Perfect Competition

Many sellers of an identical product, e.g. strawberry sellers on the side of the road.

Characteristics/assumptions

- There are many buyers in the industry

No individual buyer can influence, by his/her own actions, the market price of the good

- There are many sellers in the industry

No individual seller can influence, by his/her own actions, the market price of the good

- The goods are homogeneous

The goods supplied by producers are identical

- There is freedom of entry to and exit from the industry

No barriers to entry/exit within the industry

- Each firm tries to maximise profits

The aim of each firm is to produce that quantity where MC=MR

- Perfect knowledge as to profits and prices

Consumers are fully aware of the prices being charged for the products.

Price

- Because of the first two assumption no firm, through its own actions, can determine the market price.
- The price is determined by the interaction of the total supply of the product and the total demand for the product in the industry.
- Therefore, the firms are price-takers.
- A price-taker is any firm that can't determine its own price.

Reasons why SNP is eroded in the long-run

- Due to perfect knowledge of the industries prices and profits, other firms are attracted to the industry
- The fact that there is no barriers to entry, other firms can enter the industry
- Both the above assumptions allow for SNP to be eroded in the LR as supply would not be able to increase causing a new equilibrium without these.

Why firms don't engage in advertising

- Homogenous goods

Because the goods are identical, and no differences exist, there is no point in advertising.

- Increased costs/no additional revenue

If a firm advertises it would increase its own costs and decrease its profits

- Benefits the entire industry

Advertising by a single firm would not just benefit this firm, but the entire industry.

Advantages

- Production occurs at the point of lowest costs
- Minimum prices

The firm earns only normal profit and therefore the consumer is not being exploited.

- No advertising

The cost of advertising does not have to be passed onto consumers as an extra cost.

- Efficiency is encouraged

Competition between firms will act as encouragement to increase efficiency, as only those producing at the lowest point of the AC will survive in the long run.

Disadvantages

- No scope for economies of scale

So many small firms producing small amounts means there is no opportunity for one firm to achieve economies of scale.

- Little choice for consumers

Undifferentiated products are unattractive and give little choice to consumers.

- No research and development

Lack of supernormal profits may make investments in R&D unlikely. Important in industries such as pharmaceuticals where research is essential.

- No incentive to develop new technology

With perfect knowledge there is little incentive to develop new technology as it would be shared with other firms.

Imperfect Competition

Examples- Restaurants, Hotels, Pub's

Assumptions

- There are many buyers in the industry.

An individual buyer, by his/her own actions, cannot influence the market price of the goods.

- There are many sellers in the industry.

An individual seller can influence the quantity sold by the price it charges for its output. (act independently)

- Product differentiation exists.

The goods, supplied by the producer, are not homogenous but are close substitutes.

Firms use branding to distinguish their products from one another.

- Freedom of entry and exit.

No barriers to entry exist within the industry. / It is possible for firms to enter/leave the industry as they wish.

- Reasonable knowledge.

Within the industry each firm has reasonable knowledge of profits made by other firms. / Consumers have a reasonable knowledge of the prices being charged for different products.(achievable through market research)

- Each firm attempts to maximize profits. Firms produce where MC = MR

Each firm will attempt to minimize costs of production

Types of product differentiation

- Price charged for close substitutes
- Distribution style – Mail order, E- Commerce, Point of sale
- Packaging style – colours, sizes, containers
- Promotional methods – celebrity sponsorship,
- Product/ingredient – sizes, e.g. differentiating Nike runners

Rationale in demand curve

There are many goods which are close substitutes

if a firm increases its price there will be a reduction in the demand, as some consumers will switch to the cheaper more competitive goods.

(Price increases and demand decreases)

If a firm decreases its price it will increase its sales as

consumer will switch to this cheaper product. (Price decreases and demand increases)

- This curve is an elastic demand curve in comparison to either perfect competition or monopoly. Any % change in price causes a greater % change in quantity.
- This is because there are many close substitutes.

Shift in demand curve

- A shift to the left in the Demand curve
- The demand curve is the AR curve

Movement between short run and long run equlibrium

- New firms are attracted into the industry due to:
- Perfect knowledge of SNP and freedom of entry and exit into and from the market.
- This results in the demand curve shifting to the left due to:
- loss of part of the market share for existing suppliers due to new suppliers entering the market.
- The equilibrium price falls.
- Some firms who cannot compete will leave the market and those that can remain competitive will stay.
- Average cost may also increases as the increase in supply causes an increase in the demand for the factors of production, pushing up costs. (E.G. More labour demand for a particular industry causing wages to increase, this rises a firms costs of production.

Short to long run

- Eventually a point is reached where AC=AR ie erosion of SNP.
- No SNP – a stable level has been reached as no other firms are attracted into the market.

Advantages

- Cheaper goods – competition
- Greater choice –
- Innovative/efficient
- Normal profit – LR
- Information – competitive advertising

Disadvantages

- Not at lowest possible cost
- Excess capacity – wastage of resources
- Price exceeds MC

Monopoly Competition

When there is only one firm in the entire industry

Characteristics/Assumptions

- Only one firm in the industry.
  Therefore no competition exists, they supply the entire output of the industry
- There are barriers to entry.
  These prevent firms from entering the market to create any competition and results in the firm earning supernormal profit.
- Firm aims to make maximum profits.
  This may be a disadvantage to consumers, as the firm is not concerned about service
- The firm can determine either price or quantity, but not both.
- The firm faces a downward sloping demand curve.
- Super Normal Profits exist.
  This firm is earning SNP's –because AR > AC and they can continue to earn SNP's because Barriers to entry exist
- Waste of Scarce Resources
  Because the firm is not producing at the lowest point of the AC curve it is wasting scarce resources, product differentiation occurs.

Aim of Monopoly

- Make maximum profit
- Create "barriers to entry"
- Control price, quantity sold or both

Barriers to entry

- Large capital requirement
- Regulation may prevent it. i.e. Planning permission

- Existence of economies of scale for the monopoly firm (start up firm could never compete)
- Sole ownership of a resource (control of FoP)
- Product differentiation
- Ownership of Patent/copyright
- Cartels/collusion Mergers/take-overs

Deregulation

Involves allowing more suppliers of a good/service into the market.

Advantages

- Economies of scale
- Guaranteed supply of product. In some monopolies the product or service is sold at low profit margin. E.g Iarrrod Eireann
- Secure employment
- Reduced use of scarce resources
- Less need for competitive advertisement- less wastage of supplies.
- Potential for research, development and innovation
- Profits monopolies make can be used for investment in R&D as well as to fund high cost capital innovation.

Disadvantages

- Exploitation of customers

  Supernormal profit possibly due to exploitation.
- Inefficient use of scarce resources

  This is due to a lack of competition
- The production. Of fewer goods at a higher price than perfect competition
- Less efficient/innovative

  Due to the fact that monopolies have a dominant position they may not have to compete so have no drive to improve.

Oligopoly Competition

A market where a small number of suppliers dominate the market, it has a high concentration ratio Examples; Retail Banking industry and the detergent industry, breakfast cereal.

Assumptions underlying oligopoly

- Few Sellers in the industry.
  Because of this each seller can influence the price of the commodity /or the output sold. Price setters rather price takers
- Interdependence between firms.
  Firms in oligopoly do not act independently of each other. They will each take into the account the likely reactions of their competitors. Hence prices tend to be rigid.
- Product Differentiation occurs.
  The commodities which firms sell are close substitutes. Firms will engage in advertising to persuade consumers to buy their product rather than a competitor's product.
- Barriers to entry.
  These are common in an oligopolistic market as existing firms will wish to maintain their share of the market. Examples of barriers include: high costs of setting up in the industry, brand proliferation etc.
- Collusion may occur.
  Firms within the industry may meet to control the output in the industry and/or control prices e.g.OPEC. Cartel
- Non-price competition is more common than price competition. Due to the fear of how their competitors will react firms tend not to engage in price competition but rather they engage in non-price competitive measures to gain consumers. e.g. Vouchers or free gift
- Pursuing objectives other than profit maximisation. Firms may have objectives other than maximizing their profits i.e. increasing their share of the total market, limiting profits to discourage government investigation, satisfaction with the existing level of profits (e.g. in a small family business)

Barriers to entry

Existing firms may:

- Already have the advantages of the economies of scale
- Practise limit pricing
- Control the channels of distribution practise brand proliferation.
- High set up costs
- Access to expensive technology

Forms of anti-competitiveness

Collusion occurs when entities or individuals work together to influence a market or pricing for their own advantage.

Investopedia on Collusion

- Pricing Policy / Limit Pricing

  One firm, with the tacit(unspoken) agreement of others, could reduce prices forcing unwanted entrants out of the industry.
- Production/output policy

  Firms could join together to limit output to certain agreed amounts. E.g. OPEC
- Sales Territories.

  Firms could divide up the markets between them and agree not to compete in each other's market segments.
- Refusal to supply firms

  Firms may not supply those firms who buy from suppliers not in the cartel. E.G. suppliers of timber cannot supply furniture company's not part-taking in the cartel.
- Implicit Collusion

  Each firm recognizes that behaving as if they were branches of a single firm their joint profits would be higher.

  So firms do not provoke their rivals by cutting prices. Instead they try to increase market share by engaging in

The kinked demand curve

The shape of the demand curve

If a firm increases its price other firms leave their prices unchanged - so this firm will lose many customers.

This firm faces an ELASTIC D/C - demand curve AB.

If a firm lowers its price other firms will match this price decrease - the firm will gain few additional customers.

Hence the firm faces an INELASTIC D/C - demand curve BC.

If the price leader sets price at point Z then the firm faces a distinct demand curve: ABC,

kinked at point B.

Marginal Revenue curve

- This curve can extend below zero on the price line meaning that the marginal revenue can be negative.
- This situation can occur when a firm operating in an oligopoly market tries to reduce its price this results in a very severe drop in its quantity demanded leading to a fall in total revenue and hence a negative marginal revenue.

Objectives other than profit maximisation

- To enhance the careers of the management team.
- To leave less market share for their competitors.
- To protect the firm's market in the event of a future decrease in demand.
- By increasing sales and production they may gain maximum benefit from the economies of scale and produce the product at the minimum average cost.
- To avoid government intervention due to their SNPs.