CHAPTER 6

NON-COMPETITIVE MARKETS

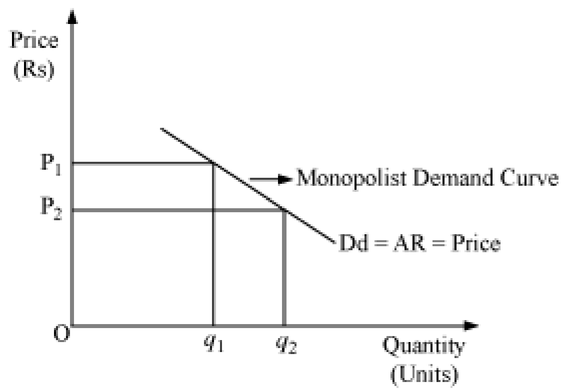
- There exist three types of non-competitive market structure

  1) Monopoly
  2) Monopolistic competition
  3) Oligopoly market

  } Imperfect competitions

- **Features of Monopoly**

  1) Single seller/firm/industry
  2) No close substitute
  3) Restricted entry of new firms
  4) Monopolist is the price marker
  5) Monopolist's perfect knowledge
  6) Downward sloping demand curve



The demand curve faced by monopolist is also the price line, i.e., AR curve.

- **Causes for Monopoly**

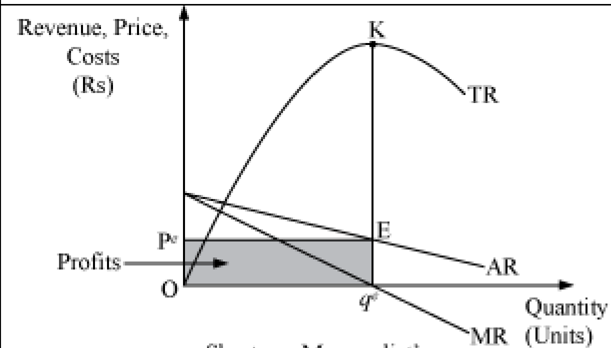
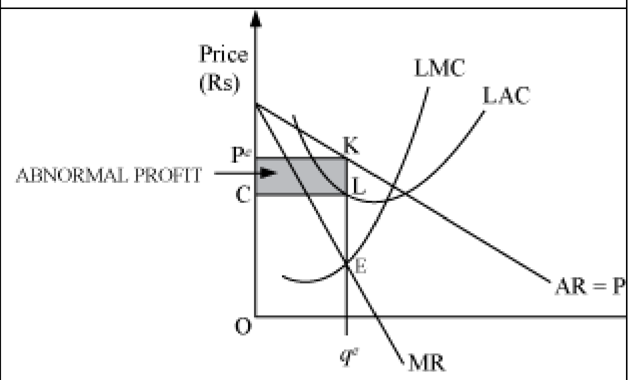
  1) Patent rights
  2) Cartels
  3) Legal barriers created by government/Licensing
  4) Endowment/Ownership of resources

- **Short-run Equilibrium under Monopoly**

  1) MR = MC at equilibrium level of output

2) MC should be upward sloping at equilibrium level of output

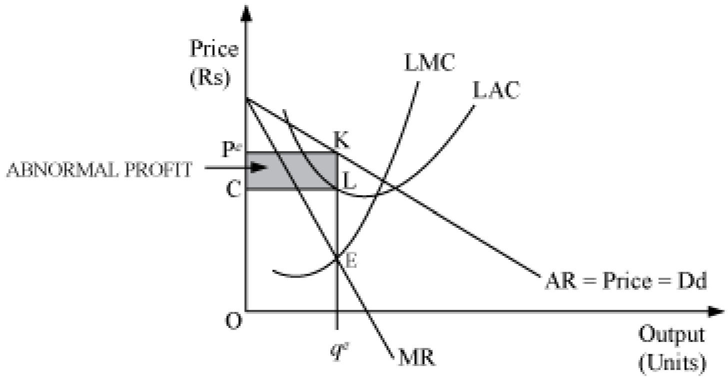
There are two cases of short run equilibrium, depending on the cost structures of monopolist.

Cases	**Revenue**	**Cost of Production**	**Profit**	**Figure**
a) When monopolist faces ***zero*** cost of production	Area of rectangle OP^eEq^e	Zero	Area of rectangle OP^eEq^e	 Short run Monopolist's Equilibrium with zero cost.
b) When monopolist faces ***positive*** cost of production	Area of rectangle OP^eEq^e	Area of rectangle Oq^eLC	Area of rectangle P^eCKL	 Long Run Equilibrium of Monopolist

❖ Long Run Equilibrium under Monopoly

A monopolist firm cannot earn loss in long run. The long run equilibrium will be at the output level where

1) LMC = LMR
2) LMC should be upward sloping at the equilibrium level of output



Long Run Equilibrium of Monopolist Firm

NOTE: *It should be worth noting that the at monopolist's equilibrium the equilibrium price would not be equal to minimum of LAC, in fact monopoly price will always be more then the long run average cost, i.e., P > LAC in long run.* ***In other words, a monopolist earns abnormal profit in long run.***

❖ **The equilibrium price greater than LAC is because of two reasons:**

1) The entry and exit in a monopolist firm is restricted.

2) If monopolist earns losses in long run then he will stop the production and exit the market.

❖ **MONOPOLISTIC COMPETITION**

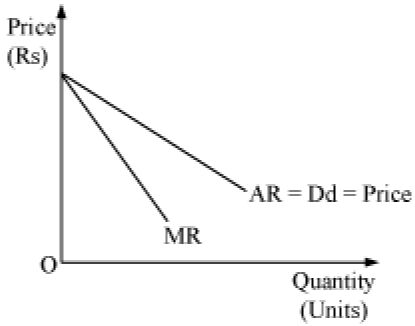
It is defined as the market structure in which there are different seller selling differentiated products but are close substitutes to each other.

❖ **Features of Monopolistic Competition**

1) Large number of buyers and sellers
2) Differentiated product
3) Heavy selling cost (advertisement costs)
4) Free entry and exit of firms
5) Imperfect knowledge
6) Firm is a **price-maker** and faces downward sloping demand curve
7) Lack of mobility of factors of production and high transportation costs

A monopolist firm is a price maker so each firm can design their own price policy and hence enjoys a monopolist (monopoly) position, as it produces the output under a specific brand name and which is different in some or other form from other products available in the market.

Hence the AR (demand curve) and MR curves faced by a monopolistic firm are downward sloping but are flatter (more elastic) than those faced by a monopolist ***because of presence of close substitutes****.*



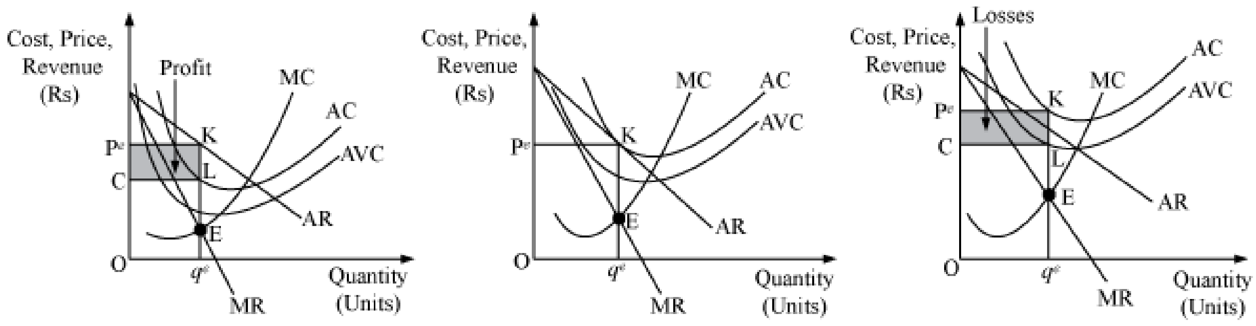
❖ Short Run Equilibrium of Monopolistic firm

The equilibrium conditions for a monopolistic firm are same as that of for the perfect competitive and the monopoly firm i.e.

1) MC = MR
2) MC should be upward sloping at equilibrium level of output.
3) Price should be greater than equal to minimum of AVC. ($P \geq$ min AVC)

Depending on the short run conditions, there are various situations:

1) Abnormal profits (when $P > AC$)
2) Normal profits (when $P = AC$)
3) Losses (when $P < AC$ but $P \geq AVC$)



(a) Abnormal Profits

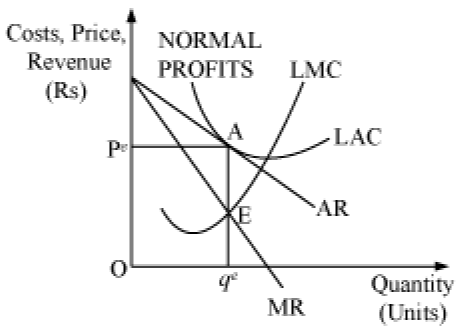
(b) Normal Profit (Zero Economic Profit)

(c) Losses

❖ Long Run Equilibrium of Monopolistic firm

In the long run, no firm under monopolistic competition earns positive profit. The profit maximising long run equilibrium of a monopolistic firm is attained where the following conditions are fulfilled:

1) MC = MR
2) MC should be upward sloping
3) Price = minimum of LAC.



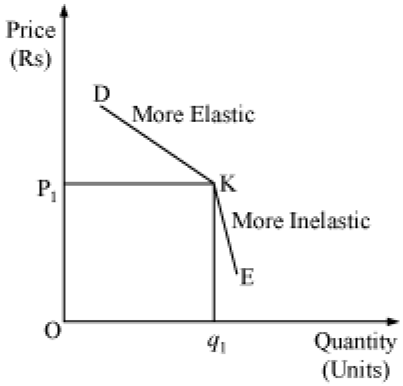
Long run equilibrium Monopolistic Firm

❖ OLIGOPOLY MARKET

1) It is that form of market in which few big firms possess major control over market by producing significant portion of market supply.
2) These firms are naturally dependent on each other in terms of price and output decisions.
3) This is the only form of market where there is high degree competition among the sellers (in fact cut-throat competition).

❖ Features of Oligopoly

1) Few large firms
2) Mutual dependence
3) Restricted entry
4) Indeterminate demand curve



5) Homogeneous product
6) Rigid prices- Prices do not move freely according to the changes in demand. This is due to the counter decisions of the rival firm. Neither of the firms is benefitted by any price change (whether price increase or price decrease) decisions.
7) Abnormal profits in long run because of restricted entry.
8) Very high selling costs, in order to attract more number of consumers.

❖ Equilibrium Output

At equilibrium, each oligopolistic firm will produce $\frac{1}{3}$ rd of the total market demand.

❖ Behaviour of Firms under Oligopoly market Structure

There are the following three ways in which an oligopoly firm might behave:

1) **Cartel** – In order to avoid undue competition the oligopolistic firms may engage in formal agreements or contracts known as cartels.
2) **Informal understanding** – Each of the firms may decide on their own about how much units of output is to be produced for maximising its individual's profit, assuming

that the other firm would not change their strategies and decision regarding the units of output to be produced.

3) **Advertisement and product differentiation** – It may happen that the firms realise that undue price competition will leave them nowhere. Consequently, they emphasise more on advertising their products that would enable them to capture minds of consumers. Therefore, this indirectly, increases their market portion.