INDIAN SCHOOL AL WADI AL KABIR

FORMS OF MARKET

PART A: PERFECT COMPETITION

Qn1. Define:

1. **Market**: Market refers to a region where buyers and sellers of a commodity come in contact with each other to effect the transactions of purchase and sale of the commodity.

2. **Market structure** refers to number of firms and types of firms operating in the industry.

3. **Homogenous product:** Products sold in the market are homogeneous, i.e., they are identical in all respects like quality, colour, size, weight, design, etc.

4. **Price Taker:** A firm is said to be a price-taker if it has to accept the price, as determined by the market forces of demand and supply.

5. **Break-even point:** It is the level of output at which total cost of production (Fixed Cost + Variable Cost) per unit just equals to Total Revenue.

Qn 2. Explain the three bases on which different market are defined.

(a) Nature of commodity: If homogeneous goods are produced in a market, it is sold at a constant price. If commodity produce is of heterogeneous or differentiated in nature, it may be sold at different prices. If commodity has no close substitute, the seller can charge higher price from the buyer.

(b) Number of buyer and sellers: If there are large number of buyers and sellers, then buyers and sellers are not in a position to influence the price of the commodity. If, there is a single seller of a commodity, then the seller has control over a price.

(c) Entry and exit of a firm: If there is a free entry and exit of a firm, then the price will be stable in the long run. It is so because then the new firm enter the industry induced by large profit, then abnormal profit will be wiped out and if inefficient firms incurring losses are free to leave the industry. In short due to free entry and exit, firm earns normal profit. If there is difficult entry of a new firm (because of patent rights), then a firm can influence the price as it has no fear of competition.

Qn 3. What are the Characteristics of a perfectly competitive market? [3 Marks]
Answer:

1. Large number of buyers and sellers
2. Homogeneous product
3. Free entry and exit of firms
4. Perfect knowledge about the market
5. Perfect mobility of factors of production

6. Absence of transportation and selling cost

Qn 4. Explain the features of Perfect Competition.
(a) Large number of sellers and buyers:
(i) Large number of sellers
• The words 'large number' simply states that the number of sellers is large enough to render a single seller's share in total market supply of the product is insignificant.
• Insignificant share means that if only one individual firm reduces or raises its own supply, the prevailing market price remains unaffected.
• The prevailing market price is the one which was set through the intersection of market demand and market supply forces, for which all the sellers and all the buyers together are responsible.
• One single seller has no option but to sell what it produces at this market determined price. This position of an individual firm in the total market is referred to as price taker. This is a unique feature of a perfectly competitive market.
(ii) Large number of buyers
• The words 'large number' simply states that the number of buyers is large enough, that an individual buyer's share in total market demand is insignificant, the buyers cannot influence the market price on his own by changing his demand.
• This makes a single buyer also a price taker.
To sum up, the feature "large number" indicates ineffectiveness of a single seller or a single buyer in influencing the prevailing market price on its own, rendering him simply a price taker.
(b) Homogeneous Products:
(i) Product sold in the market are homogeneous, i.e., they are identical in all respects like quality, colour, size, weight, design, etc.
(ii) The products sold by different firms in the market are equal in the eyes of the buyers.
(iii) Since, a buyer cannot distinguish between the product of one firm and that of another, he becomes indifferent as to the firms from which he buys.
(iv) The implication of this feature is that since the buyers treat the products as identical they are not ready to pay a different price for the product of any one firm. They will pay the same price for the products of all the firms in the industry. On the other hand, any attempt by a firm to sell its product at a higher price will fail. To sum up, the "homogenous products" feature ensures a uniform price for the products of all the firms in the industry.
(c) Free entry and exit of firms:
(i) Buyers and sellers are free to enter or leave the market at any time they like. New firms induced by large profits can enter the industry whereas losses make inefficient firms to leave the industry.
(ii) The freedom of entry and exit of firms has an important implication. This ensures that no firm can earn above normal profit in the long run. Each firm earns just the normal profit, i.e., minimum necessary to carry on business.
(iii) Suppose the existing firms are earning above normal profits, i.e. positive economic profits. Attracted by the positive profits, the new firms enter the industry. The industry's output, i.e. market supply, goes up. The prices come down. New firms continue to enter and the prices continue to fall till economic profits are reduced to zero.
(iv) Now suppose the existing firms are incurring losses. The firms start leaving. The industry's output starts falling, prices going up, and all this continues till losses are wiped out.

The remaining firms in the industry then once again earn just the normal profits.
(v) Only zero economic profit in the long run is the basic outcome of a perfectly competitive market.
(d) Perfect Knowledge about the market:
(i) Perfect Knowledge means both buyers and sellers are fully informed about the market.
(ii) The firms have all the knowledge about the product market and the input markets. Buyers also have perfect knowledge about the product market.
(iii) The implication of perfect knowledge about the product market is that any attempt by any firm to charge a price higher than the prevailing uniform price will fail. The buyers will not pay because they have perfect knowledge. A uniform price prevails in the market.
(iv) Regarding the knowledge about the input markets the implicit assumption is that each firm has an equal access to the technology and the inputs used in the technology.
(ii) No firm has any cost advantage. Cost structure of each firm is the same. All the firms have a uniform cost structure.
(vi) Since there is uniform price and uniform cost in case of all firms, and since profit equals revenue less cost, all the firms earn uniform profits.
(e) Perfect mobility:
(i) There is perfect mobility in the market both for goods and factors of production.
(ii) There should be no restriction on their movement. Goods can be sold at any place.
(iii) Similarly, factors of production can freely move from one place to another or from one occupation to another.
(j) Absence of transportation and selling cost.
(i) In perfect competition, it is assumed that there is no transport cost for consumers who may buy from any firm and also there is no selling cost.
(ii) This insures existence of a single uniform price of the product.

Qn 5. Explain the implication of homogeneous product in perfect competition.
Answer:

1. Products sold in the market are homogeneous, i.e., they are identical in all respects like quality, colour, size, weight, design, etc.
2. The products sold by different firms in the market are equal in the eyes of the buyers.
3. Since, a buyer cannot distinguish between the product of one firm and that of another, he becomes indifferent as to the firms from which he buys.
4. The implication of this feature is that since the buyers treat the products as identical they are not ready to pay a different price for the product of any one firm. They will pay the same price for the products of all the firms in the industry. On the other hand, any attempt by a firm to sell its product at a higher price will fail.
   To sum up, the "homogeneous products" feature ensures a uniform price for the products of all the firms in the industry.

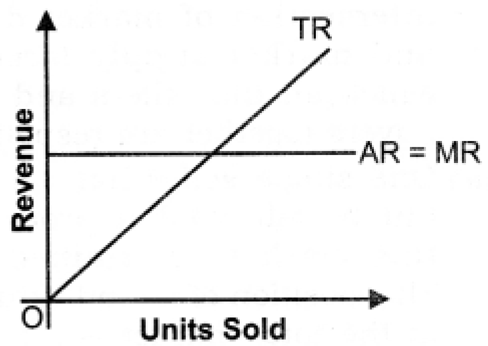
Qn 6. Explain the implication of perfect knowledge about the market.
Answer:

1. Perfect Knowledge means both buyers and sellers are fully informed about the market.

2. The firms have all the knowledge about the product market and the input markets. Buyers also have perfect knowledge about the product market.
3. Let us first take the product market. The implication of perfect knowledge about the product market is that any attempt by any firm to charge a price higher than the prevailing uniform price will fail. The buyers will not pay because they have perfect knowledge. A uniform price prevails in the market.
4. Regarding the knowledge about the input markets the implicit assumption is that each firm has an equal access to the technology and the inputs used in the technology.
5. No firm has any cost advantage. Cost structure of each firm is the same.
6. Since there is uniform price and uniform cost in case of all firms, and since profit equals revenue less cost, all the firms earn uniform profits.

Qn 7. What is the relationship between TR, AR and MR under perfect competition?
Answer:

1. In the perfect competition, a firm is a price taker.
2. It has to sell its product at the same price as given (determined) by the industry. Consequently, price = AR = MR.
3. Hence, a firm's AR and MR curve will be a horizontal straight line parallel to X axis.
4. Since price remains the same, i.e., MR is constant, therefore, TR increases at the Constant rate as increase in the output sold.
5. As the result of, TR curve facing a competitive firm is positively sloped straight line. Again, because at zero output Total Revenue is zero therefore, TR curve passes through the origin O as shown in the given figure.



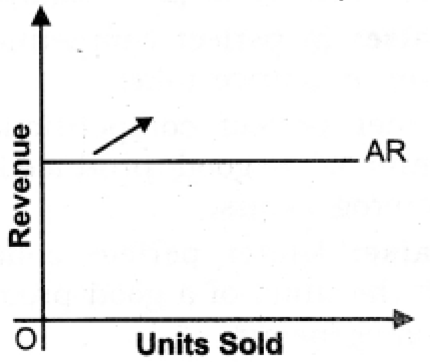
Qn 8. There are large number of sellers in a perfectly competitive market. Explain the significance of this feature. [CBSE 2015]
Answer: Large number of sellers—:

1. The words large number' simply states that the number of sellers is large enough to render a single seller's share in total market supply of the product insignificant,
2. Insignificant share means that if only one individual firm reduces or raises its own supply, the prevailing market price remains unaffected.
3. The prevailing market price is the one which was set through the intersection of market demand and market supply forces, for which all the sellers and all the buyers together are responsible.

4. One single seller has no option but to sell what it produces at this market determined price. This position of an individual firm in the total market is referred to as price taker. This is a unique feature of a perfectly competitive market.

Qn 9. Why is AR curve of a firm under perfect competition parallel to X-axis? [CBSE 2006]
Answer:

1. AR curve of a firm under perfect competition is parallel to X-axis because in perfect competition homogeneous product are produced, that is why price remains constant and as we know AR = TR/Q = PX Q/Q = Price. So, AR remains constant.
2. As, AR is on Y-axis, that is why AR curve remains constant and parallel to X-axis.



10.Why is a perfectly competitive firm a price taker?

A: In a perfectly competitive market there are a large number of producers of a product. All of them produce a homogeneous product. Therefore, all the firms have to sell at the same price. This price is determined by industry demand and supply.

PART B: OLIGOPOLY

Qn1. Define:

1. **Oligopoly**: is a market situation in which an industry has only a few firms (or few large firms producing most of its output) mutually dependent for taking decisions about price and output.
2. **Cartel**: It is defined as a group of firms that gets together to make output and price decisions.

   Note: The organization of petroleum-exporting countries (OPEC) is perhaps the best-known **example** of an international **cartel**; OPEC members meet regularly to decide how much oil each member of the **cartel** will be allowed to produce.

3. **Price rigidity:** It refers to a situation in which whether there is change in demand and supply the price tends to stay fixed.

Qn 2. Explain the term oligopoly.
(a) The term oligopoly is derived from two Greek words: ‘oligoi’ means few and ‘poleein’ means ‘to sell.’
(b) Oligopoly is a market situation in which an industry has only a few firms (or few large firms producing most of its output) mutually dependent for taking decisions about price and output.
(c) William Fellner defines oligopoly as “Competition among the few”.
(d) In India, markets for carbonated beverages, “National Newspapers” market, mobile services provider, washing products, automobiles, cement, aluminium, etc., are the examples of oligopolistic market. In all these markets there are few firms for each particular product.

Qn 3. Explain the features of oligopoly.
(a) Few Large Sellers:
(i) The number of sellers in an oligopoly market is small – when there are two or more than two, but not many sellers.
(ii) What matters is that these few sellers account for most of the industry’s sales.
(iii) These “few” sellers consciously dominate the industry and indulge in intense competition. Each firm is aware of that it possesses a large degree of monopoly power.
(iv) For example, the market for mobile service provider in India is an oligopolist structure as there are only few producers of mobile service provider. There exists severe competition among different firms and each firm tries to manipulate both prices and volume of production to outsmart each other.

(b) Interdependence of Decisions:
(i) Interdependence means that actions of one firm affects the actions of other firms.
(ii) Since the number of sellers is small, each firm has to take into consideration the possible reaction of its competitors, when making decisions.
(iii) The business decision of a single seller will have a substantial impact on the product price, output and profits of the rival firms.
(iv) For example in the “National Newspapers” market, when the “Economic Times” introduced invitation pricing policy—they offered the newspaper at a price of Rs.1.50 on weekdays. The Hindustan Times was forced to reduce its prices from Rs. 2.50 per copy to ? 1.50 per copy on weekdays. When Hindustan Times was celebrating its 75 years of service, they offered the newspaper at Rs. 1/- weekdays. The Times of India responded by matching the price cut.

(c) Non-Price Competition:

(i) Oligopoly firms try to avoid price competition for the fear of price war.
(ii) They use non-price competition methods like better services to customers, advertising, etc. to compete with each other.
(iii) Oligopoly firms are in a position to influence the prices. However, they follow the policy of price stability or price rigidity.
(iv) Price rigidity refers to a situation in which whether there is change in demand and supply the price tends to stay fixed.
(v) If a firm tries to reduce the price the rivals will also react by reducing their prices. Likewise, if it tries to raise the price, other firms will not do so. It will lead to loss of customers for the firm which intended to raise the price.
(vi) So, firms prefer non-price competition instead of price competition.

(d) Barriers to the entry of firms:
(i) The main reason why the number of firms is small is that there are barriers which prevent entry of firms into industry.
(ii) Patents, large capital, control over the crucial raw material etc., prevent new firms from entering into industry.
(iii) Only those who are able to cross these barriers are able to enter.

(e) Role of selling costs:
(i) Due to severe competition and interdependence of the firms various sales promotion techniques are used.
(ii) For example, T.V. commercials war between pepsi and coke.
(iii) It relies more on non-price competition.

(f) Oligopoly firms may produce either a homogeneous or a differentiated product.
(i) Oligopoly firms may sell homogeneous products such as steel, aluminium, LPG cylinders etc. They are called pure oligopolies, as the products of the respective firms are indistinguishable.
(ii) Firms producing differentiated products are called impure oligopolies.
(iii) In case of a pure oligopoly market situation rival firms will rely on “price” or “lowercosts” to compete in the market.
(iv) On the other hand, in case of impure oligopolies, with firms producing differentiated products, firms can use “product variations” and “promotional” strategies to compete.
(g) Group Behaviour:
(i) In an oligopoly situation, there are a few firms who control the entire market and each firm recognizes interdependence in their decision-making.
(ii) So, price-output decisions of a particular firm directly influence the competing firms.
(iii) Instead of independent price and output strategy, oligopoly firms prefer group decisions that will protect the interest of all the firms.
(iv) Group Behaviour means that firms tend to behave as if they were a single firm even though individually they retain their independence.

(h) Indeterminate demand curve facing an oligopoly firm:
(i) The most distinguishing feature of oligopoly is the "interdependence in decision making" of the rival firms.
(ii) The consequence of such interdependence is the high degree of uncertainty regarding the reaction pattern of rival oligopolists.
(iii) Interdependence and uncertainly result in "indeterminateness of the demand curve" facing an oligopolist. The firm cannot assume that his rivals will not react to its decision regarding change in its variables.
(iv) The demand curve facing an oligopoly firm keeps shifting as rival firms react to changes made by this firm. The demand curve thus loses its definiteness and determinateness.

Qn 4. Explain the various types of Oligopoly.

(a) Pure or Perfect Oligopoly:
(i) In the case of pure oligopoly, firms produce homogenous products like copper, iron, steel and aluminium.
(ii) So, decisions by consumers to purchase the goods of a particular firm are influenced by the price considerations.

(b) Imperfect or Impure or Differentiated Oligopoly:
(i) In differentiated oligopoly, firms produce differentiated products such as toilet soap, cigarettes or soft drinks.
(ii) The goods produced by different firms have their own distinguishing characteristics, but they are close substitutes of each other.

(c) Collusive Oligopoly: If the firms cooperate with each other in determining price or output or both, it is called collusive oligopoly or cooperative oligopoly.

(d) Non-collusive Oligopoly: If firms in an oligopoly market compete with each other, it is called a non-collusive or non-cooperative oligopoly.

Qn 5: Give the meaning of 'Oligopoly'. [CBSE, Sample Paper 2010]
Answer: Oligopoly is a market situation in which an industry has only a few firms (or few large firms producing most of its output) mutually dependent for taking decisions about price and output.

Qn 6. Explain the feature of few firms in an oligopoly market. [AI 2012]
Answer:

1. The number of sellers in an oligopoly market is small—when there are two or more than two, but not many sellers.
2. What matters is that these few sellers account for most of the industry's sales.
3. These "few" sellers consciously dominate the industry and indulge in intense competition. Each firm is aware of that it possesses a large degree of monopoly power.
4. For example, the market for mobile service provider in India is an oligopolist structure as there are only few producers of mobile service provider. There exists severe competition among different firms and each firm tries to manipulate both prices and volume of production to outsmart each other.

Qn 7. Question 4. List the three different ways in which oligopoly firms may behave. [3 Marks]
Answer: Oligopoly firm may—:

1. cooperate with each other and formally have a contract or written document of their policies.
2. cooperate with each other but have tacit (informal) understanding.
3. not cooperate with each other.

Qn 8. What is meant by prices being rigid? How can oligopoly behaviour lead to such an outcome? [3-4 Marks]
Answer:

1. Price rigidity refers to a situation in which whether there is change in demand and supply, the price tends to stay fixed.
2. In an oligopolistic market firms . are in a position to influence the prices.
3. However, they stick to their prices in order to avoid a price war. If a firm tries to reduce the price the rivals will also react by reducing their prices. So, it will be of no benefit.
4. Likewise, if a firm tries to raise the price other firms will not do so. As a result, the firm which intended to raise the price will lose its customers. So, oligopoly behaviour leads to price rigidity in an oligopolistic market.