Center For Professional Studies

CA - Foundation CA - Intermediate CA - Final

CA-FOUNDATION

CRASH COURSE MATERIAL

Business Economics

Chapter 4 – Meaning & types of Market

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Unit 1- Meaning and types of Market

Market
It is an arrangement or situation where buyers & sellers contact (either Direct or Indirect contact) to exchange goods and services for a value
Market need not be a physical place always

Features of Market
1. Two groups (Buyers & sellers)
2. Contact (Direct or In-direct)
3. Product
4. Value/Consideration
5. Willingness and ability to B&S

In this unit we are interested to understand Market based on competition

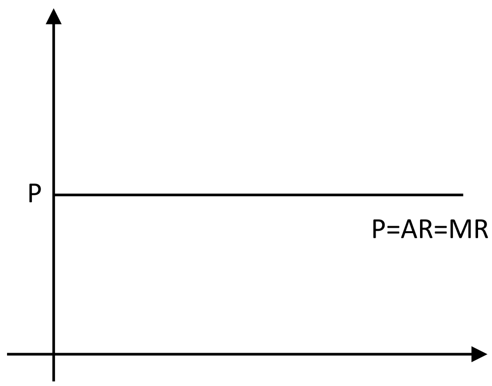
Market
- Perfect Competition
  - Pure Competition
- Im-perfect Competition
  - Monopoly
  - Oligopoly

Monopolistic Competition

PERFECT COMPETITION
The most idealistic market, which is free from all kinds of defects & perfect.
It is Myth / Un-realistic.

<u>Features of Perfect-Competition market</u>
1. Existence of large number of buyers & sellers
2. Manufacturer is only a price taker, not a price maker
   i.e. market forces/ Price mechanism (D&S) will determine the selling price
3. Uniform pricing throughout the market. (TD=TS)
4. Homogenous/ Identical goods & services are produced by all the manufacturers
   (Perfect Substitutes)

Output	Price	TR	AR	MR
2	5	10	5	
4	5	20	5	
6	5	30	5	
8	5	40	5	
10	5	50	5	



TR= P x Q MR= $TR_n - TR_{n-1}$
AR= TR/Q

5. Free entry & free exit from firms into Industry.
6. Buyers & Sellers have complete knowledge about the market
7. No transportation cost
8. Perfect mobility of FOP

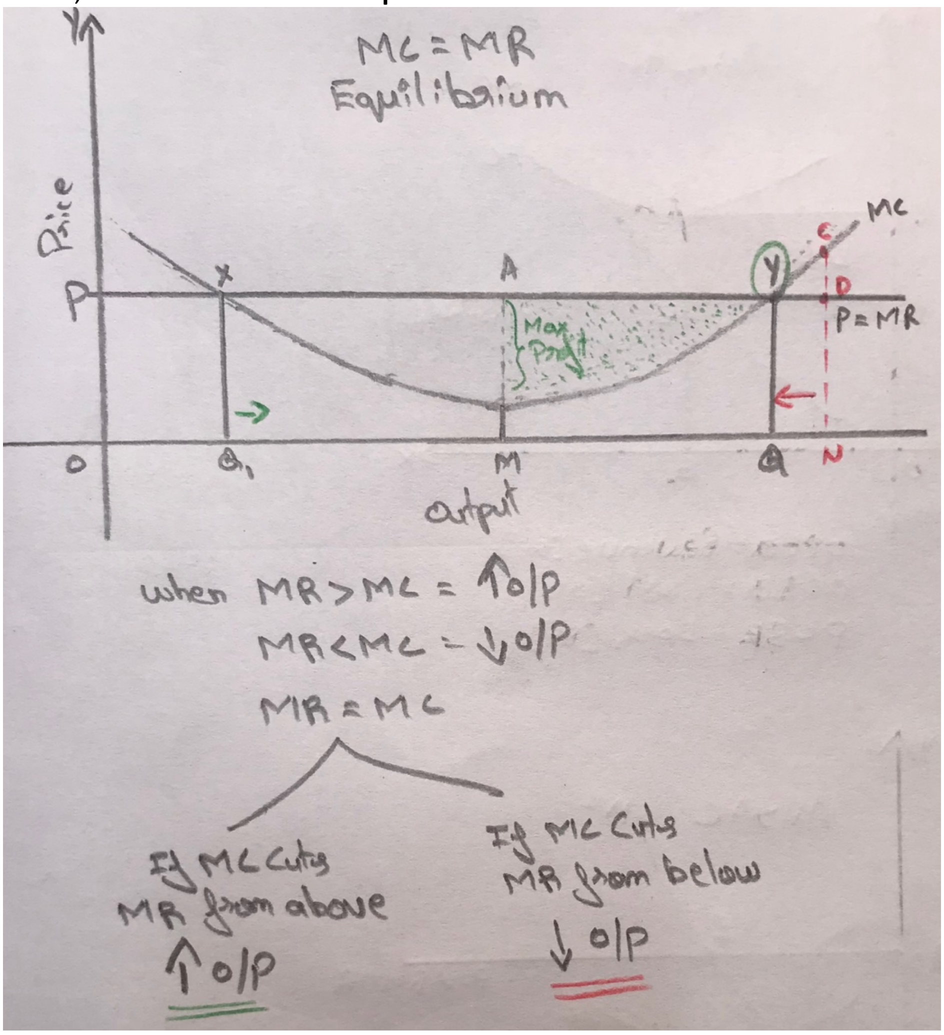
Note: If first 4 points are satisfied it is called as PURE Competition, If all 8 points are satisfied it is called as Perfect competition.

Price & Output determination under perfect competition market.

Relationship between MC & MR (Equilibrium)

MR & MC are the two important things on which a manufacturer decides whether to produce or not.

When, MC=MR it is known as **Equilibrium & MC should cut MR from below.**



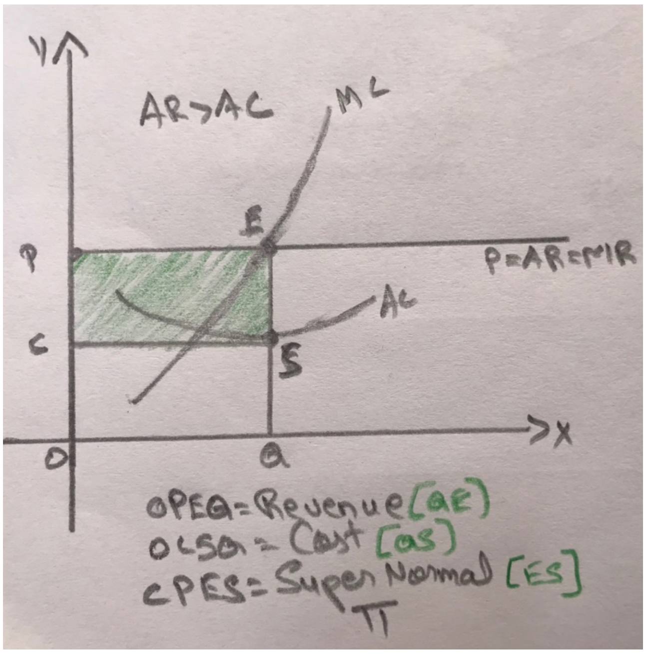
In perfect competition market there will be larger number of buyers, hence no seller will opt to produce only till OQ_1 level of output when Selling price remains same, <u>So OQ level will be Equilibrium.</u>

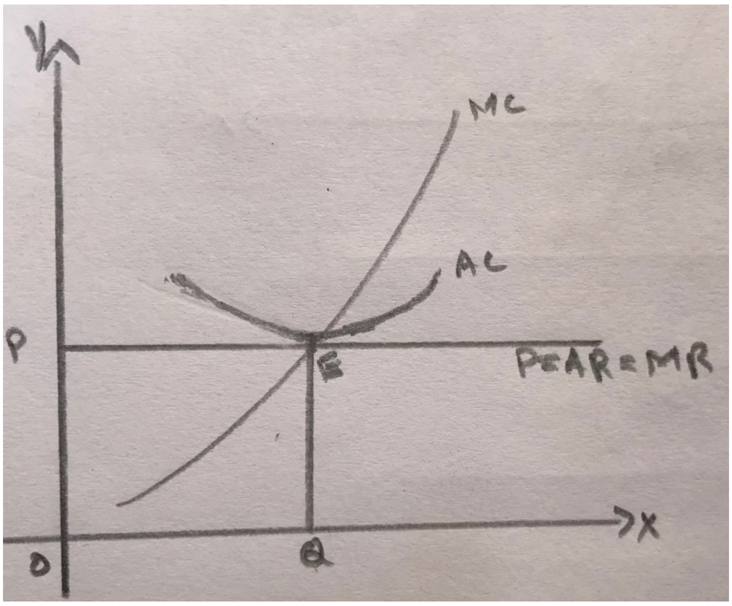
If producer continues to produce beyond OQ_1 level of output, Income/revenue remains same but cost/expenses starts decreasing.
Hence any producer will get an opportunity to earn more profit.

Price determination in SHORTRUN

A firm will undergo with three possibility.

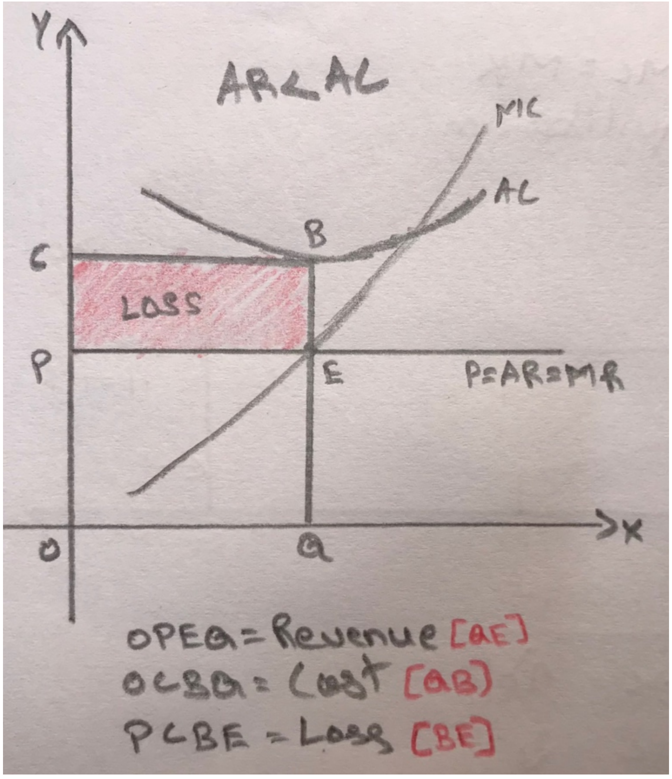
1. Super normal profit , when AR > AC
2. Normal profit , when AR = AC
3. Loss, when AR < AC





Hence Short run equilibrium of Perfect competition market will be

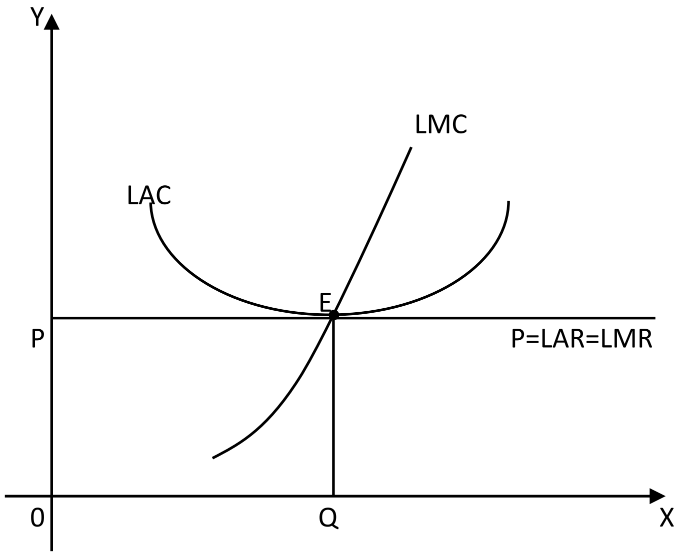
P=AR=MR=AC=MC



Price determination in LONGRUN

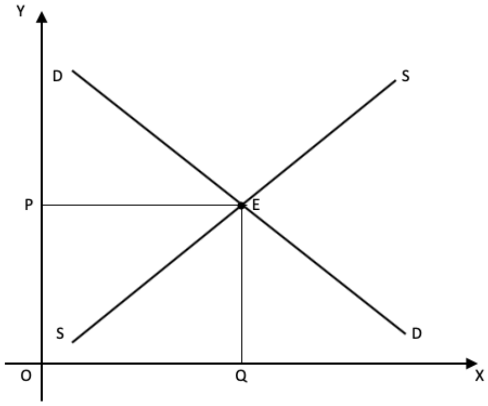
A firm will undergo only with NORMAL PROFIT.
Even tough a feature says Free entry & exit of firms into industry, manufacturer will not try to earn super normal profit even though they have scope to attain it, because of they does so it attracts computation.

In perfect competition market there is no existence of competition because price of a commodity is determined through price mechanism.



Hence Long run equilibrium of Perfect competition market will be
P=LAR=LMR=LAC=LMC

What if the entire Industry should be in equilibrium ?
When, Total Demand = Total Supply it is considered as Industry equilibrium



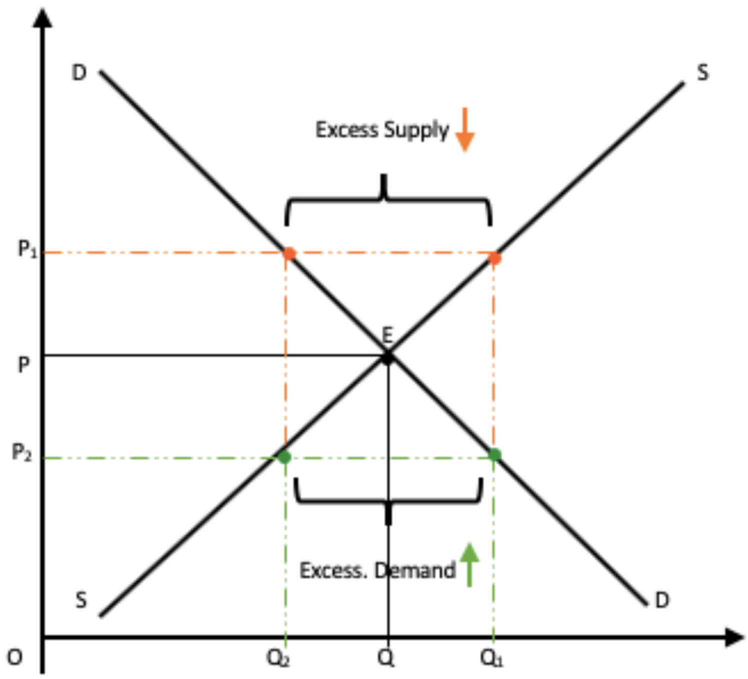
Market Equilibrium
When Total Demand = Total Supply

Unit 2- Determination of Price

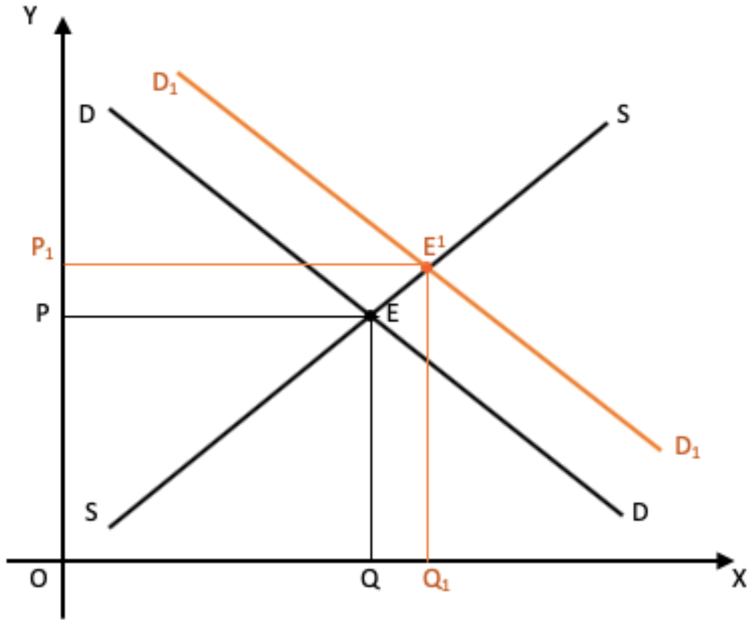
Due to Demand & Supply price of the commodity can be determined
When Price increases, Demand Decreases
When price decreases, Demand increases

When Price increases, Supply increases
When Price decreases, supply decreases

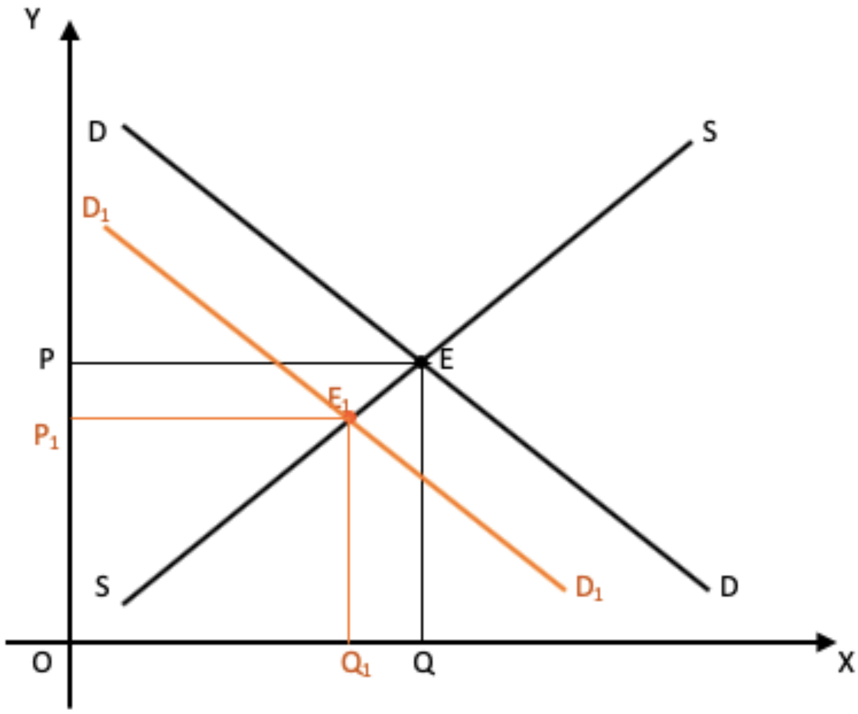
Price	Demand	Supply	Effect of Price
2	5	1	⇧
4	4	2	⇧
6	3	3	⟺
8	2	4	⇩
10	1	5	⇩



CHANGE IN DEMAND, When Supply is constant

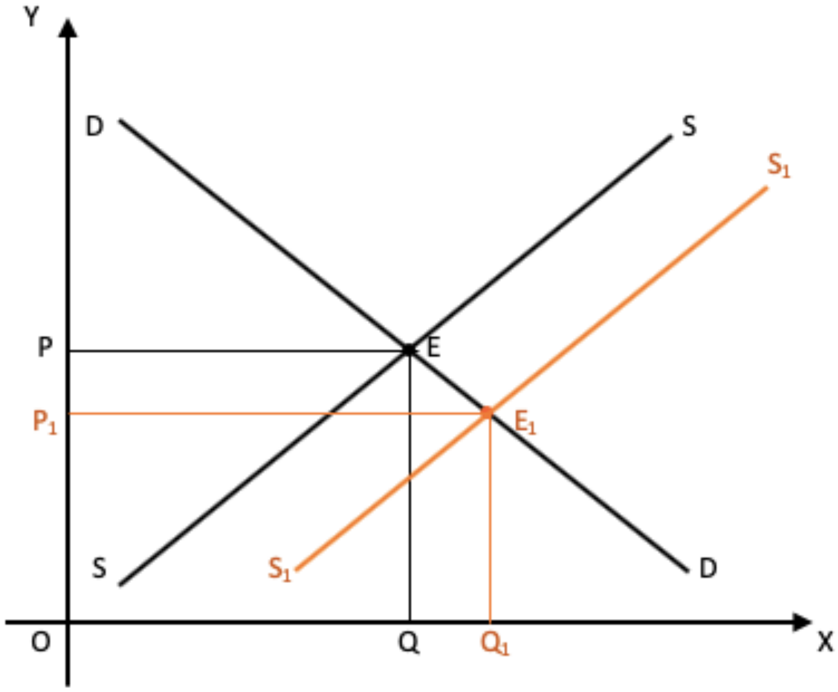


When SUPPLY remains constant & Demand Increases,
Price ↑ Quantity ↑

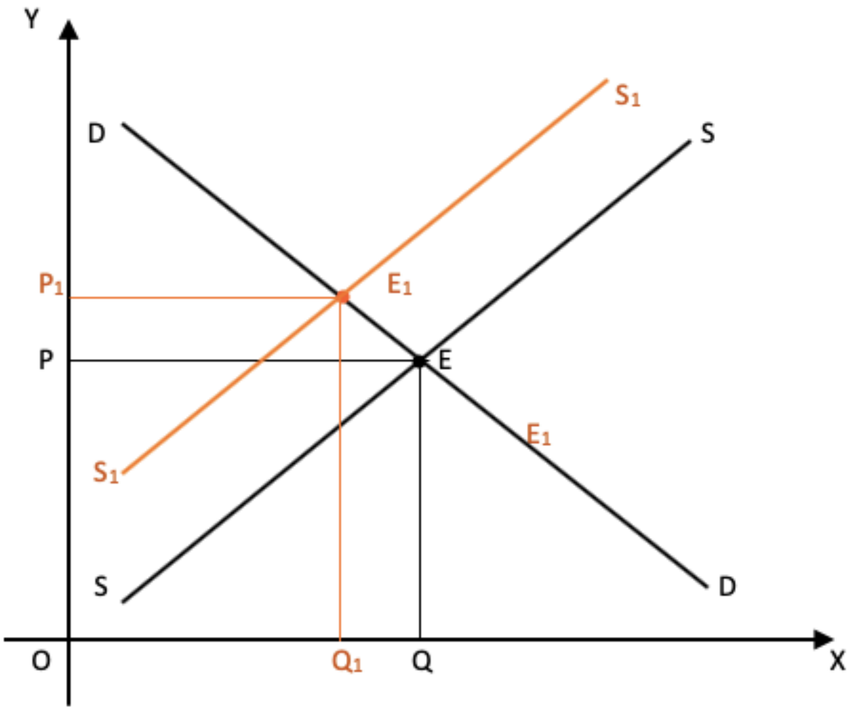


When SUPPLY remains constant & Demand decreases,
Price ↓ Quantity ↓

CHANGE IN SUPPLY, When Demand remains constant



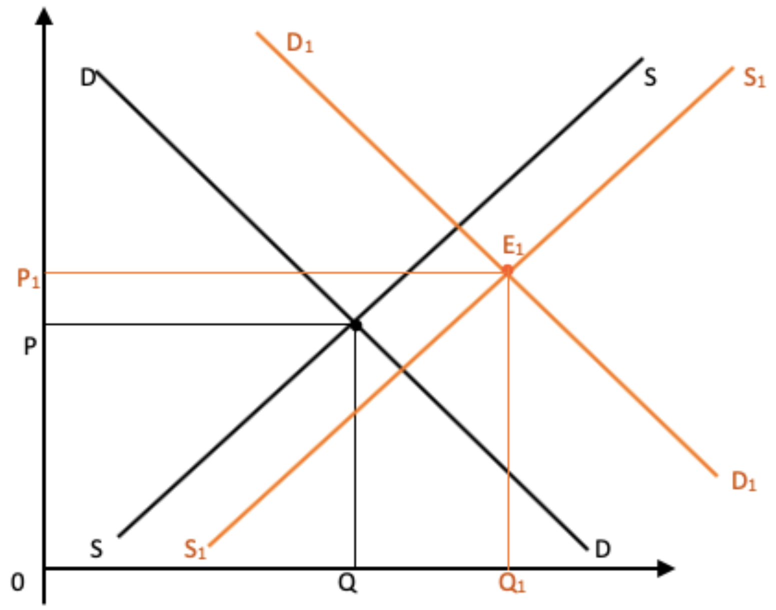
When DEMAND remains constant & Supply Increases,
Price ↓ Quantity ↑



When DEMAND remains constant & Supply decreases,
Price ↑ Quantity ↓

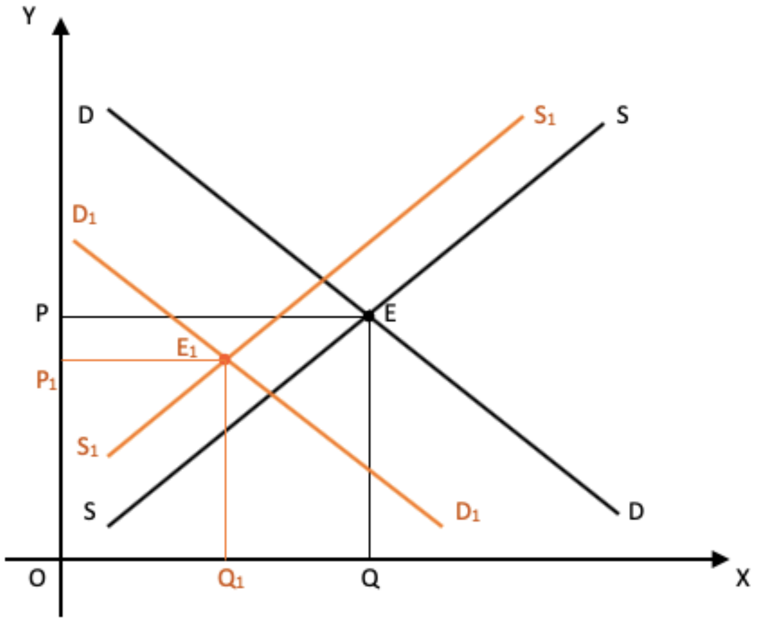
SIMULTANEOUS CHANGE IN DEMAND & SUPPLY

A. When Demand increases more proportionate then supply



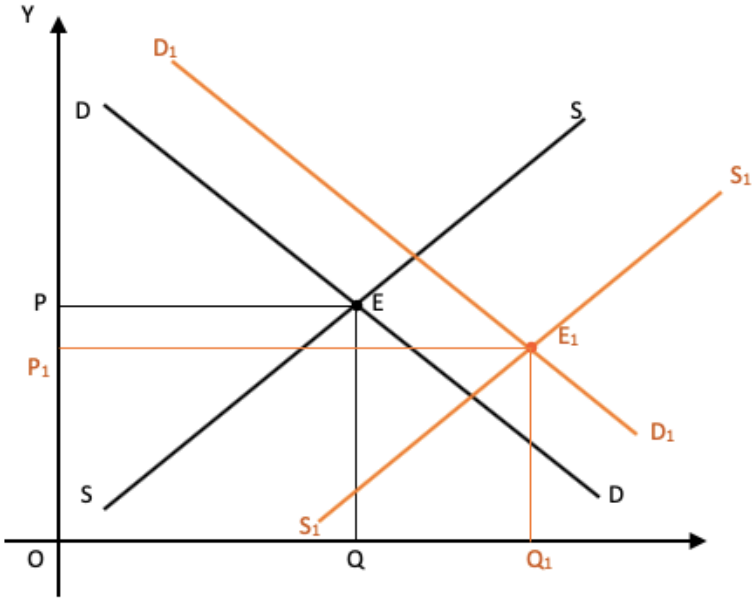
When Demand Increases more proportionate then supply,
Price ↑ Quantity ↑

B. When Demand decreases more proportionate then supply



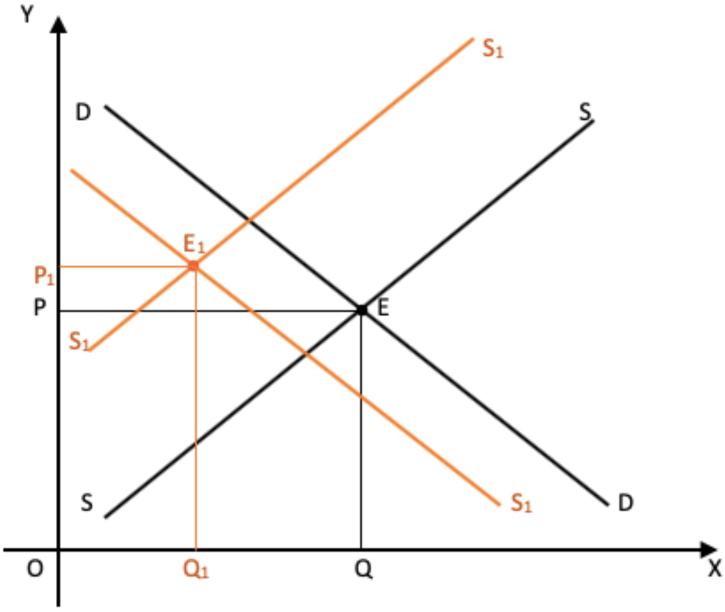
When Demand decreases more proportionate then supply,
Price ↓ Quantity ↓

C. When Supply increases more proportionate then demand



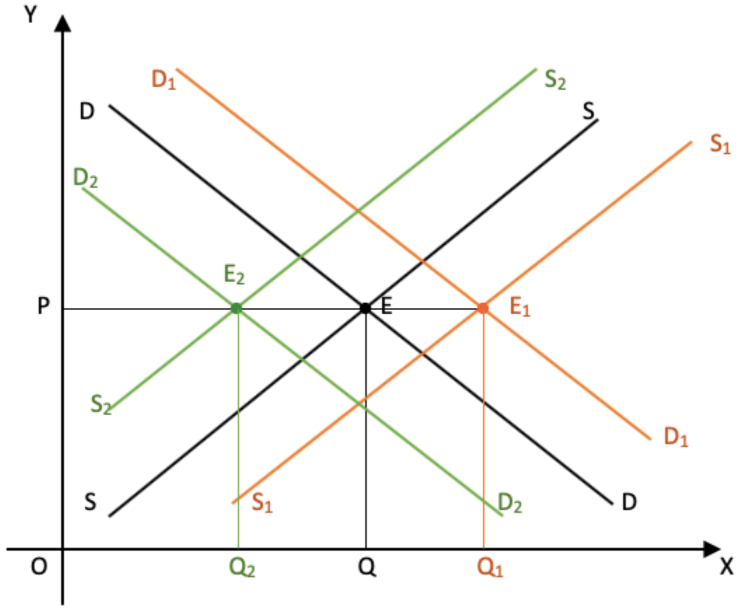
When Supply Increases more proportionate then Demand,
Price ↓ Quantity ↑

D. When Supply decreases more proportionate then demand



When Supply Decreases more proportionate then Demand,
Price ↑ Quantity ↓

E. When Demand & Supply change i.e. Increases/ Decrease in same proportion simultaneously



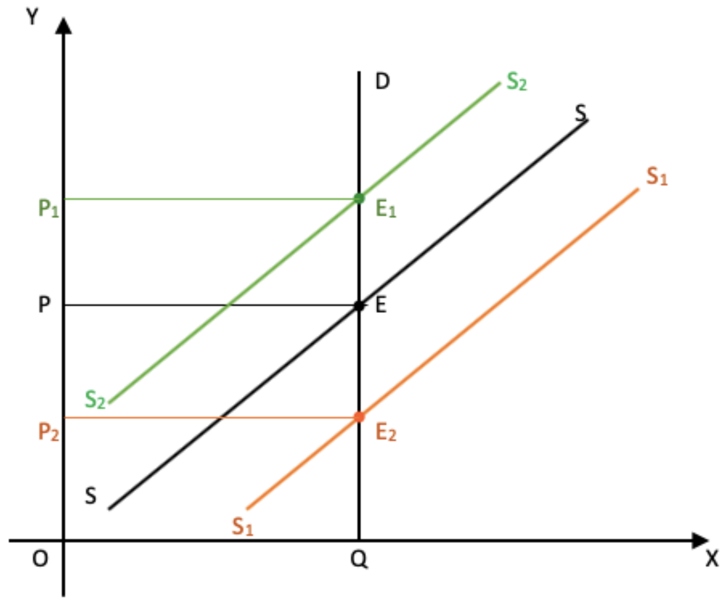
When Demand & Supply Increases/ Decreases in **same proportionate** then,

Price remains constant,

D & S Increases Quantity ↑

D & S Decreases Quantity ↓

F. When Demand is perfectly in-elastic & Supply changes i.e. Increase / decreases.



When Demand is Perfectly in-elastic & Supply changes

Quantity remains constant

Price ↓ when supply ↑

Price ↑ when supply ↓

Unit 3- Price and Output determination in different markets

MONOPOLY

Single seller in an Industry

Features of Monopoly

1. Single seller in an economy
2. Price maker
3. Always enjoys super normal profit i.e. AR > AC
4. No close substitutes
5. Entry Barrier- Any new company to enter this industry is completely restricted
   Types of Entry barrier
   - Legal Entry barrier: The Law of a nation will not allow somebody to start same/similar kind of business.
   - Natural Entry barrier: The climatic condition of different states acts as an entry barriers for different kinds of business.
   - Business Formations: Initial competition can be converted into co-operation
     CARTLES- Few comes together & form an association/organisation and only they operate.
   - Investment factor: Ex- Indian Railways
     Even if Government provides permission to start , a private organisation cannot invest such a huge money what government has invested from decades to provide a cheaper means of public transport.
6. Price Discrimination – Charging different prices from different customers for a same commodity
   Types of Price discrimination
   1^{st} Degree price discrimination : Based on consumer surplus
   2^{nd} Degree price discrimination : Based on volume of transaction
   3^{rd} Degree price discrimination : Based on personal attributes.

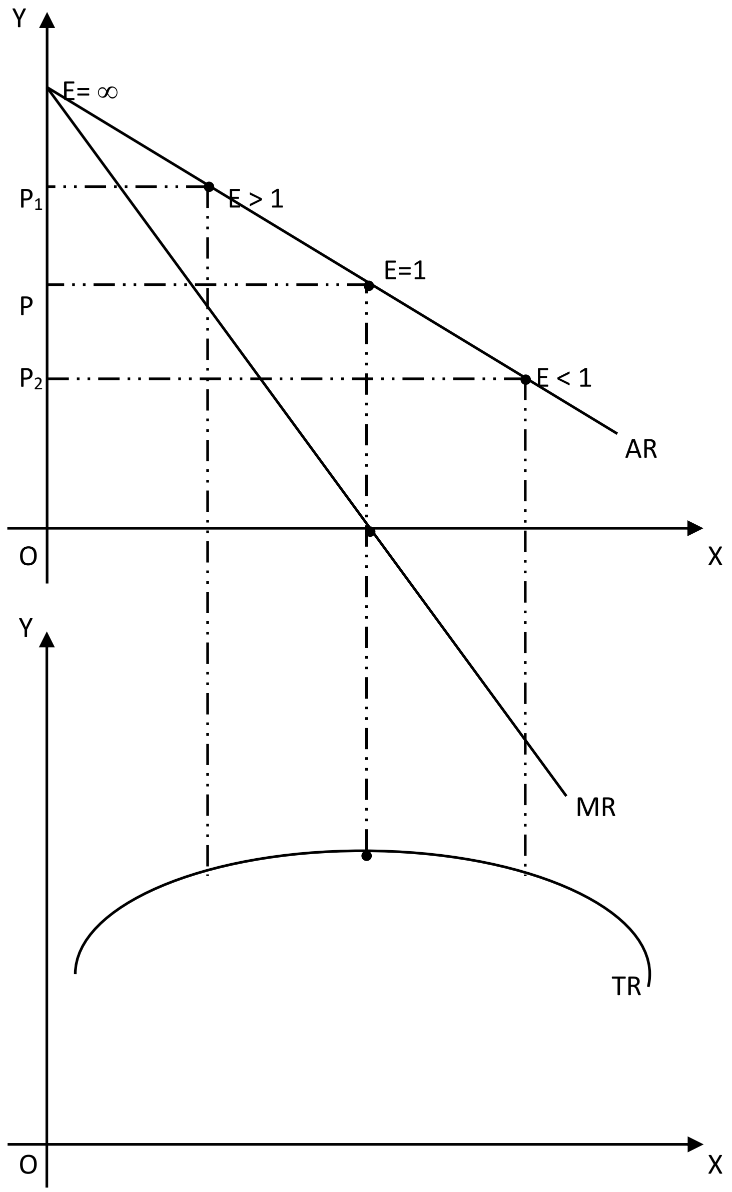
   Price discrimination is always & always profitable, it is a combination of relatively elastic & relatively in-elastic demand.

Revenue curve in monopoly

Price	Quantity	TR	AR	MR
20	1	20	20	20
18	2	36	18	16
16	3	48	16	12
14	4	56	14	8
12	5	60	12	4
10	6	60	10	0
8	7	56	8	-4
6	8	48	6	-8
4	9	36	4	-12
2	10	20	2	-16

TR = P x Q
AR= TR/Q
MR= $TR_n - TR_{n-1}$

Note: The fall in MR will be double then AR
AR curve will be flatter
MR curve will be steeper
AR is also known as selling price, hence it never becomes 'Zero'
AR curve is also known as DEMAND CURVE
When TR is maximum, MR will be ZERO



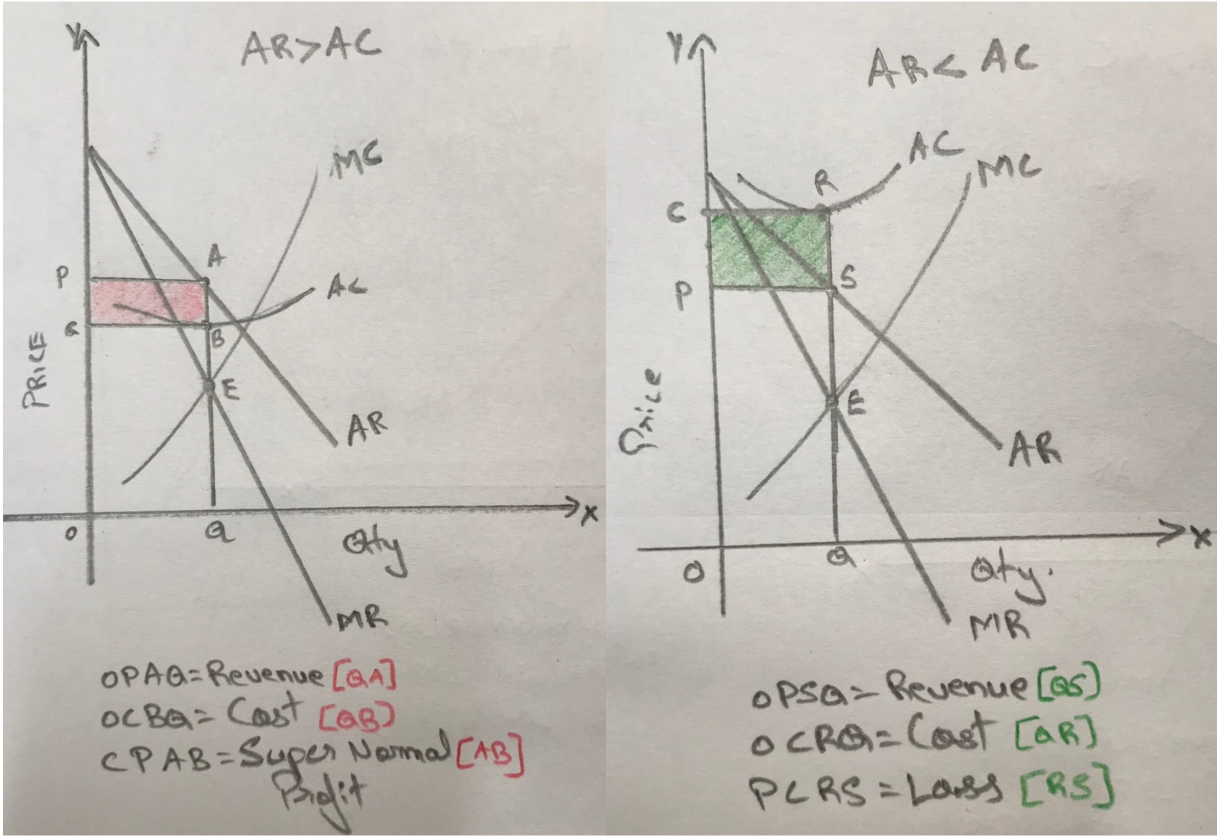
Price determination / Profit Maximisation in SHORTRUN

A firm will undergo with two possibility in SHORT RUN

1. Super normal profit , when AR > AC
2. Loss, when AR < AC

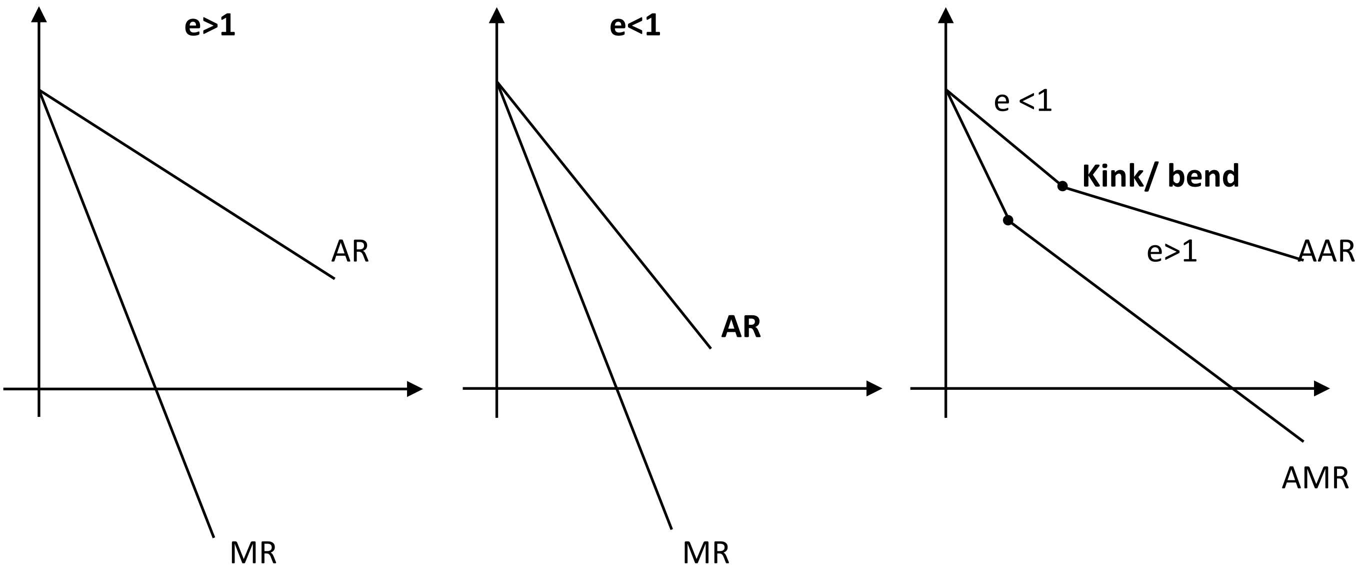
When a society accepts a commodity of a monopolist a monopolist earns super normal profit,
If Society doesn't accepts the commodity a monopolist will incur LOSS.

A firm can undergo with only & only Super normal profit in LONG RUN, a monopolist is the only seller of a commodity in an economy & he is a Price maker.



Profit Maximisation in Price Discrimination

Market A | Market B | Aggregate market



Kinked Demand curve is due to Price discrimination,
Which is Convex to a origin (Combination of Relatively elastic & In-elastic)
$MR_A=MR_B$, MR in both the markets are same.

OLIGOPOLY

Few Sellers in an Economy.

Features of Oligopoly

1. Few sellers & large number of buyers
2. Close Interdependency
3. Price rigidity – If any one producer decreases a price other producers will also decrease but if any one producer increases a price other will think before increasing,
   Because no one will compete in terms of price for all the producers customers is important.
4. Existence of selling cost (Advertisement & transportation cost)

Types of Oligopoly

1. **Pure Oligopoly & Differentiated oligopoly**
   Pure oligopoly- where all the producers are producing homogeneous/same types goods & services
   Differentiated oligopoly- where all the producers are producing heterogeneous/ different goods & services

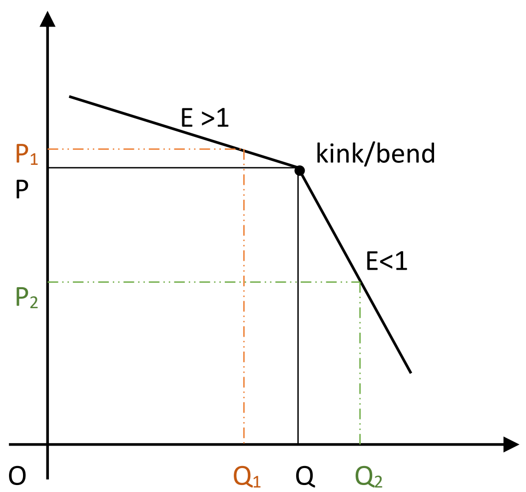
2. **Open Oligopoly & Closed oligopoly**
   Open Oligopoly- Entry of new firm is not restricted
   Closed Oligopoly- Entry of new firm is restricted

3. **Collusive Oligopoly & Competitive oligopoly**.
   Collusive Oligopoly- All the producers come under one roof & determine common selling price
   Competitive oligopoly- All the producers are not ready to come under one roof & they compete others with their own pricing strategies

4. **Partial Oligopoly & Full Oligopoly**
   Partial Oligopoly- Since the number of sellers is few, out of them any one dominating company becomes a PRICE LEADER & fixes the price of products and others will follow similar pricing strategy.
   Full Oligopoly- There will be no price leader existing 7 all the producers fixes their own selling price.

Revenue curve in oligopoly

It will be a Kinked Demand curve which will be concave to a origin.(combination of e>1 & e<1)
Kinked demand curve is due to PRICE REGIDITY.



MONOPOLISTIC COMPETITION MARKET

It is a combination of Perfect competition & Monopoly market

A manufacturer will be having complete control over the products BUT the manufacturer will not only be a person, instead he has to compete with others in order to sell his product.

They have complete control to make any changes/ modification in their product to compete with others.

<u>Features of monopolistic competition market</u>

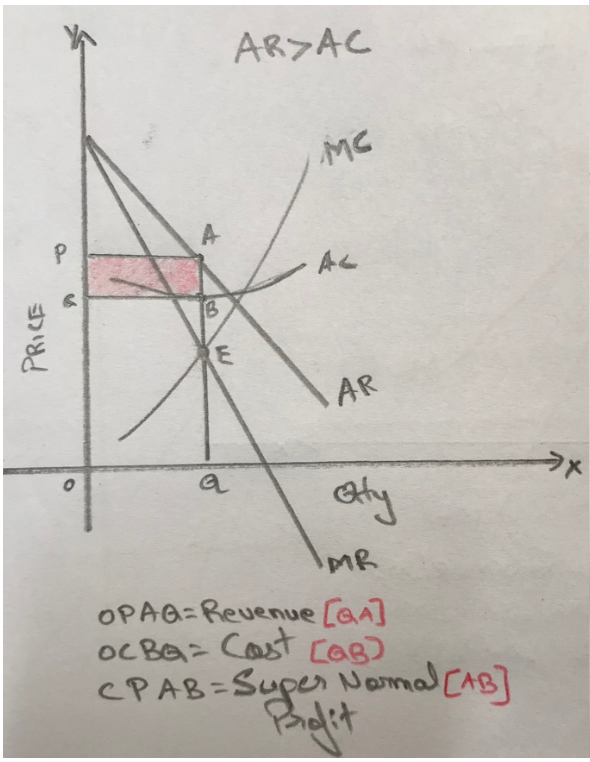
1. Large number of Buyers & Sellers
2. Free entry & exit of firms into industry
3. Product differentiation
4. Existence of selling cost
5. Brand loyalty

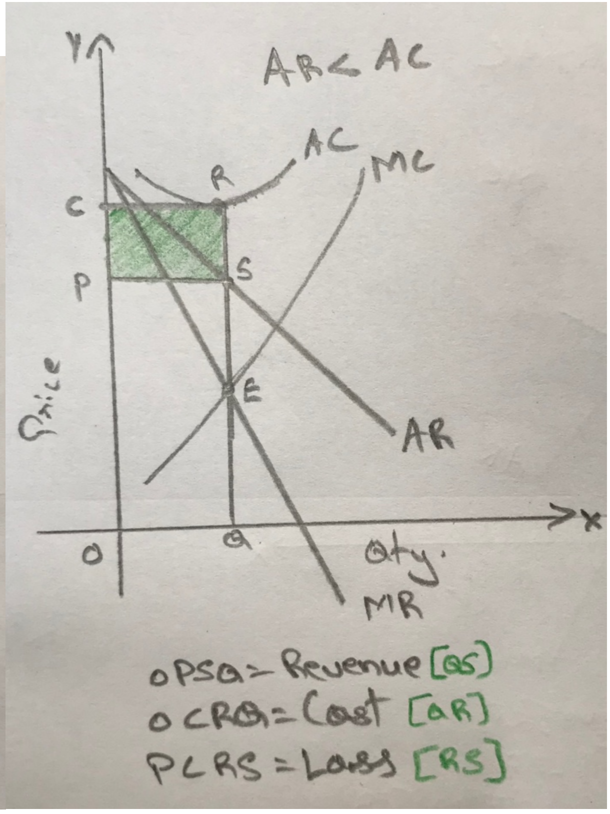
<u>Price & output determinisation under Monopolistic competition market</u>

A. SHORTRUN

Firm can either earn Supernormal profit AR>AC or

Firm can incur LOSS AR < AC

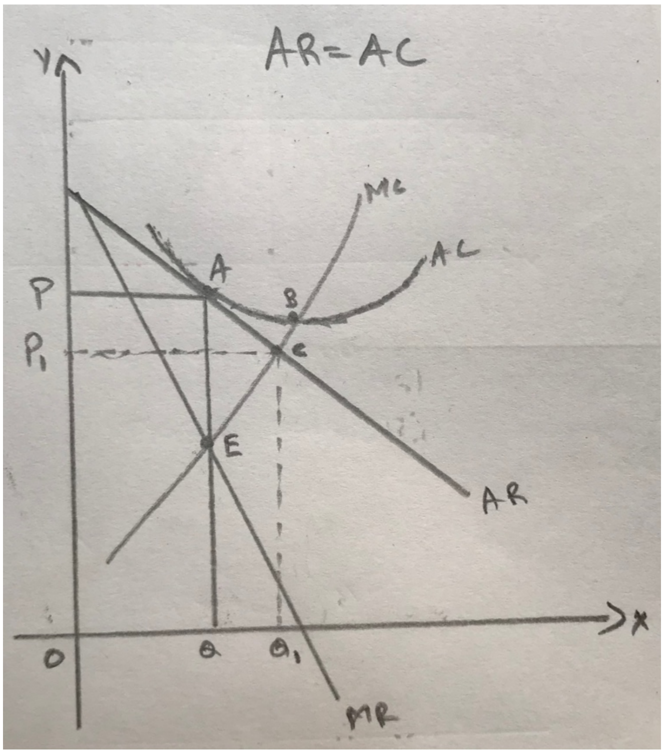




B. LONGRUN

Firm can operate only when there is an existence of BUFFER STOCK i.e. Normal profit level of output

AR=AC



- AC curve is tangent to AR curve & sloping downwards to point B
- Point A to B is a situation where expenses are falling & it is considered as excess capacity left out (Buffer stock)
- If we increase output from OQ to OQ_1 level cost decreases when output increases but revenue decreases from point A to C
- When we reduce selling price from point A to C, Revenue decreases much more faster than cost
- When COP (AC) comes down we can reduce selling price

Conclusion : If any strong competitor enters the market, we utilise buffer stock to reduce COP & selling price , when Price decreases demand increases

A Firm is long run set to be in Equilibrium when there is an existence of Excess capacity i.e. Buffer stock.