Market Structures

Market Structures

- Type of market structure influences how a firm behaves:
  - Pricing
  - Supply
  - Barriers to Entry
  - Efficiency
  - Competition

Market Structures

- Degree of competition in the industry
- High levels of competition – Perfect competition
- Limited competition – Monopoly
- Degrees of competition in between

Market Structure

- Determinants of market structure
  - Freedom of entry and exit
  - Nature of the product – homogenous (identical), differentiated?
  - Control over supply/output
  - Control over price
  - Barriers to entry

Market Structure

- Perfect Competition:
  - Free entry and exit to industry
  - Homogenous product – identical so no consumer preference
  - Large number of buyers and sellers – no individual seller can influence price
  - Sellers are price takers – have to accept the market price
  - Perfect information available to buyers and sellers

Market Structure

- Examples of perfect competition:
  - Financial markets – stock exchange, currency markets, bond markets?
  - Agriculture?
- To what extent?

Market Structure

- **Advantages of Perfect Competition:**
- High degree of competition helps allocate resources to most efficient use
- Price = marginal costs
- Normal profit made in the long run
- Firms operate at maximum efficiency
- Consumers benefit

Market Structure

- **What happens in a competitive environment?**
  - New idea? – firm makes short term abnormal profit
  - Other firms enter the industry to take advantage of abnormal profit
  - Supply increases – price falls
  - Long run – normal profit made
  - Choice for consumer
  - Price sufficient for normal profit to be made but no more!

Market Structure

- **Imperfect or Monopolistic Competition**
  - Many buyers and sellers
  - Products differentiated
  - Relatively free entry and exit
  - Each firm may have a tiny 'monopoly' because of the differentiation of their product
  - Firm has some control over price
  - **Examples** – restaurants, professions – solicitors, etc., building firms – plasterers, plumbers, etc.

Market Structure

- **Oligopoly – Competition amongst the few**
  - Industry dominated by small number of large firms
  - Many firms may make up the industry
  - High barriers to entry
  - Products could be highly differentiated – branding or homogenous
  - Non–price competition
  - Price stability within the market - kinked demand curve?
  - Potential for collusion?
  - Abnormal profits
  - High degree of interdependence between firms

Market Structure

- **Examples of oligopolistic structures:**
  - Supermarkets
  - Banking industry
  - Chemicals
  - Oil
  - Medicinal drugs
  - Broadcasting

Market Structure

- Measuring Oligopoly:
- **Concentration ratio** – the proportion of market share accounted for by top X number of firms:
  - E.g. 5 firm concentration ratio of 80% - means top 5 five firms account for 80% of market share
  - 3 firm CR of 72% - top 3 firms account for 72% of market share

Market Structure

- **Duopoly:**
- Industry dominated by two large firms
- Possibility of price leader emerging – rival will follow price leaders pricing decisions
- High barriers to entry
- Abnormal profits likely

Market Structure

- **Monopoly:**
- Pure monopoly – industry is the firm!
- Actual monopoly – where firm has >25% market share
- Natural Monopoly – high fixed costs – gas, electricity, water, telecommunications, rail

Market Structure

- **Monopoly:**
  - High barriers to entry
  - Firm controls price OR output/supply
  - Abnormal profits in long run
  - Possibility of price discrimination
  - Consumer choice limited
  - Prices in excess of MC

Market Structure

- **Advantages and disadvantages of monopoly:**
- **Advantages:**
  - May be appropriate if natural monopoly
  - Encourages R&D
  - Encourages innovation
  - Development of some products not likely without some guarantee of monopoly in production
  - Economies of scale can be gained – consumer may benefit

Market Structure

- **Disadvantages:**
  - Exploitation of consumer – higher prices
  - Potential for supply to be limited - less choice
  - Potential for inefficiency –

    X-inefficiency – complacency over controls on costs

Market Structure