Imperfect Competition Market Structure Models (11/5/09)

Today: Monopoly and Review Exam II

Next Week: Imperfect Competition Models and Structure-Conduct Performance Applications

Nov 17th, 19th – Price Discovery

Exam III (Nov 24th)

Comparisons of Industry Market Structures

<table>
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<tr>
<th>Characteristics</th>
<th>Perfect Competition</th>
<th>Monopolistic Competition</th>
<th>Oligopoly</th>
<th>Monopoly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Buyers/Sellers</td>
<td>Very large #</td>
<td>Many</td>
<td>Few</td>
<td>One</td>
</tr>
<tr>
<td>Product Differentiation</td>
<td>Homogenous</td>
<td>Slightly Differentiated</td>
<td>Homogenous or Unique</td>
<td>Unique</td>
</tr>
<tr>
<td>Ease of Entry/Exit</td>
<td>Easy</td>
<td>Relatively Easy</td>
<td>Difficult</td>
<td>Blocked or Closed</td>
</tr>
<tr>
<td>Degree of Info Available to Competitors</td>
<td>Perfect</td>
<td>A Lot</td>
<td>Limited</td>
<td>None, Unless Regulated</td>
</tr>
<tr>
<td>Influence on Price (yes or no)</td>
<td>No</td>
<td>Yes, But Ltd by # of Substitutes</td>
<td>Yes, Price Maker</td>
<td>Yes, Price Maker</td>
</tr>
</tbody>
</table>

Competitive Markets Review

- Many buyers and sellers who have no influence on price – individual demand is perfectly elastic
- Easy to enter and exit the industry, everyone has complete information
- Producer’s determine quantity where: \( P = MR = MC \)
- Economic Profits can exist in the short run, firms don’t compete on price (they are price takers) or quality (homogenous goods), but attempt to lower their costs
- Production in the long-run occurs at the minimum of the LRAC --- can be earning accounting profits, but not economic profits (allows for enough return on investment to keep remaining firms in the business)
Producer Price Determination Under Monopoly Market Structure

Monopolist has control over setting quantity and price (price setter) ... (Note: \( P > MR = MC \))

Monopolist faces a downward sloping demand curve which is the market demand curve

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Monopoly

- Complete freedom in selecting price or quantity
- Monopolist faces the entire (downward sloping) demand curve
- Prices will be higher and quantity lower than those represented by competitive market conditions, assuming same costs and demand schedules
- No guarantee of profitability ... perhaps there is a reason there is only one firm
- Would a monopolist ever consider selling at a price that did not maximize profits?
  - (threat of entry or government regulation)

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Reasons for the Existence of a Monopoly

- Single seller has a patent/sole owner of technology
- The potential benefits of economies of scale for a single “large” firm versus a higher cost structure for a large number of smaller firms
- Location advantages
- Government sanctioned
- Quality advantage that no other firm/market can duplicate

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Monopoly -- Examples

- Sole Owner of Patent/Copyright/Technology/Rights - Microsoft (Windows), NCAA (college sports), Pharmaceutical Companies
- Government Sanctioned
  - Public Utilities (e.g. water and electric companies)
  - Trade Policy (restrict imports)
  - Network Solutions Inc.
- Location Monopolies
  - (e.g., corner grocery in isolated area, gas station/agribusiness in rural area, cinema/stadium/theme park concessions, airport dining/shops)
- Quality/Quantity Superiority Sometimes Lead to “Monopoly Market Power”
  - (e.g., U.S. tobacco prior to 1970s, first local tomatoes at local farmers market)

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Perfect vs Imperfect Competition Models

As with other imperfect competition models, produce where \( MR = MC \), with price being determined along the demand curve

But note that demand is more elastic ... more close substitutes, not much incentive to compete on price ... Why? Consequently they compete more on product differentiation and product promotion/better services
Monopolistic Competition – characteristics of both perfect competition and monopoly

- Many sellers dealing with slightly differentiated products (physical/perceived differences, and/or varying services)
- Extensive knowledge
- Ease of Entry/Exit
- Limited market power
- Demand curve very elastic, but a price maker
- Emphasis on non-price competition and services
- Attempt to develop customer loyalty, but must be aware of actions of close competitors
- Examples include fast food restaurants, convenience stores, clothing stores, gas stations, pizza delivery firms