping Demand Curve

Each firm faces a downward-sloping demand curve because it sells a differentiated product. A reduction in price may increase the quantity demanded for its product.

8. Imperfect Knowledge

Consumers may not have complete information about all products, prices, and qualities available in the market.

Oligopoly: Meaning and Features

Meaning of Oligopoly

Oligopoly is a type of imperfect market structure in which a small number of large firms dominate the market and control a major portion of the total supply of a product or service. Each firm has a significant share of the market, and the decisions of one firm directly affect the other firms. Therefore, firms must consider the actions and reactions of their competitors before deciding the price, output, advertising, and business strategies.

The products sold under oligopoly may be homogeneous or differentiated. In some industries, firms sell identical products, while in others, they offer products with different brands, designs, and features. Oligopoly markets may have high barriers to entry, making it difficult for new firms to enter the industry.

Example: The automobile industry, where a few major companies account for a large share of the market, has characteristics of oligopoly.

Features of Oligopoly

1. Few Large Sellers

The main feature of oligopoly is the presence of a small number of large firms. These firms dominate the market and supply a major portion of the total output. Each firm's decisions can influence the market price and the sales of other firms.

Example: A few major automobile manufacturers may dominate the car market.

2. Interdependence of Firms

In an oligopoly market, firms are mutually dependent on one another. The pricing, production, advertising, and marketing decisions of one firm affect the sales and profits of its competitors. Therefore, every firm must consider the possible reactions of other firms before making important decisions.

Example: If one automobile company reduces the price of a car, other companies may also reduce their prices to retain customers.

3. Barriers to Entry

Oligopoly markets generally have significant barriers to entry. These barriers may arise due to high capital requirements, advanced technology, strong brand loyalty, economies of scale, patents, and control over distribution networks. As a result, new firms may find it difficult to enter the market.

Example: Establishing a large automobile manufacturing plant requires substantial investment and advanced technology.

4. Product Differentiation

Oligopoly firms may sell either homogeneous products or differentiated products. Homogeneous products are identical in nature, while differentiated products differ in quality, design, brand, and features.

Example: Steel may be a relatively homogeneous product, whereas cars sold by different automobile companies are differentiated by design, comfort, technology, and brand image.

5. Price Rigidity

Price rigidity means that prices tend to remain stable for a period of time. In an oligopoly market, a firm may hesitate to change its price because competitors may react in an unfavourable manner. A price increase may cause customers to shift to competitors, while a price reduction may lead to a price war.

Example: If one company increases the price of its product, competing companies may maintain their existing prices, causing the first company to lose customers.

6. Non-Price Competition

Oligopoly firms often compete through methods other than price changes. They use advertising, product quality, attractive packaging, after-sales service, warranties, and technological improvements to attract customers.

Example: Smartphone companies compete by offering better cameras, longer battery life, new features, and attractive promotional offers.

7. Selling Costs

Selling costs are the expenses incurred by firms to promote their products and increase sales. Oligopoly firms may spend large amounts on advertising, sales promotion, sponsorships, and brand-building activities.

Example: A major automobile company may spend heavily on television advertisements, digital marketing, and promotional campaigns.

8. Possibility of Collusion

Collusion occurs when competing firms cooperate, formally or informally, to influence prices, output, or market conditions. Firms may enter into agreements to reduce competition or maintain stable prices. Such agreements may be prohibited by competition laws.

Example: A group of firms may attempt to agree on a common price for a product. Such price-fixing arrangements can be illegal.

9. Uncertainty in Decision-Making

Oligopoly firms face uncertainty because they cannot always predict how competitors will react to their decisions. A change in price, production, advertising, or technology may lead to unexpected responses from other firms.

Example: If one company launches a new product at a lower price, competitors may introduce improved products or offer discounts.

10. Presence of Large Firms

Oligopoly industries are generally dominated by large firms that possess substantial financial resources, advanced technology, and extensive distribution networks. These firms can produce on a large scale and may enjoy economies of scale.

Example: Large companies in the airline, automobile, and telecommunications industries often compete through extensive infrastructure and investment.