Competitive and non-competitive markets critical thinkings examples

Business, Company

A market is a system through which the buyers and sellers of a product interact. Markets can be identified by the product it deals in. For example market for computer software, market for crude oil etc. Markets can also be distinguished by the geographical expanse like the local market or the international market for a product. In economic analysis it is more important and more usual to classify markets in terms of the degree of competition present in the market. In this mode of classification we consider two forms of market, the buyer's market and the seller's market.

In the seller's market, the degree of competition depends on the number of sellers present in the market where there are a large number of buyers. We have demarcated four distinct market forms depending on the degree of competition among the buyers, monopoly, oligopoly, monopolistic competition and perfect competition. In a buyers' market there are a number of sellers. The competition depends on the number of buyers present in the market. A market where there is only one buyer but a number of sellers is a monopsony. With a 2 to 4 buyers in a market but a large number of sellers, we have a oligopsony. In this discussion we mainly concentrate on the competitive forces and its effect in a sellers' market as these are more common forms of market that we see in the real world.

Let us begin with the market form that is devoid of any competitive forces. This is a monopoly market where there is only one seller. The monopolist being the only seller has the power to decide on the price. In economic analysis we say that the monopolist is the ' price maker'. (Pindyck & Rubinfield). The monopolist tends to keep the output low so that the price is high enough to earn super-normal profits. The monopolist operates at the

suboptimal part of the average cost curve. The monopolistic system is often criticized as being inefficient in terms of resource utilization and income distribution. The prices are higher so the consumers enjoy less consumer surplus whereas the monopolist earns high profits. A monopolist tries to build effective barriers in terms of limit pricing or patents and copy-rights to retain his monopoly power.

The oligopolistic form of market is characterized by a few large firms, usually 2 to 4, that cater to a market where there are a large number of consumers. This form of market is characterized by cut-throat competition. The firms try to capture as much of market share as they can, through various strategies. In such a market if price competition sets in, the firms try to undercut each others’ prices and moves into a loss-making situation. Usually in a oligopolistic market the firms engage in non-price competition. The firms adopt various marketing strategies like advertisements, door-to-door campaigns and such other means to enhance their market power. A greater market power gives them a greater freedom to influence the price and hence earn handsome profit. The firms may also collude to create a monopoly situation. In this market form also the prices are high and the sellers earn super-normal profit.

Just in the opposite pole of a monopoly is the perfect competition type of market. In a perfectly competitive market there are large number of sellers and a large number of buyers. The sellers offer products that are similar in nature. The buyers cannot distinguish the product of one seller form that of the other. The homogeneity in the products creates a situation where the sellers fail to influence the market price. The market price is determined by

the market demand and supply. The individual sellers and buyers are price takers. In the long-run all the sellers sell at the lowest point of the long-run average cost curve. Thus, in a perfectly competitive market situation the firms operate at the social optimal level of production. The firms earn normal profits. The buyers enjoy a lower price compared to a non-competitive market. This form of market is believed to ensure more allocative efficiency than a monopolistic or oligopolistic market.

In the real world a perfect competition is not very common. Though there are markets with large number of sellers but the products are seldom perfectly homogeneous. What is more common is a monopolistic competition. In this form of market there are a large number of sellers as well as a large number of buyers. But the products are distinguishable. The products are a part of a product group. That is, they serve the same purpose but they are differentiated. The firms tend to project their product as different from the products of the other firms. This differentiation may be in the form of packaging, or advertisement or the appearance or even the geographical locations of the outlets of the firms. The after-sales service or the physical characteristics of the products may also distinguish the product of one firm from that of the others. The firms are both price-makers and price takers. But their price-making behavior is limited as they have to adhere to some price limit that is set by the market forces. Since their product is differentiated, they can charge a higher price than their competitors and enjoy higher returns. But in the long-run all the firms tend to be price-takers and earn normal profit. But in this market form also the firms operate at the sub-optimal point leaving some amount of excess capacity in their

production units.

The discussions above point to the fact that a competitive market is more preferable to the consumers as it offers lower prices. It also ensures socially optimal level of production. The firms earn normal profit. The market ensures equality of distribution of profit and consumer surplus among the producers and consumers. In contrast, a non-competitive market like a monopoly or an oligopoly leads to inefficiency in production as the firms deliberately keeps the production low. The prices are also higher. Such market favors the producers rather than the consumers.

References

Pindyck, R. and Rubinfield, D. (2008). Microeconomics. 7th edition. New Jersey:

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