

Course: Economics of Industry



Lecture 8: Market Structure

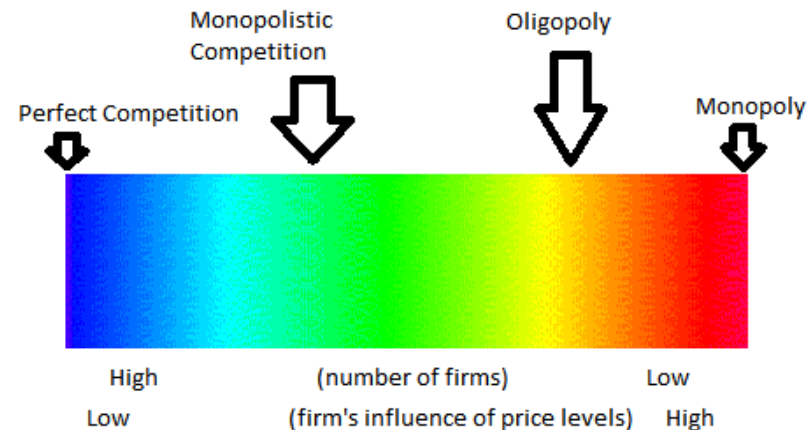
Presented by Rustam Gulyamov

Market Structures

- What is the primary aim/goal of businesses?
 - *To maximize profits*
 - *This goal can motivate companies to eliminate competition, increase prices and lower quality of products.*
- What is competition?
 - *Striving against others to reach an objective*
 - *The government attempts to maintain competition in the market to insure low prices and high quality of products*
 - *Antitrust laws are in place to stop monopoly power*

4 Types of Competition

- Perfect Competition
 - ✓ Pure Competition
- Imperfect Competition
 - ✓ Monopolistic Competition
 - ✓ Oligopoly
 - ✓ Monopoly

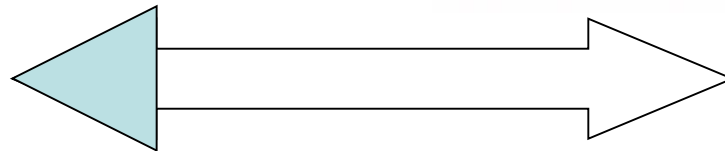
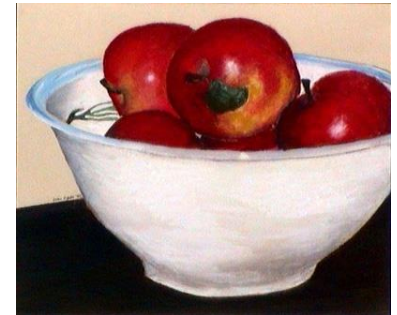


Pure/Perfect Competition

- Doesn't really exist (theoretical)
- Large number of buyers and sellers
- *Identical* product
- Well informed buyers and sellers
- *Agricultural or Produce



Closest



More Competition

Less Competition

All other forms of
competition are
imperfect competition

imperfect means the
products are slightly
different



Monopolistic Competition

- Lots of buyers and sellers who are well informed, but products are slightly different.

- **Product differentiation**
- **Wopper vs. Big Mac**



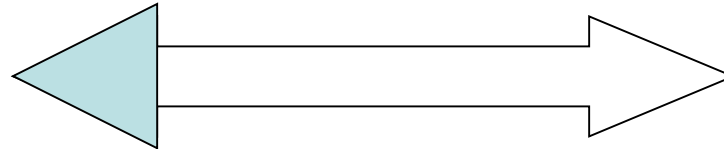
vs.



- Monopolistic competitors use non-price competition
 - Advertising, giveaways, or other promotions



Fast food industry is an example



More Competition

Less Competition

Monopolistic Competition



Gap
J.Crew



Levis



Same as pure competition except for
product differentiation

Monopolistic Competition



Are these shampoos/conditioners different?

Pantene \$14.50

Frederic

Fekkai \$54

Monopolistic Competition



Are these mascaras different?

Maybelline

\$4

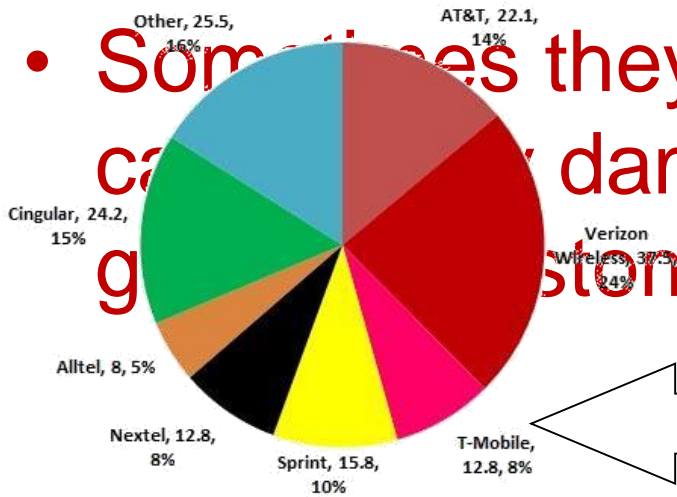
Sisley

\$43

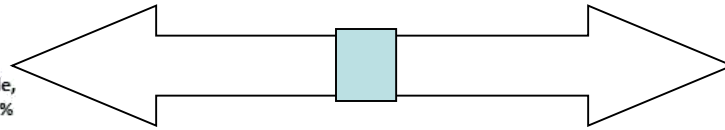
Oligopoly

- A **few** very large sellers dominate the industry
- **Collusion:** some oligopolies formally agree to set prices

- Sometimes they engage in price fixing, which can be damaging to consumers



ars, which any, but



More Competition

Less Competition

Oligopoly



Oligopoly



Boeing



Air-Bus



Oligopoly



Few producers control supply and price

Coca-Cola Classic

- Coca-Cola classic
- Sprite
- Dasani
- Barq's
- Dannon
- Nestea
- Rockstar
- Evian
- Fanta
- Fresca
- Minute Maid
- Mr. Pibb
- Powerade
- Seagrams Ginger Ale & Mixers
- TAB



Nestlé SA

- Nestlé Waters
- Perrier
- S. Pellegrino
- Nespresso
- Nescafé
- Carnation Milk



Pepsi-co

- Aquafina
- Pepsi
- Mountain Dew
- Sierra Mist
- Sobe
- Lipton Br
- MUG Root Beer
- Slice
- Gatorade
- Dole Juice
- Tropicana



Toyota



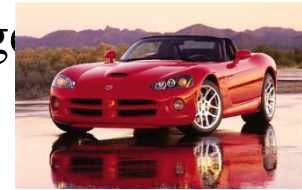
- Toyota
- Scion
- Lexus

- Chevrolet
- Buick
- Pontiac

General Motors

Chrysler

- Chrysler
- Jeep
- Dodge



- Saturn
- Hummer
- SAAB
- Cadillac



Monopoly

- Only **one** seller of a particular product
- There are very few monopolies
- Many regulations limit them, or they are illegal
- **One** seller dominates the market for a product with at least 75% control.
*defined by the Sherman Act

amazon



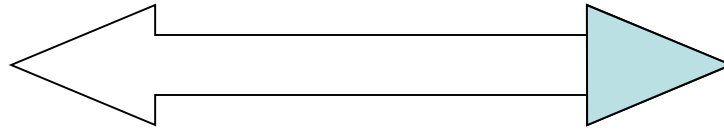
Microsoft®



MONSANTO



Walmart 



More Competition

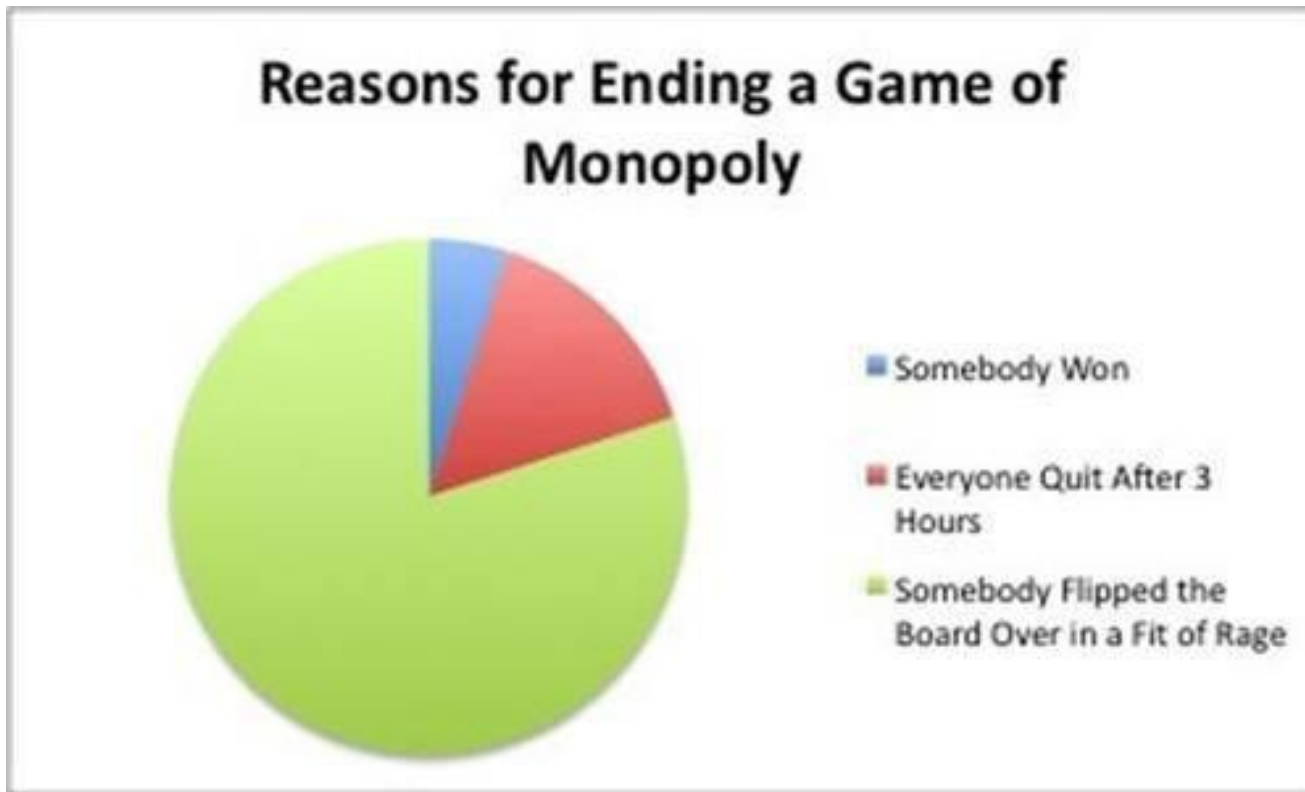
Less Competition

Some companies that have just recently lost monopoly power

Google



Types of Monopolies



- **Natural Monopoly** - exists as a result of the high startup costs for infrastructure or materials. They appear in industries that require unique raw materials, technology or equipment. The market cant handle competition in this product and it is inefficient to have failure.



Entergy



CLECO®

Government Monopoly –
a government agency is the sole provider of a particular good or service and competition is sometimes prohibited by law.



*You and I ...
We are*



Waterworks

PARISH LOGO

Technological Monopoly - occurs when one company controls manufacturing methods or has rights/patents to use it.



i-Pad



Segway



Antitrust Exemption Monopoly-
Companies that are considered sporting events or exhibitions, or are not a form of commerce, thus do not need to be limited.



wikicarinsurance.com



wikicarinsurance.com



- Geographic Monopoly –
A condition that exists in a local area or region where one company is the sole provider of a good or service in an isolated area.



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

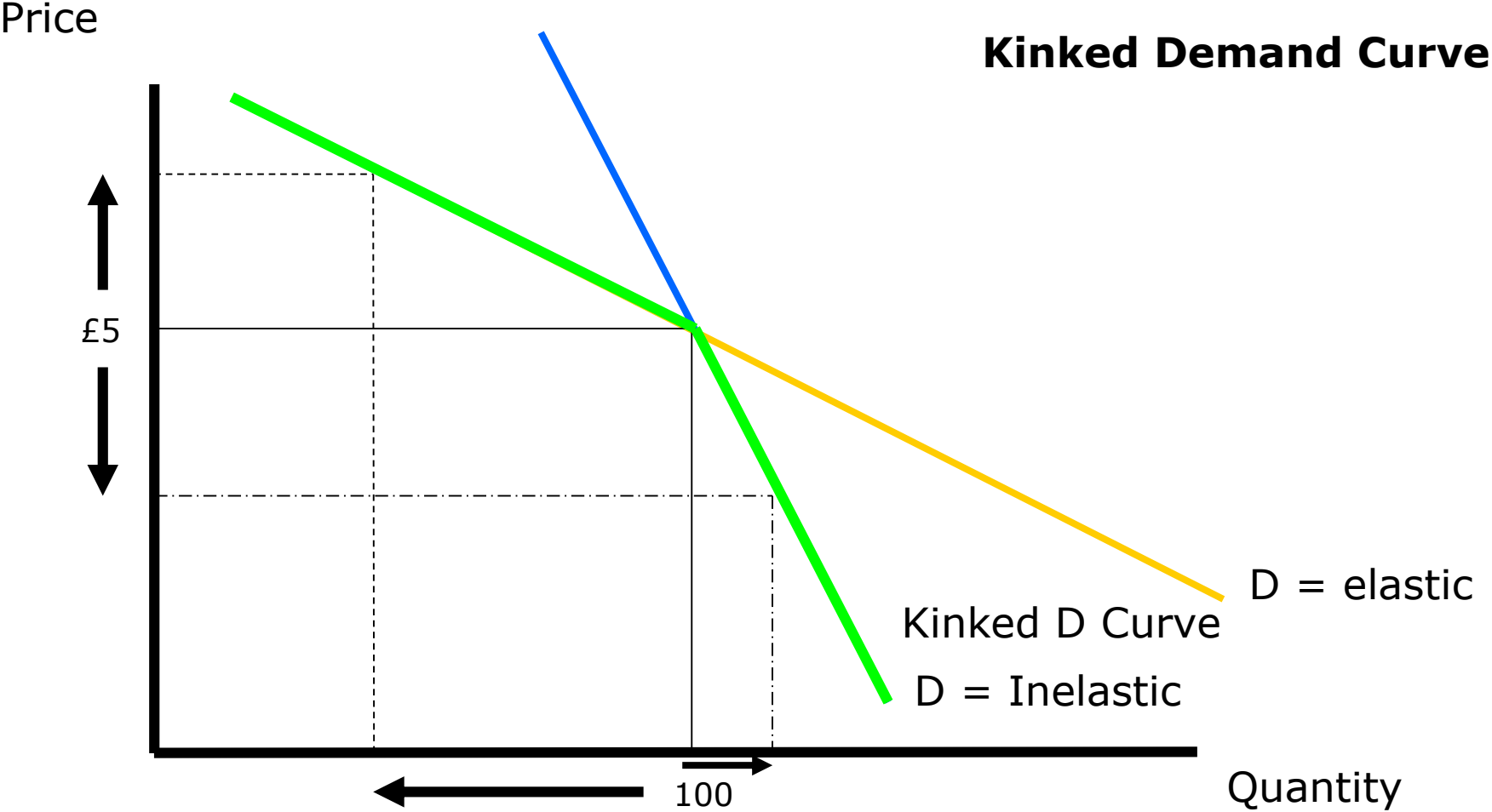
Market Structure

- **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



Reference

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The End