Param Pujya Dr. Babasaheb Ambedkar Smarak Samiti's

DAIMSR

Dr. Ambedkar Institute of Management Studies & Research

Deeksha Bhoomi, Nagpur - 440010 (Maharashtra State) INDIA

NAAC Accredited with 'A' Grade

Tel: +91 712 6521204, 6521203 ,6501379
Email: info@daimsr.in

Programme Educational Objectives

Our program will create graduates who:

1. *Will be recognized as a creative and an enterprising team leader.*
2. *Will be a flexible, adaptable and an ethical individual.*
3. *Will have a holistic approach to problem solving in the dynamic business environment.*

Managerial Economics Course Outcomes

- CO1-Given the changes in the price of a commodity, substitute or complementary goods and services, consumers' income in addition to the changes in quantity demanded, the student manager will be able to establish the interrelationship between the independent variable and demand that would aid in decision making.
- CO2-Given a set of historical & current demand data the student manager will be able to estimate future demand for goods and services using survey and statistical techniques (such as Consumer survey, Sales force opinion, Expert opinion and Delphi technique; times series analysis and regression technique).
- CO3-Given the scale of inputs in a production scenario, the student manager will be able to comment on the output and categorize the reasons for economies and diseconomies of scale.

- CO4-Given the structural details of a market (Monopoly, Oligopoly, Monopolistic competition and Perfect competition) the student manager will be able to determine the price and output for a given market structure.

- CO5-Given the components of national income, the student managers will be able to ascertain the GDP, GNP, NDP & NNP at factor cost and market prices using the product, income and expenditure method and vice-versa.

- CO6-Given the components of monetary and fiscal policy, the student manager will be able to explain the impact of the same on the business activities.

MARKET STRUCTURES

By Amardip Kurukwar

What Are Markets?

A market is where buyers and sellers:

- ***meet to exchange goods and services.***
- ***are affected by some level of competition.***

The market may be in one specific place
<u>or</u>
It does not exist physically at all

What Are Markets?

- Markets are classified by 4 structures

1. Pure (perfect) Competition

2. Monopolistic Competition

3. Oligopoly

4. Monopoly

1. Perfect Competition

BEFORE WE BEGIN!!

This is a theoretical situation.

NO TRUE Perfectly Competitive Market exists.

The <u>5</u> conditions of ***perfect competition***

1) <u>**LARGE**</u> number of <u>**SMALL**</u> firms.

   No single buyer or seller can influence the price.

2) **Buyers and sellers deal in *<u>identical</u>* products. No product differences. *(EXAMPLES: Fruits, Vegetables, Corn)***

3) <u>**Unlimited Competition:**</u> so many firms, that suppliers lose the ability to set their own price.

4) **<u>No Barriers to Entry</u>. Sellers are free to enter the market, conduct business and free to leave the market. (Low cost to enter)**

5) **Each firm is a <u>PRICE-TAKER</u>**

The <u>5</u> conditions of ***perfect competition***

Perfect competition is the opposite of monopoly.
Here, any firm can get into the market at very little cost.

- **Suppose there was a market for spinach. Growing spinach requires little start-up cost.**
- **All you need are spinach seeds, soil, water, and some sunlight.**
- **There is no difference between one spinach and another, so the market has a similar product.**

The agricultural market is the best example of a perfectly competitive market.

Perfect Competition

- Each individual firm is ***too small*** to influence prices.
- Price becomes **fixed** to everyone in the industry.

EXAMPLE: *the price of a tones of wheat is set only by the interaction of supply and demand.*

Generally speaking, wheat is the same per tones across Nagpur.

Perfect Competition

Firms in a perfectly competitive market are <u>price takers</u>. *(they **take** the price they are given, they can't change the price)*

Since they have no control over their own prices, **they have** ***<u>NO MARKET POWER</u>*** .

[redacted]

- **In other words, no one will buy an overpriced** Spinach**. Why should they?**
- **A 40 Rs** Spinach **is the same as the 30 Rs. one, so there is no reason to spend that extra penny.**

Monopolistic Competition

The <u>5</u> conditions of ***Monopolistic Competition***

1) **<u>LARGE</u> number of large companies** ***(but fewer than perfect competition).***

   Sellers can influence the price through creating a <u>product identity</u>

2) **Products are <u>NOT exactly identical</u>, *BUT VERY SIMILAR,* s companies use *<u>PRODUCT DIFFERENTIATION</u>***

3) **<u>Heavy Competition:</u> Firms must remain aware of their competitor's actions, but they each have some ability to control their own prices.**

4) **<u>Low Barriers to Entry:</u> somewhat harder to get started because of the amount of competition.**

5) **Monopolistic competition takes its name and its structure**

Monopolistic Competitive Market

STUDY TIP:

The key idea to understanding monopolistic competition is that firms sell products that are **similar**, but not exactly alike.

EXAMPLE: Hand Soap

- **Essentially, all hand soaps are the same. Yet firms can create a brand identity that separates their hand soap from their competitor's.**
- **This brand identity can be formed through *packaging*, *product support*, and *especially advertising*.**
- **If effective, consumers will positively identify a certain brand and purchase it even if hand soap costs more.**

Conditions of Monopolistic Competition

The point is that firms in Monopolistic Competition must use Product Differentiation & Non-price Competition to sell their products.

Product Differentiation:

- **The real or imagined differences between competing products in the same industry.**
- **Differences may be real or imagined.**
- **Differentiation may be color, packaging, store location, store design, store decorations, delivery, service….. anything to make it stand out!**

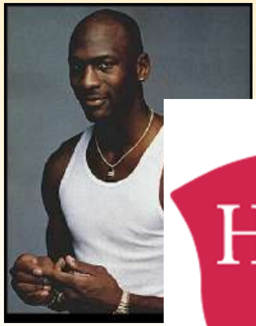
Conditions of Monopolistic Competition

The point is that firms in Monopolistic Competition must use <u>Product Differentiation</u> & <u>Non-price Competition</u> to sell their products.

<u>Non-Price Competition:</u>

- ***<u>Non-Price Competition</u>*** **involves the advertising of a product's appearance, quality, or design, *rather than its price*.**

- **Advertising to help the consumer believe that this product is different and worth more money.**



Notice these commercials never mention price.

Examples of Monopolistic Competition

- Restaurants, Builders, Solicitors, Consumer Durables

What is an Oligopoly?

A market in which a two-three large sellers control most of the production of a good or service and they work together on setting prices.

Conditions of an **Oligopoly**

1) **Very <u>few</u> Sellers that control the entire market.**
2) **Products may be differentiated or identical *(but they are usually standardized)***
3) **<u>Medium barriers to entry:</u> Difficult to Enter the market because the competitors work together to control all the resources & prices.**
4) **The actions of <u>one</u> affects <u>all</u> the producers.**
5) **<u>Collusion</u> = an agreement to act together or behave in a cooperative manner.**

What is an Oligopoly?

A market in which a two-three large sellers control most of the production of a good or service and they work together on setting prices.

Conditions of **Oligopoly**

5) **Collusion** = ***an agreement to act together or behave in a cooperative manner.***

- **Collusion Agreements:** usually **illegal**, among producers to fix prices, limit output, or divide markets. *(hard to prove that a group of companies is doing this)*
- It is also called **Price Fixing:** *setting the same prices across the industry.*

Basically, the companies are acting a one large monopoly.

Price Behavior in Oligopoly

WAR

Price Wars: **Series of price cuts that competitors must follow or lose business.**

- it is a fierce price competition between sellers, sometimes the price is lower than the cost of production.
  - ***Why is that bad???***

- Oligopolists would like to be *Independent Price* setters:
  - **a firm sets prices based on demand, cost of input and other factors** *(not based on other companies prices).*

OLIGOPOLY

Chemicals

Oils

Medicine,

Steel

Auto

2 Types of Price Behavior in an Oligopoly

Price Leader: independent pricing decisions made by a dominate firm on a regular basis that results in generally uniform industry-wide prices.

ADVANTAGE: you are the company leading the price.

Independent Pricing: policy by a competitor that ignores other producer's prices.

DISADVANTAGE: other firms shut you down by agreeing to set lower prices than yours.

Conditions of Monopoly

Exact Opposite of Pure Competition.

- A <u>**price maker**</u>. *(set their own price, without regard to supply and demand)*

- There is a <u>**single**</u> seller

- No <u>**close**</u> substitute goods are available

- <u>**High Barriers to Entry:**</u> Other sellers cannot enter the Market.

Types of Monopolies

4 Distinct Types of Monopolies:

1) Natural Monopoly: Where costs are minimized by having a single producer of the product.
   - Gas, water, electricity: government creates Natural Monopolies by Franchising some utilities.
     - Franchise - *the right to produce or do business in a certain area without competition.*
     - *Government franchises come with government regulation. Georgia PSC (Public Service Commission)*

WHY WOULD GOVERNMENT DO THIS???

Economies of Scale: As natural monopolies grow larger, this reduces its production costs *(economies of scale)*.

- Because normally companies become more efficient as the firm becomes larger.
  - **Example: It is cheaper for the Tennessee Valley Authority (TVA) to provide power in Georgia than two or three companies.**

Types of Monopolies

2) **Geographic Monopoly:** The only business in a location due to size of market.

- Decreasing in the India because of mobility.

EXAMPLE: Only person selling water in the desert.

Types of Monopolies

3) **Technological Monopoly:** Firm has discovered a new process or product.

Constitution gave government the right to grant technological monopolies.

- ***Patent:*** 17 years exclusive rights to a developed technology.
- ***Indian Rail:*** Government has given the exclusive rights

Types of Monopolies

4) <u>**Government Monopoly:**</u> Retained by the government.

- Electricity Generation and Distribution in the states, Coal production, water, etc.

3 Conditions of Efficient & Successful Markets

Markets work best when four conditions are met:

1) **Adequate competition must exist in all markets.**
2) **Buyers and sellers are reasonably well-informed about conditions and opportunities.**
3) **Resources must be free to move from one industry to another.**

Market Failure occurs when any of the 3 conditions alter significantly.

Types & Causes for Market Failure

1) Inadequate Competition: Dangers to monopolies
   - Monopolies may waste and misallocate scarce resources because there is no competition.

2) Inadequate Information: A free enterprise economy requires information.
   - *It is difficult to employ resources for the fullest benefit of society without adequate information.*

3) Resource Immobility: The efficient allocation or resources require that land, labor, capital and entrepreneurs be free to move to markets where returns are the highest

4) Externalities / Side Effects: **A side effect that benefits or harms a third party that was not directly involved in the activity.**
   - Negative Externality: ***People are harmed or inconvenienced by an economic decision.***

Perfect Competition

Perfect Competition

Perfect competition is a market structure characterized by a complete absence of rivalry among the individual firms – A. Koutsoyannis

Perfect competition is a market structure in which all firms in an industry are price takers an in which there is freedom of entry into and exit from industry - R.G. Lipsey

What is Perfect Competition?

Suppliers

- Large number of small suppliers
- entry or exit of a firm makes Negligible effect on the market supply

Customers

- Large number of small consumers
- Entry or exit of a consumer makes negligible effect on the market demand

Products will be homogeneous, products supplied by all the supplier should be identical in color, size, taste and type.

What is Perfect Competition?

- Perfect Market Knowledge
  - Customers are aware about the price and products that will be supplied by the supplier at this price
  - Suppliers are aware about the price and products that will be demanded by the customers at this price
  - This knowledge guarantees uniformity in price across the market
- Customers going to the market with free mind, there is no pre conception about the suppliers in the mind of customers
- Any supplier can enter or exit from the market at any time
- There is unique price for identical products,

Price decision under Perfect Competition

- Thought of Demand
- Thought of Supply
- Thought of Demand and Supply together
- Equilibrium Price
- Equilibrium Output
- Market price or short period price
- Normal price or long period price

Market price vs Normal price

- Market price is resulting from the equilibrium condition between demand and supply in the short period. While normal price is resulting from the equilibrium condition between demand and supply in the long period.
- Compared to long period price, in case of short period, there will be change of price on number of times. Normal price is stable.
- Market price always exist, but normal may not exist. As, market price is a price that is determined at a particular moment of time. And on the other side, Normal price is the average price calculated from a set of short period prices of the same product.

Market price vs Normal price

- Considering a very long period, there will be many changes in the market price of a product and comparatively there will be less number of changes in the normal price of a product.
- Since in the short period quantity of output cannot be varied, cost of product has no influence on the market price. Market price may be above or below the marginal cost and average cost of production depending upon the demand conditions.
- But in the long run, normal price must be equal to both the marginal cost and the minimum log run average cost.

Price determination

- In a perfectly competitive market, the main problem for a profit maximizing firm is not to determine the price of its product but to adjust its output to the market price so that profit is maximum.
- The mode of price determination – price level and its variation – depends on the time taken by the supply position to adjust itself to the changing demand conditions. Therefore, price determination under perfect competition is analyzed under three different time periods as follows:
  - Market period or very short run
  - Short run
  - Long run

Monopolistic Competition

Monopolistic Competition

- The model of monopolistic competition describes a common market structure in which firms have many competitors, but each one sells a slightly different product.
- Monopolistic competition as a market structure was first identified in the 1930s by American economist Edward Chamberlin, and English economist Joan Robinson.
- Many small businesses operate under conditions of monopolistic competition, including independently owned and operated high-street stores and restaurants. In the case of restaurants, each one offers something different and possesses an element of uniqueness, but all are essentially competing for the same customers.

Characteristics of Monopolistic Competition

- Each firm makes independent decisions about price and output, based on its product, its market, and its costs of production.
- Knowledge is widely spread between participants, but it is unlikely to be perfect. For example, diners can review all the menus available from restaurants in a town, before they make their choice. Once inside the restaurant, they can view the menu again, before ordering. However, they cannot fully appreciate the restaurant or the meal until after they have dined.
- The entrepreneur has a more significant role than in firms that are perfectly competitive because of the increased risks associated with decision making.
- There is freedom to enter or leave the market, as there are no major barriers to entry or exit.

Differentiation

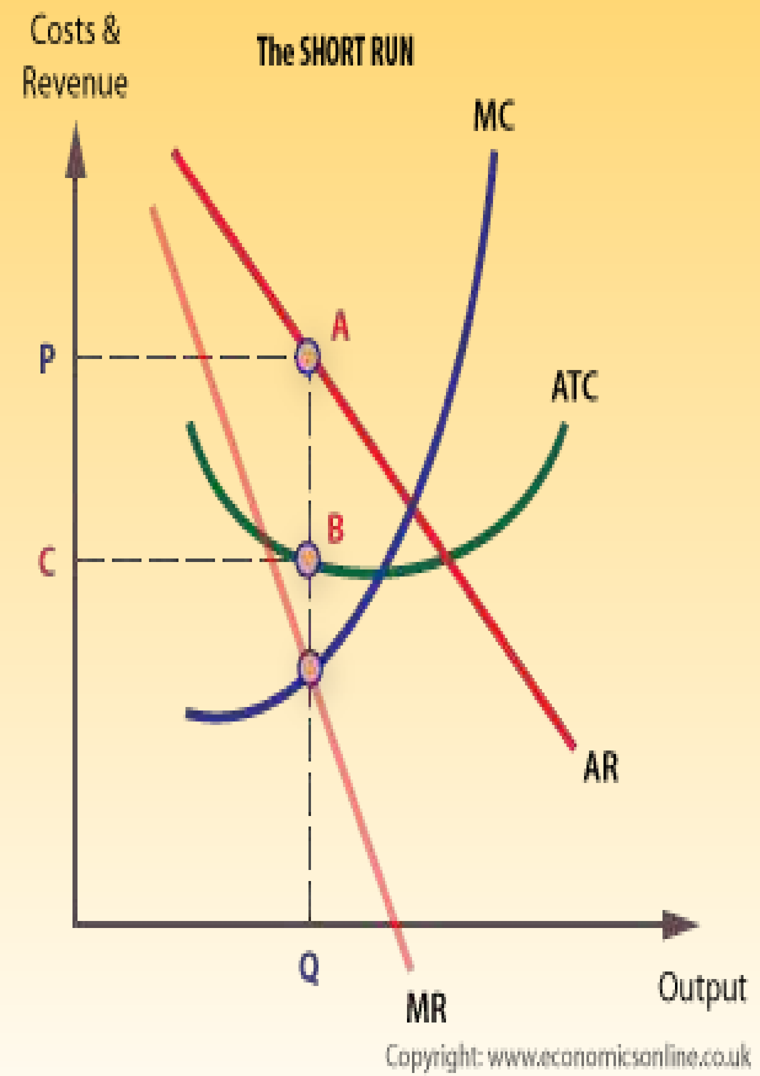
- A central feature of monopolistic competition is that products are differentiated. There are four main types of differentiation:
- *Physical product differentiation*, where firms use size, design, colour, shape, performance, and features to make their products different. For example, consumer electronics can easily be physically differentiated.
- *Marketing differentiation*, where firms try to differentiate their product by distinctive packaging and other promotional techniques. For example, breakfast products can easily be differentiated through packaging.
- *Human capital differentiation*, where the firm creates differences through the skill of its employees, the level of training received, distinctive uniforms, and so on.
- *Differentiation through distribution*, including distribution via mail order or through internet shopping, such as Amazon.com, which differentiates itself from traditional bookstores by selling online.

Characteristics of Monopolistic Competition

- Firms are *price makers* and are faced with a downward sloping demand curve. Because each firm makes a unique product, it can charge a higher or lower price than its rivals.
- Firms operating under monopolistic competition usually have to engage in advertising. Firms are often in fierce competition with other (local) firms offering a similar product or service, and may need to advertise on a local basis, to let customers know their differences. Common methods of advertising for these firms are through local press and radio, local cinema, posters, leaflets and special promotions.
- There are usually a large numbers of independent firms competing in the market.

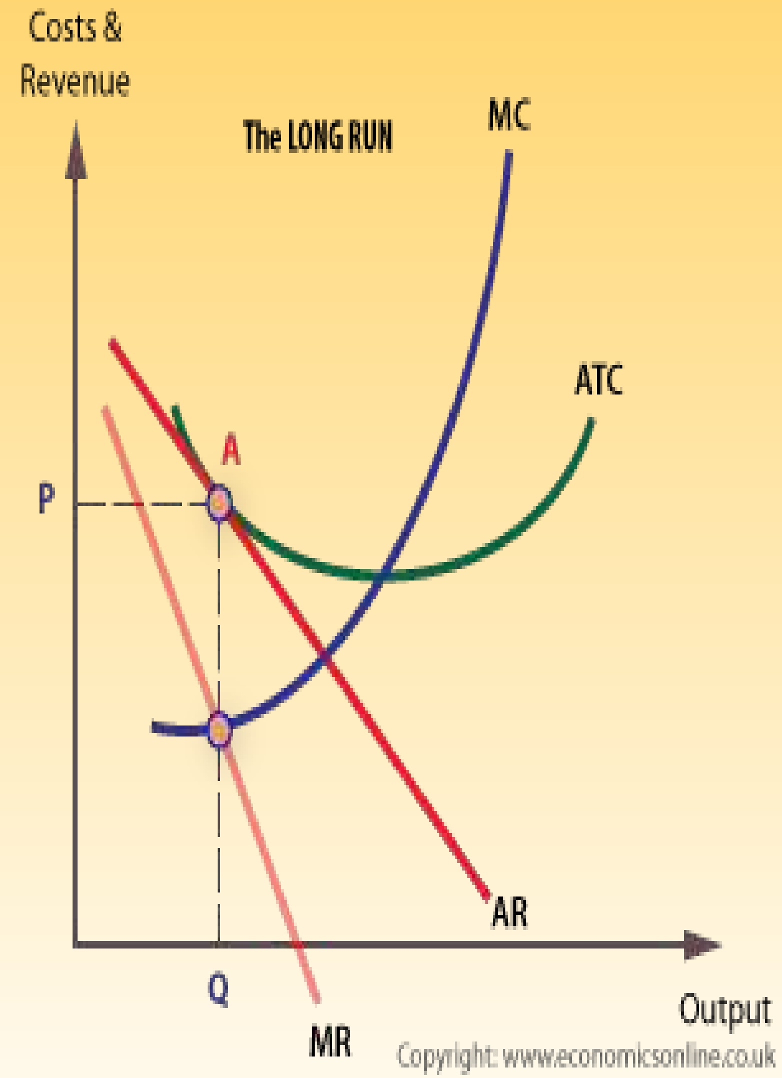
<u>Equilibrium under monopolistic competition in the Short Run</u>

- In the short run supernormal profits are possible.
- At profit maximization, MC = MR, and output is Q and price P. Given that price (AR) is above ATC at Q, supernormal profits are possible (area PABC).
- Some firms may earn only normal profit if there costs are higher than those of others. For the same reasons, some firms may make even losses in the short run.

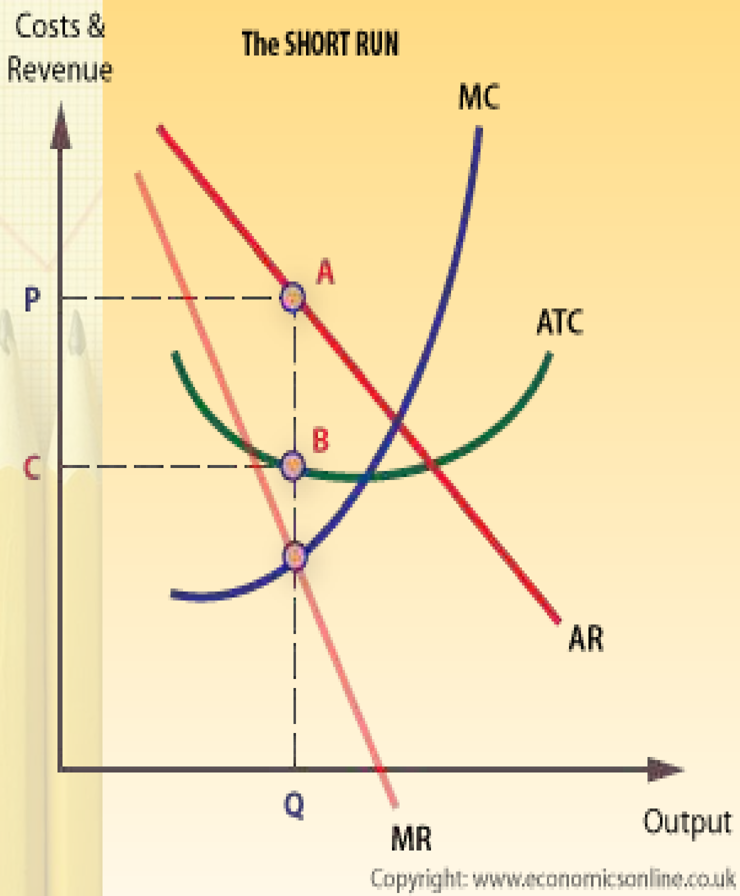


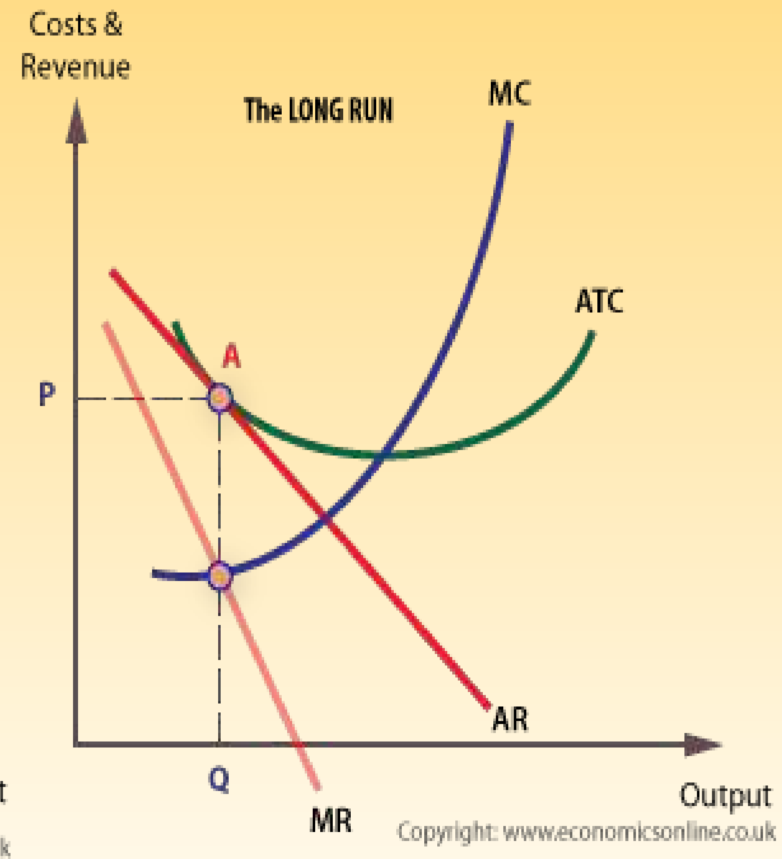
Equilibrium under monopolistic competition in the Long Run

- Super-normal profits in the short run earned by some firms attracts the new entrants in the long run into the industry.
- This is because of low barriers to entry, good knowledge and an opportunity to differentiate.
- This situation shifts the demand curve for existing firm to the left. New entrants continue until only normal profit is available. At this point, firms have reached their long run equilibrium.



Equilibrium under Monopolistic Competition





Examples of monopolistic competition

- Examples of monopolistic competition can be found in every high street. Monopolistically competitive firms are most common in industries where differentiation is possible, such as:
- The restaurant business
- Hotels and pubs
- Retailing
- Consumer services, such as hairdressing

Advantages of Monopolistic Competition

- There are no significant barriers to entry; therefore markets are relatively contestable.
- Differentiation creates diversity, choice and utility. For example, a typical high street (e.g. at futala lake) in any town will have a number of different restaurants from which to choose.
- Firms operating under Monopolistic Competition may be dynamically efficient, innovative. For example, retailers often constantly have to develop new ways to attract and retain local customers.

Disadvantages of Monopolistic Competition

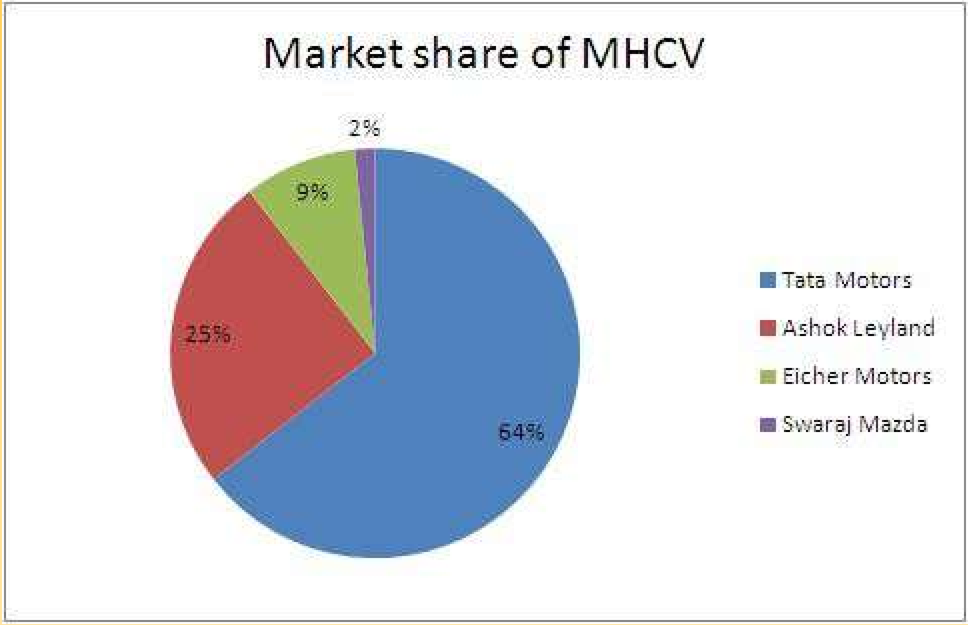
- Some differentiation does not create utility but generates unnecessary waste.
- More cost incurred by firms on excess of packaging. Thus it unnecessary increases the price of the product.
- Advertising may also be considered wasteful, though most is informative rather than persuasive.

Oligopoly

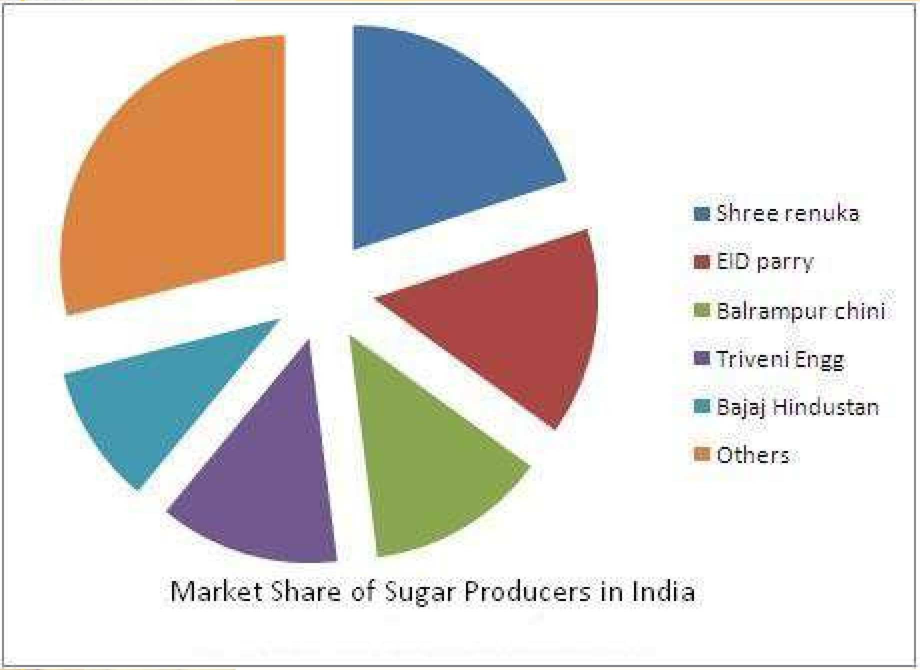
Oligopoly

- Oligopoly is defined as a market structure in which there are few sellers selling homogenous or differentiated products.
- 75% of the market share is captured by less than 10 firms
- Where oligopoly firms sell homogeneous product, it is called pure or homogeneous oligopoly.
- E.g. industries producing cement, steel, petrol, cooking gas, chemicals, aluminum and sugar
- Where firms of an oligopoly sell differentiated products, it is called differentiated or heterogeneous oligopoly.
- E.g. industries manufacturing Automobiles, soft drinks

Oligopoly



Market share of MHCV
2%
9%
25%
64%
Tata Motors
Ashok Leyland
Eicher Motors
Swaraj Mazda



Shree renuka
EID parry
Balrampur chini
Triveni Engg
Bajaj Hindustan
Others
Market Share of Sugar Producers in India

Key characteristics

- Interdependence: Firms that are interdependent cannot act independently of each other. A firm operating in a market with just a few competitors must take the potential reaction of its closest rivals into account when making its own decisions.
- Strategy: Strategy is extremely important to firms that are interdependent. Because firms cannot act independently, they must anticipate the likely response of a rival to any given change in their price, or their non-price activity
- Barriers to entry: Oligopolies and monopolies frequently maintain their position of dominance in a market might because it is too costly or difficult for potential rivals to enter the market
- Natural Barriers are Economies of large scale production, High set-up costs, High R&D costs. Artificial barriers include predatory pricing, strong brand, advertising, loyalty.
- Sticky prices: in order to avoid adverse reaction by rivals, there is tendency by the firms to avoid change in price, hence stability in prices.

Oligopolies

- Collusive oligopolies
- Another key feature of oligopolistic markets is that firms may attempt to collude, rather than compete. If colluding, participants act like a monopoly and can enjoy the benefits of higher profits over the long term.
- Competitive oligopolies
- When competing, oligopolists prefer non-price competition in order to avoid price wars. A price reduction may achieve strategic benefits, such as gaining market share, or deterring entry, but the danger is that rivals will simply reduce their prices in response.
- This leads to little or no gain, but can lead to falling revenues and profits. Hence, a far more beneficial strategy may be to undertake non-price competition.

Non Price Competition

- Oligopolies tend to compete on terms other than price.
- Loyalty schemes
- Advertisement
- Product differentiation

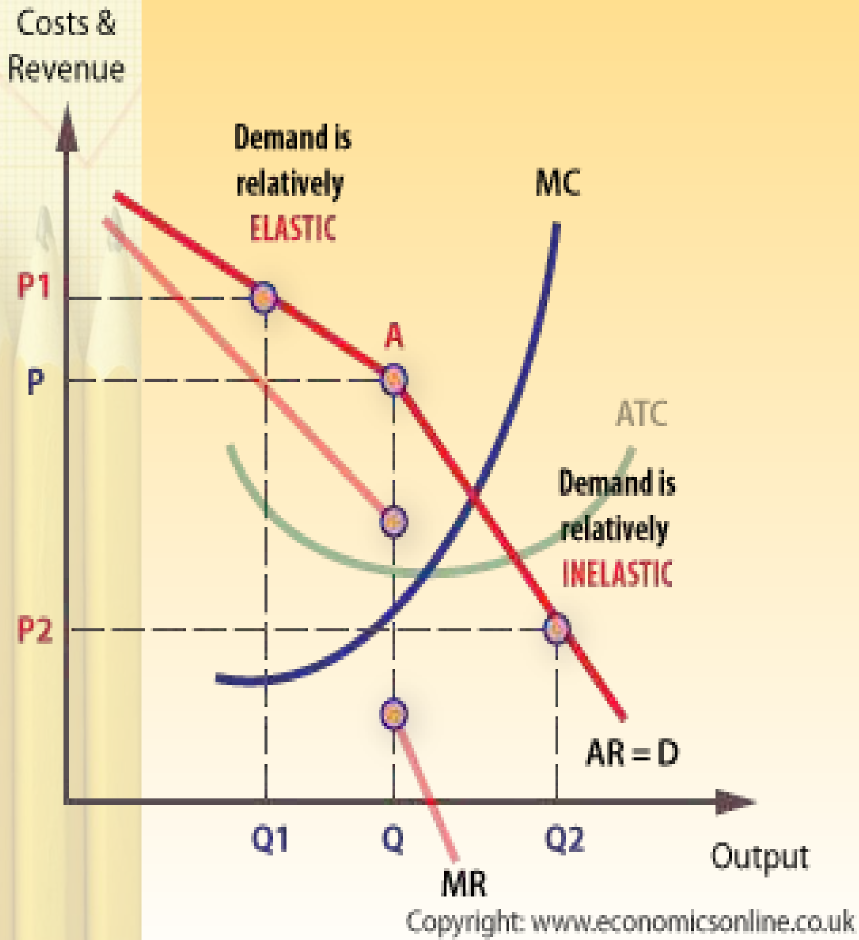
Cartels

- There is a tendency for cartels to form because co-operation is likely to be highly rewarding.
- Co-operation reduces the uncertainty associated with the *mutual interdependence* of rivals in an oligopolistic market.
- While cartels are ‘unlawful’ in most countries, they may still operate, with members concealing their unlawful behavior.
- Cartels are designed to protect the interests of members, and the interests of consumers may suffer because of:
- Higher prices
- Lower output
- Restricted choice

Price leadership in Oligopoly

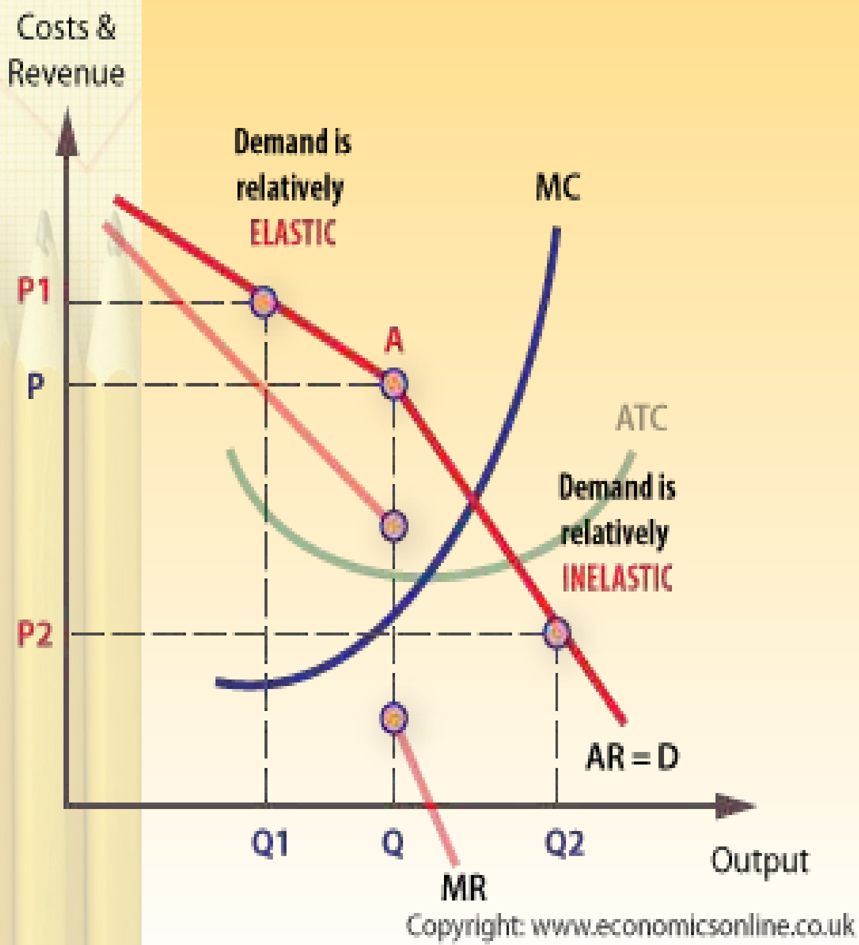
- The price-leadership model of oligopoly assumes that there is one dominant firm in the industry that sets the price and then all the other firms in the industry behave like perfectly competitive price-taking firms.
- As the name implies, the price leadership model consists of a leader and a bunch of followers. Once all the other small firms have chosen their desired quantity, the price leader will produce to meet the remaining demand at that price.
- This model implies that the dominant firm is better off with larger amounts of the market share and less competition. As a result, the price leader may choose prices to minimize the participation of smaller firms. This pricing strategy is called predatory pricing.

Price Output determination Sweezy model of kinked demand curve



- If a oligopolistic firm increase the price, then it’s rival firms will not follow the same and they will enjoy the market share of this firm as the consumers will shift from this price maker firm to the rival firms to purchase product. So, there will be greater impact of price change on the demand of the firm. So, it will be relatively elastic in nature.
- A relatively more elastic segment for price increases
-

Price Output determination Sweezy model of kinked demand curve



- It assumes that if a competitor lowers the price of the products it's rivals will follow the same i.e. they will cut down the prices of their products. So, there will not be much impact of price decrease on the price makers demand. So, it will be relatively inelastic in nature.
- A relatively inelastic segment for price decreases.

The advantages of oligopolies

- Oligopolies may adopt a highly competitive strategy, in which case they can generate similar benefits to more competitive market structures, such as lower prices.
- Oligopolists may be dynamically efficient in terms of innovation and new product and process development. The super-normal profits they generate may be used to innovate, in which case the consumer may gain.
- Price stability may bring advantages to consumers and the macro-economy because it helps consumers plan ahead and stabilizes their expenditure, which may help stabilize the trade cycle.

The disadvantages of Oligopolies

- Oligopolies can be criticized on a number of obvious grounds, including:
- High concentration reduces consumer choice.
- Cartel-like behavior reduces competition and can lead to higher prices and reduced output.
- Firms can be prevented from entering a market because of deliberate (intentional or purposeful) barriers to entry.
- There is a potential loss of economic welfare.

Monopoly

Conditions of Monopoly

- Exact Opposite of Pure Competition.
- A price maker. (set their own price, without regard to supply and demand)

- There is a single seller
- No close substitute goods are available
- High Barriers to Entry: Other sellers cannot enter the Market.

Types of Monopolies

Four Distinct Types of Monopolies:

- Natural Monopoly: Where costs are minimized by having a single producer of the product.
- Gas, water, electricity: government creates Natural Monopolies by Franchising some utilities.

Types of Monopolies

Geographic Monopoly: The only business in a location due to size of market.

– Decreasing in the India because of mobility.

EXAMPLE: Only person selling water in the desert.

Types of Monopolies

Technological Monopoly: Firm has discovered a new process or product.

- Constitution gave government the right to grant technological monopolies.
  - Patent: 17 years exclusive rights to a developed technology.
  - Indian Rail: Government has given the exclusive rights

Types of Monopolies

Government Monopoly: Retained by the government.

- Electricity Generation and Distribution in the states, Coal production, water, etc.

Types of monopolies

Natural monopoly (crude oil, Gulf)

Social or welfare monopoly (water supply, defense, Government)

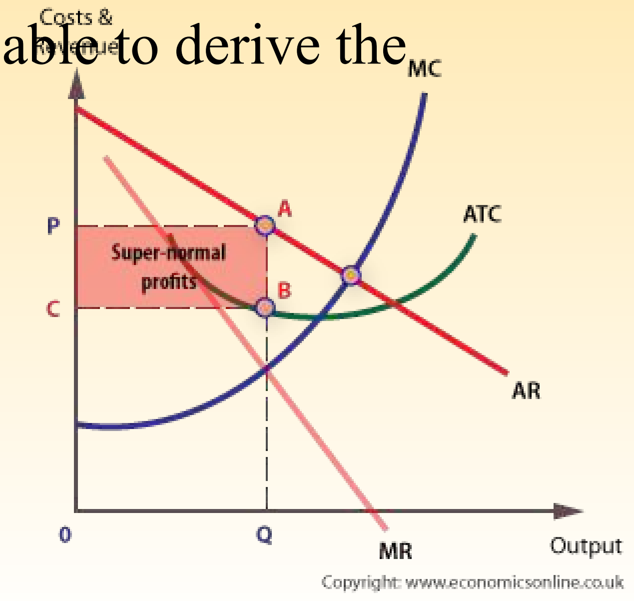
Fiscal monopoly (printing currency, RBI)

Price and Output determination

- The aim of monopolist is to secure maximum profit
- He tries to sell the product at a price which yields maximum profit
- So, he can either fix supply or price but can not both
- If he fixes price, quantity to supplied is determined by demand
- If he fixes supply, price is determined by demand
- So, the question is where he should stop producing?
- He should produce till Marginal revenue = Marginal Cost

Price and Output determination

- Monopolies can maintain super-normal profits in the long run. As with all firms, profits are maximized when MC = MR. In general, the level of profit depends upon the degree of competition in the market, which for a pure monopoly is zero. At profit maximisation, MC = MR, and output is Q and price P. Given that price (AR) is above ATC at Q, supernormal profits are possible (area PABC).
- With no close substitutes, the monopolist can derive super-normal profits, area PABC.
- A monopolist with no substitutes would be able to derive the greatest monopoly power.



Price discrimination

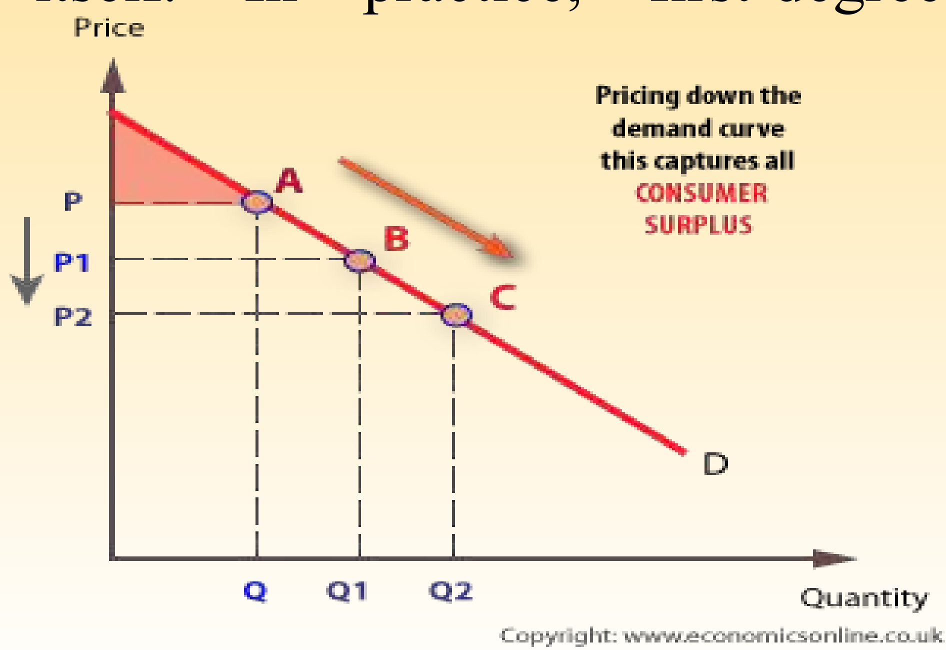
- Price discrimination is the practice of charging a different price for the same good or service.
- There are three of types of price discrimination –
  - first-degree,
  - second-degree, and
  - third-degree price discrimination.

Necessary conditions for successful discrimination

- Price discrimination can only occur if certain conditions are met.
- The firm must be able to identify different market segments, such as domestic users and industrial users.
- Different segments must have different price elasticities (PEDs).
- Markets must be kept separate, either by time, physical distance and nature of use, such as Microsoft Office 'Schools' edition which is only available to educational institutions, at a lower price.
- There must be no leakage between the two markets, which means that a consumer cannot purchase at the low price in the elastic sub-market, and then re-sell to other consumers in the inelastic sub-market, at a higher price.

First degree

- *First-degree* discrimination, alternatively known as *perfect* price discrimination, occurs when a firm charges a different price for every unit consumed.
- Price charged according to the marginal utility of each unit.
- The firm is able to charge the maximum possible price for each unit which enables the firm to *capture* all available consumer surplus for itself. In practice, first-degree discrimination is rare.



Second degree

- *Second-degree* price discrimination means charging a different price for different quantities, such as quantity discounts for bulk purchases.
- It refers to discrimination with declining rate schedules and lower prices per unit as larger quantities are bought like that at super markets. And talking about electric supply higher charges for rising consumption of electricity.

Third degree

- *Third-degree* price discrimination means charging a different price to different consumer groups.
- For example, rail and tube travellers can be subdivided into commuter and casual travellers, and cinema goers can be subdivide into adults and children.
- Third-degree discrimination is the commonest type.

Advantages of Monopoly

- They can benefit from economies of scale, and may be ‘natural’ monopolies, so it may be argued that it is best for them to remain monopolies to avoid the wasteful duplication of infrastructure that would happen if new firms were encouraged to build their own infrastructure.
- Domestic monopolies can become dominant in their own territory and then penetrate overseas markets, earning a country valuable export revenues. This is certainly the case with Microsoft.
- The firms earns supernormal profit
- Supernormal profit is invested to increase the infrastructure and R&D facilities

Disadvantages of Monopoly

- Monopolies can be criticized because of their potential negative effects on the consumer, including:
  - Restricting output on the market.
  - Charging a higher price than in a more competitive market.
  - Reducing consumer surplus and economic welfare.
  - Restricting choice for consumers.
  - Reducing consumer independence.

Remedies
(how to protect consumer)

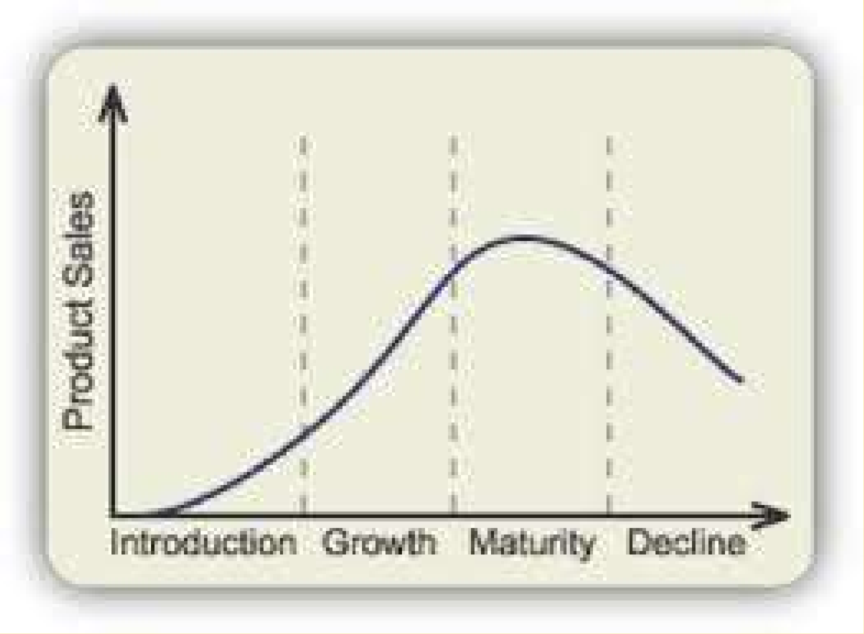
- It is widely believed that the costs to society arising from the existence of monopolies and monopoly power are greater than the benefits and that monopolies should be regulated.
- Monopoly power can be controlled, or reduced by price controls .
- An alternative to price-cap regulation is *rate-of-return* regulation.

Pricing Strategies

Pricing strategies under various market structure

- While forming the pricing strategy, two things have to be considered:
- Firstly, the market structure that we are talking about, i.e. Perfect Competition or Imperfect Competition (i.e. Monopoly, Monopolistic and oligopoly)
- Secondly, the life cycle of the product in that market structure. Pricing also have to be according to the stage of PLC that the product is in.

PLC



- The **product life cycle** is an important concept in marketing. It describes the stages a product goes through from when it was first thought of until it finally is removed from the market. Not all products reach this final stage. Some continue to grow and others rise and fall.
- The main stages of the product life cycle are:
- **Introduction** – researching, developing and then launching the product
- **Growth** – when sales are increasing at their fastest rate
- **Maturity** – sales are near their highest, but the rate of growth is slowing down, e.g. new competitors in market or saturation
- **Decline** – final stage of the cycle, when sales begin to fall

Penetration pricing

- You often see the tagline "special introductory offer" – the classic sign of penetration pricing.
- Penetration pricing is generally applicable in case of the products, where close substitutes are available.
- Penetration pricing is the pricing technique of setting a relatively low initial entry price, usually lower than the intended established price, to attract new customers.
- The strategy aims to encourage customers to **switch** to the new product because of the lower price.
- The aim of penetration pricing is usually to increase market share of a product, providing the opportunity to increase price once this objective has been achieved.

Skimming

- Skimming is adopted where a new product is launched. And there are no close substitutes available. So, the cross elasticity of demand is usually very low.
- During introduction of the product, demand is relatively inelastic in nature because of consumers desire for distinctiveness by the consumption of new product.
- The initial high price would generally be accompanied by heavy sales promoting expenditure.
- The seller chooses to start by setting a high price to earn more profit, as this is a unique and very differentiated product in the market
- Over the time to meet the varying price elasticities of demand, he will reduce the price
- Best example is that of consumer durable markets

Value-based pricing

- In maturity stage of product life cycle, the producer resort to value based pricing. The term is used when prices are based on the value of a product as perceived from the customer's perspective.
- The perceived value determines the customer's willingness to pay and thus the maximum price a company can charge for its product.
- An essential component of value-based pricing is the necessity to determine the value for the customer.
- The manufacture adds value by refining the product and the service conditions.
- If business consultants determine their rates as a percentage of costs saved for their clients due to their work, they apply value-based pricing. In this case they calculate their rates depending on the benefits they generate for their clients.

Pricing in relation to established products

- Pricing below the ongoing price
  - When the firm expect to face tough competition in the market
  - In case if a firms product has earned brand loyalty, then this method is harmful
- Pricing at par with the prevailing market price
  - This is very common price strategy in oligopolistic market
  - This strategy is adopted by a seller who is not price maker but a price taker or price follower
- Pricing above the existing market price
  - This strategy is adopted when sellers intends to achieve prestigious position among the sellers of his locality
  - The demand for the commodity must have a low cross elasticity in respect of competing goods.

Cost plus pricing

- Cost plus pricing is also known as mark up pricing, average cost pricing and full cost pricing.
- The cost plus pricing is the most common method of pricing used by the manufacturing firms.
- The general practice under this method is to add a fair percentage of profit margin to the average variable cost.
- P = AVC + AVC (m), where AVC (m) = AFC + NPM
- The level of profit can be normal or supernormal depending upon the market structure
- For the same, firm should have a plan or budget of level of output during one accounting year

Transfer pricing

- Large size firms often divide their production into different product divisions or their subsidiaries
- The goods and services produced by subsidiary is used by the parent organization
- E.g. TATA Steel produced steel is used for manufacturing of vehicles at TATA Motors.
- Pricing of such transfer of product from subsidiary to parent organization is called transfer pricing.
- Parent organization is now having option to use all the goods and services for manufacturing final products and if some goods remaining then it can be sold in the market.
- Most of the times, no cash transaction takes place, just the debit and credit entries will takes place.

Marginal Cost pricing

- While arriving at the price, the firm uses only those cost that are directly attributable to production
- The logic used here is pricing should not be based on all past expenditure (fixed cost) the firm has incurred.
- It should be based on things like current demand, current revenue and current expenditure.
- Some of the firm use this pricing after recovering the suitable amount of fixed cost for the year. And thus, after cost plus pricing to a certain level of output, for rest of the output marginal cost pricing will be used.

Prestige pricing

- Prestige pricing is followed in markets and segments of markets where price is associated with quality and more with prestige – customer perception in this market is, higher the price better is the quality and more is the prestige.
- Branded Jewellery and luxury automobiles are some of the examples

Auction pricing

- Auction pricing takes place most in the case of Government old Asset Selling, selling of antique works and sale of assets by banks after seizing of loan defaulters asset.
- A base price will be announced and after that the prospective number of purchaser will be asked to quote their prices.
- At last the goods will be compulsorily sold at the higher most price.

Competitive bidding of price

- A kind of pricing in which a firm is required to quote its price under uncertain cost and price conditions with a view to winning a contract or a tender.
- Number of tenders received will be evaluated on the basis of capabilities and experience along with strong financial background. And thereafter lowest price will be observed.
- It is done to supply goods and services over a specified period of time.
- This is known as competitive bidding or contract pricing.
- Quoting contract price is very common in the construction of road, railways, airports, building etc. and supply of labor and raw materials to private and public firms, and supply of mid day meal to school children.

Peak load pricing

- There are certain non storable goods e.g. electricity, telephones, transport and security services.
- These are demanded in varying measures during the day as well as night. Other category is in varying measures during different seasons.
- During summers, electricity will be much used in the form of running air conditioners, coolers, fans etc. so, this summer season will be peak load season. So, in such case charges of electricity will be more in some parts of the country. Industrial consumers are also charged similarly.
- During nights, there are less number of telephonic or mobile conversation, so its off peak time and companies will be having different pricing for this as compared to peak load time during day. It will be off peak pricing.