Market Structure Types And Related Factors

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With reference to economics, a market structure may be defined as an expressive organizational word used for deliberating the characteristics of the market, as well as the economics of the market. There are four types of market structures, and they include Monopolistic competition- here, numerous producers sell goods and services which are discerned from one another. Oligopoly market- where markets are run by a small number of firms, which together control a large proportion of the market share. Monopoly market- there is one sole provider of goods and services (Mazzeo 2002). Lastly, perfect competition- this is simply a theoretical market structure that entails identical products, many buyers, many sellers, has perfectly elastic demand curve, and low barriers to entry. This paper shall, therefore, focus on only two types of market structures, oligopoly and monopolistic, in order to analyze various factors related to these two distinct market structures (Shubik, 1959).

1) Explain the Monopolistic Competition market structure and Oligopoly market structure. Using diagrams, explain short-run and long-run profits and losses in each market structure (One diagram for the Monopolistic Competition market structure and one diagram for the Oligopoly market structure) and explain all diagrams. (Hand-draw the graph, then scan it to insert in your file).

Monopolistic competition refers to a market structure that combines the elements of both competitive markets and monopolies. On the other hand, an oligopoly is a form of market structure where there are few firms that are independent and vary their prices with respect to the prices of their rivals.

Short-Run Profits In Monopolistic Market Structure

Explanation

Economic Profit

Similarly to firms in a monopolist and perfect competitive market structure, the businesses in a monopolistic market maximize profits at the point where Marginal revenue equals Marginal cost (MR=MC). At this point, the firm has no more potential for profit, this is because producing output beyond this point would not benefit since it reduces its total profit. Hence, the monopolistic firm has a similar short-run cost curve just as a monopolist or competitive firm. These curves include the Average Total Cos (ATC) curve, Marginal Cost (MC) curve, Average Fixed Cost (AFC) curve, and Average Variable Cost (AVC) curve.

Recall: ATC= TC/Q.

The Average Total Cost is the cost incurred while producing one unit of output. The price (P) is the total amount of money the producer gets for selling one unit of output.

Therefore, P– ATC = Average Loss/Profit.

In the short run, the condition for maximizing profits is MR= MC. At this point, Q1 is the profit-maximizing output. Therefore, given the output Q1 and the demand curve, the product price is P1. Also, given Q1, the corresponding Average Total Cost is A1 (Lin, 2015). In our scenario, the price of the good is greater than the Average Total Cost (P1>A1); thus, the monopolist generates revenue that is equal to (P1-A1). Consequently, the profits generated by the monopolist is the shaded region of rectangle abcd.

Monopolistic Competitive Firm In The Long Run

One of its most attractive features is that there are minimal barriers to entry or exit. This implies that if there is an opportunity to make a profit, firms can as well enter in order to make a profit (Ciliberto et al., 2016). As the number of firms increases in the market, profitability gradually reduces. So, in the long run, there are zero economic gains for each business. In our graphical demonstration, the ATC curve moves upwards as the number of firms in the market increases.

Monopolistic Competitive Market Structure (Long-Run Profits)

The profit-maximizing condition is where MR=MC. Q1 is the corresponding profit-maximizing output. Given Q1 and the demand curve, we conclude that the price of the product is P1. Given Q1, the corresponding Average Total Cost is A1 (Kokovin et al., 2017). Thus, the price of the products is greater than the Average Total Cost (P1 > A1), and the monopolist makes an average revenue that is equal to (P1 – A1). Henceforth, the total amount of profit generated by the monopolist firm is the point of tangency between the Average Cost curve and the Demand curve.

Short-Run Profits In Oligopolistic Market Structure

One distinct feature of the oligopolistic market is that there are strict barriers to entry and exit. Thus there exist only a small number of large firms within this market, which control almost the entire market share (Carranza et al., 2015). Just like other firms, oligopolistic firms maximize profit when MR-MC and that is at point P1, Q1 in our diagram.

Long-Run Profits In Oligopolistic Market Structure

Oligopolies may be able to retain the long-run abnormal profits. This is because of the higher barriers that prevent firms from entering the market to take advantage of the excess profits.

2) Identify the key factors that distinguish them (Monopolistic Competition and Oligopoly market). Discuss the key features of each market structure, such as the number of sellers, type of product, and entry conditions.

The characteristics of these two market structures are the main factor that distinguishes them. For instance, in a monopolistic market, there are;

Characteristics Of Monopolist

Product Differentiation

The goods sold in this market are not similar or homogeneous. However, these differences are not so large as to disqualify other goods as substitutes.

Many Firms

There exist many firms within the monopolistic market; hence, due to this fact, the monopolistic competitive firms have the freedom of setting their desired prices as firms without engaging in the process of strategic decision-making.

Freedom Of Entry And Exit

Just as in perfectly competitive markets, in monopolistic competition, the firms may enter or leave the market at will. In most cases, the firms enter when there is a possibility of making super-normal profits and exit when the firm is sustaining losses.

Market Power

In monopolistic competition, the firms have some degree of market authority. What is meant by market power is that the businesses in this market have some control over the terms and conditions of exchange. That is, it can either increase or reduce prices.

Characteristics Of Oligopolistic

Small Number Of Large Firms

In an oligopoly market structure, there are few firms that are extremely large in that they control a large percentage of the overall economic market. Thus, all the firms in the market have substantial control over the market.

Identical Or Differentiated Products

Oligopoly firms, in this case, may either produce homogeneous goods just like a perfectly competitive market, while other firms produce different products. The oligopoly may either be an Identical Product Monopoly or a Differentiated Product Monopoly.

Barriers To Entry

Institutions existing in the oligopolistic industry retain and attain market control through trade barriers. Some of these barriers are exclusive ownership, copyrights and patents, high starting capital, and government restrictions. This makes it impossible for any firm that wants to get into an oligopoly market (Arthur, 2018).

3) Choose two different industries from your home country (My home country: India) representing

Monopolistic Competition and Oligopoly and identify their key characteristics in relation to the factors used to differentiate between the market structures.

In India, the market research is a monopolistic business; an example of a company in this bracket is GFK in consumer durables. There exist many market research businesses in India since it is not costly to begin a market research firm in India (Comanor & Wilson, 1972). For oligopoly the airline is a perfect example of an oligopoly, and in this case, we have Air India. Airlines in India are few, with Air India being the oldest and the biggest airline operator. By being the largest, it implies that it has a large share in the economic market of India. This is one characteristic that differentiates Air India, which is an oligopoly, from GFK, which is monopolistic.

4) Compare the allocation of resources in Oligopoly and Monopolistic Competition market structures with the Perfectly Competitive market structure and provide one diagram and explain it.

In monopolistic markets, there are many sellers and buyers who produce dissimilar commodities. Thus, the product of each firm has a certain nature that distinguishes it from other businesses, and this makes the firms charge different prices. As a result, these firms do not operate at optimal maximum, by producing less than its capability. Hence the occurrence of excess capacity is an unswerving consequence of the existence of misallocation of resources in monopolistic competition (Shubik & Levitan, 1980). As compared to a perfectly competitive market in terms of resource allocation, monopolistic firms reduce their economic efficiency through inappropriate activities such as advertisements, misallocation of resources, and product differentiation.

On the other hand, in an oligopoly market structure, there are fewer firms that sell either differentiated (differentiated oligopoly) or identical products (perfect oligopoly). In most instances, an oligopoly is a price seeker, and the firms in this market structure are interdependent when it comes to decision-making. As a result, any slight change in prices by their rivals triggers a defensive and aggressive defense mechanism from other businesses in the market. In an oligopoly, there is a misallocation of resources (Bresnahan & Reiss, 1991). Oligopoly may take two forms: non-collusive or collusive oligopolies. Therefore, in the case of price leadership or non-collusive oligopoly, there is a greater probability of wastage and misallocation of resources as compared to perfectly competitive markets.

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