The importance of pricing strategies in market structures

Business

Running Head: THE IMPORTANCE OF PRICING STRAGETIES IN MARKET STRUCTURES THE IMPORTANCE OF PRICING STRAGETIES IN MARKET STRUCTURES Yvette Daniels American Public University Systems October 15, 2011 The importance of pricing strategies is different depending upon the type of market structure because each market structure has special components that affect the pricing schema and determination of output. Although the pricing strategies are different, it is highly important for a select market structure to choose the optimal pricing policy to insure that the firm is able to be successful and earn long-term profit.

It also important to remember that pricing policies are subject to change considering that the business environment is ever changing as well; implementation is critical for a firm to remain stable within its industry and competitive. The importance of pricing strategies influence firms within its market structure to make the necessary adjustments to pricing depending upon the demand of it consumers, most importantly. According to Bobette Kyle (n. d.), “ A higher or lower price can dramatically change both gross margins and sales volume” (para.

). If a firm sets a price that is not appealing to the consumer then it has a higher chance of losing a sale or forcing a consumer to shop around for a substitute with a cheaper price tag. Ineffective pricing strategies may generate overstock which will then cause the profit to be stored in the warehouse until some type of action is taken to move the overstock through advertising or sale promotions (Kyle, n. d.). Pricing policies are critical depending on the type of market structure to avoid the business failure.

The analysis of perfect competition, monopolistic competition, oligopoly, and monopoly market structures builds a the foundation on which pricing strategry is necessary to generate the optimal profit. Perfect competition market structures depict a market were single firms do not effect the price and consist of many buyers and sellers. Additionaly, the firms offer homogeneous products with a demand that is highly(perfectly) elastic; giving them the opportunity of free entry or exit of the industry without extensive entry barriers. A perfectly elastic demand curve is a horizontal line at the price" (Perfect Competition, n. d.

, " Demand"). "[Perfect competition] have make profit as their one and only goal" (Competition, n. d. , para. 1). Moreover, perfect competition mareket structures mean they are price takers and have no market control or the buyers and sellers have no influence on the price or quantity of a product .

Perfect competition does not truly exist rather it is used as a measurement against other market sturctures such as monopolistic competition, oligopoly, and monopoly (Competition, n. d.) . Monopolistic competition is somewhat the same as a perfect competition market structure; the only difference betweent is "[…] perfect competition is charaterized by firms producing identical standardized products, monopolistic competition is marked by product differentiation" (Samuelson & Marks, 2010, pg. 265). There are a large amount of number of small firms that charaterize this type of market structure.

Due to the inability to sell/produce identical products as the perfect competition market structure, there is a competitive arena which

demonstrates that some market control is given to firms. Moreover, the competitve arena is not based on pricing of products instead on the differiantation of it (The charateristics of a monopolistically competitive market, 2009). “ This means that an individual firm’s demand curve is downward sloping, in contrast to perfect competition, which has a perfectly elastic demand schedule” (The charateristics of a monopolistically competitive market, 2009, para. 2). Additionally, monopolistic market structures have a little more freedom of entry and exiting the industry. These types of market structures fall between those of a perfect competition and monopoly analysis.

Oligopoly is a market structure that lies between that of a perfect competition and monoopoly. These market sturctures consist of a few firms or sellers and the entry barriers are moderate to high for protection from possible entrants (Samuelson & Marks, 2010). Oligopolies may have either homogeneous or differentiated products (Samuelson & Marks, 2010). Firms are interconnected with one another within an oligopoly and etting prices will effect the other firms within the industry. The demand curve of a oliopogy is kinked and elastic to price increases (Samuelson & Marks, 2010).

A monopoly is the most common type of market structure in which firms aim to achieve ultimately within a industry. Monopoly the opposite of the perfect competition because a monoploy has a single firm that produces a superior product. Additionally, the a single firm ususally owns over 90 percent of the market (Samuelson & Marks, 2010). The products are not able to be substituted which allows a monopoly to set it prices or a price maker,

however the price must not be unbearable to the consumers. The demand curve that monopoloies have is downward sloping because of the fact that monopoloies are able to control the price and quality (Samuelson & Marks, 2010). A monopoly has strict barrieres to entry and some barriers are placed by the government that allow a monopoly to remain a leader within its market structure and industry.

Monopoloies are considered such due to the offering of one particular product/service mainly. The analysis of the various types of market structures are similar in many ways but have minor difference to tell them apart. As with pricing strategies, the same concept is present. The characteristics of a certain market structure help to determine the optimal pricing strategies. Each marketing structure have a way of dealing with pricing policies to accompany its build up whether it is a perfect competition, monopolistic competition, oligopoly, or monopoly. In a perfect competition were the firm is considered a price taker, the firm is has the ablility to sell without a limit according to the market price.

Since the demand curve is horizontal, these types of firms would be attracted to any price that inceases above the demand curve in the market (Perfect Competition, 2010). The pricing is a simple strategy for perfect competition market structures because there is not a pricing strategy because there is no influence on price, however, changing the output involves more research because sellers are more prone to sell the quantity where MC= MR (Perfect Competition, 2010). It important to remember these types of market structures have no market power to set prices. The pricing

strategy of a monopolistic competition is different from that of a perfect competition in a few ways. In a monopolistic competition prices are set by competition (Monopolistic Competition, Oligopoly, and Strategic Pricing, 2004).

It critical to understand the affect of a short run and long run and how it effects the pricing strategies. In the long run, the monopolistic competition when additional markets enter it the demand curve moves causing it sells its products at a price lower than its average cost(Monopolistic Competition, Oligopoly, and Strategic Pricing, 2004). But in the short run, the firm is able to maximize profit based upon equilibrium and produces a quantity where the MR= MC and the price is able to base a price on the difference between average revenue and cost curve (Monopolistic Competition, Oligopoly, and Strategic Pricing, 2004). The short run pricing strategy is more complex because it is based on a differentiation of products offered within the industry. Oligopoly is a market structure that is regulated through a few number of sellers; the sellers are somewhat knowledgable of one another in reference to pricing strategies (Samuelson & Marks, 2010).

Prices dependent upon whatever price the leading firm sets as the others will follow the lead. The influence price places on the demand curve is kinked which it is elastic above equilibrium and inelastic below equilibrium illustrating if a decrease in price by one firm will cause other firms to decrase its price to continue receiving a market share but if an increase in price occurs other firms will not follow instead it will lose its market share (Samuelson & Marks, 2010). There are times when firms may utilitze

particulare pricing strategies such as predatory and limiting pricing. Predatory pricing is the attempt of a firm create a low price that will force competitors out of the market and limiting pricing is when a firm sets a price lower than the average total cost while maintain a high output to avoid entrants (Oligopoly – Defining and measuring oligopoly, n. d.).

In a monopoly the firm is able to set prices. Moreover, the abesence of competitors being able to acquire a larger market share by charging lower prices is what allows a monopoly to have market power. Predatory, limit, and market penetration pricing are different strategies used by both oligopoly cartels and monopoly. Market penetration pricing is a pricing strategy of charging very low initial prices to create a bew market or grab narket share ub ab established market" (Hirschey, 2009, pg. 565).

Another pricing strategy that is used by a monopoly is called price discrimination which is consisted as a way of selling to various markets at a different price. The most well-known monopolist of the 21st century isMicrosoft. Microsoft is a computer software firm that is highly recognized by consumers world wide (Economides, 2003). Microsoft has gained the majority if not all of the market share. It sets its own prices for the products/services that offered to consumers; competition is not a problem for Microsoft because it is has strict entry barriers.

However, the government has been stepped in to help regualate the pricing strategies and monopoly power of Microsoft. " In the complaint filed against Microsoft in the U. S. District Court of the District of Columbia on May 18, 1998, the Justice Department declares unequivovacally that ' Microsoft

possesses (and for several years has possessed) monopoly power in the market for personal computer operating systems'" (McKenzie ; Shughart II, 1998, para.) . Microsoft has and continues to have monopoly power.

They have become well-established and the pricing strategies of it is of many. Microsoft has found ways and innovative ideas to make the firm a total success. In conclusion, the analysis and pricing strategies of perfect competition, monopolistic competition, oligopoly, and monopoly is what set each structure separate from one another. The structures of similar but have a few differecnces that allow certain factors to exist; instance how monopoly fails to have competition as where other structures have the possibility of having competitiors. As with pricing strategies, the market structures must be knowledge of the type of market in which it operates in to make the optimal pricing decisions.

Pricing strategies have allow market structures to generate profit or its desired outcome. Moreover, it is critical to understand that a perfect competition is a model in which other market structures are compared and pricing strategies are not necessary since there is not competition in such a market. Sources: Competition. (n. d.

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