Market Structures

This hand-out gives an overview of the main market structures including perfect competition, monopoly, monopolistic competition, and oligopoly.

Summary Chart

	Perfect Competition	**Monopoly**	**Oligopoly**	**Monopolistic Competition**
# of firms	Many	One	2 or more	Many
Average size of firms	Small	Very large	Large	Small to medium
Nature of product	Same	Unique	Identical/ differentiated	Differentiated
Barriers to entry	None	Significant	Significant	Few
Government intervention	No	Yes	Some	No
Output decisions	No output restriction	Most output restriction	Output restricted	Output restricted
Interdependence	Each firm is independent	No competitors	Interdependent decisions	Each firm is independent
Profit making possibility	Low	High	High	Medium
Price and Marginal Cost	P = MC	P > MC	P > MC	P > MC
Implication for Demand Curve	Horizontal	Downward slopping; inelastic	Kinked/Downward slopping; inelastic	Downward slopping; elastic
Pricing decisions	MC = MR = P	MC = MR	Strategic pricing	MC = MR

(Note: P = price; MC = marginal cost; MR = marginal revenue)

Perfect Competition

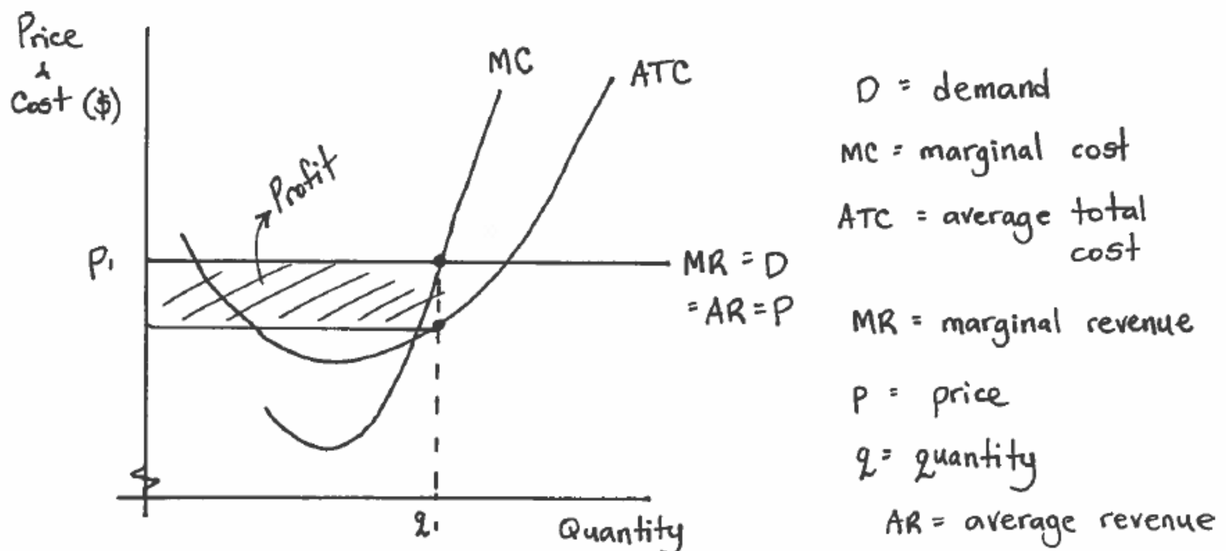
Perfect competition is a market in which:

- There is generally a large number of buyers and sellers.
- Buyers and sellers sell identical products (there is no need for advertising).
- Each buyer and seller acts independently.
- Sellers and buyers are reasonably well-informed about products and prices.
- Competitors are free to enter into the market, conduct business or leave the market.
- Examples: local vegetable farmers, dry cleaning businesses, grocery retailers, plumbing, etc.

Perfect competition markets are highly competitive markets in which many sellers are competing to sell their product. Each seller produces a product that has no unique characteristics so buyers "don't care" about which seller's product to buy.

Other notes:

- Firms cannot influence the market price because the individual firm's production is an insignificant part of the total market. Firms are "**price-takers**."
- Market demand and market supply determine the market price and quantity.
- The demand for a firm's product is perfectly elastic (i.e. one firm's product is a perfect substitute for another firm's product).
- **In perfect competition, the firm's marginal revenue equals the market price.**
- **If MR = MC, economic profit is maximized.**



Monopoly

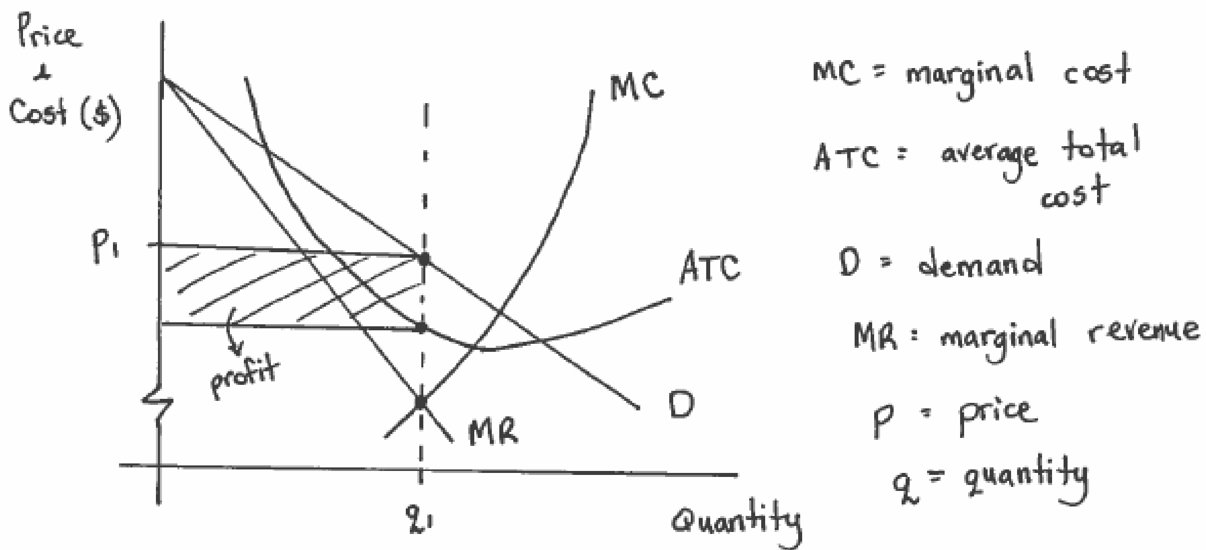
Monopoly is a market in which:

- there is one seller of a particular product
- there are barriers to entry of the market to prevent competition
- Examples: Toronto Hydro (has monopoly over electric services in the GTA); LCBO (has monopoly over alcohol sales in Ontario).

Types of Monopolies

1. **Natural Monopoly** – market situation where the costs of production are minimized by having a single firm produce the product (e.g. public utility companies, oil pipeline in Alaska)
2. **Geographic Monopoly** – based on absence of other sellers in a certain geographic area (e.g. gas station or drugstore in small town)
3. **Technological Monopoly** – based on ownership or control of a manufacturing method, process or other scientific advance (e.g. certain pharmaceutical drugs)
    a. **Patent** – exclusive right to manufacture, use or sell invention (usually good for 20 years).
    b. **Copyright** – authors, art (good for their lifetime plus 50 years)
4. **Government Monopoly** - monopoly owned and operated by the government (e.g. military, water and sewage)

A monopoly maximizes profit by producing output when **MR = MC** and by charging **maximum price** that consumers are willing to pay for that output.



Economic Profit in Single-Price Monopoly

Monopolistic Competition

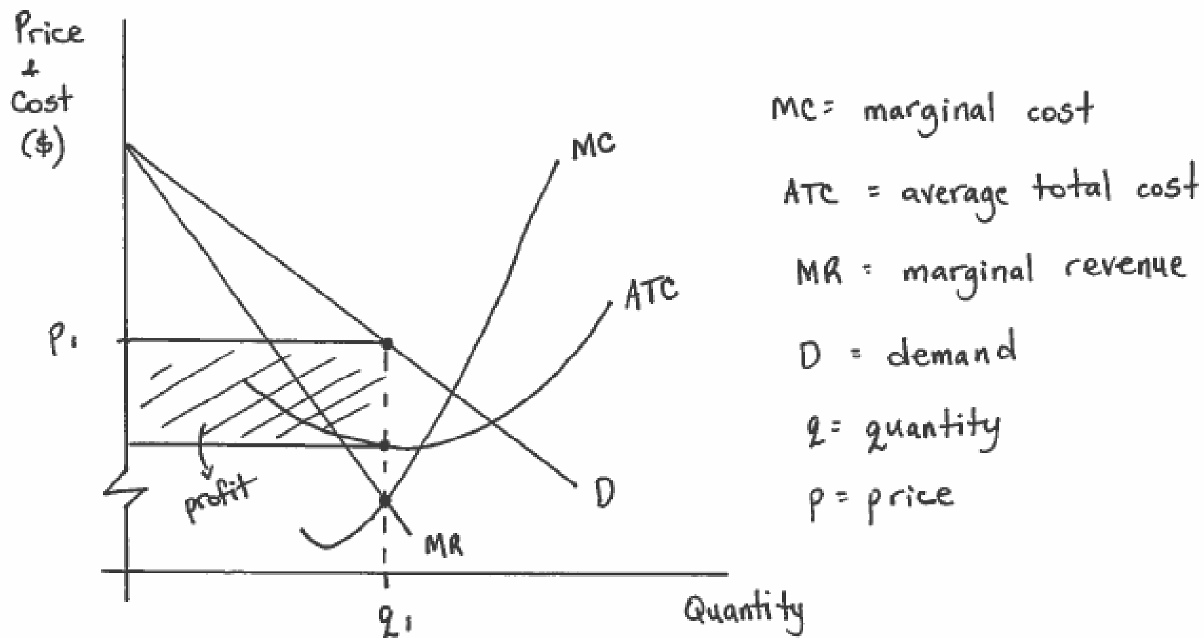
Monopolistic competition is a market in which:

- A large number of firms compete.
- Each firm produces a differentiated product.
- Firms compete on product quality, price and marketing.
- Firms are free to enter and exit the industry.

Other notes:

- All conditions of perfect competition are met except products are NOT identical.
- **Product differentiation** – real or perceived differences between competing products in same industry (e.g. Pure life Water vs. Dasani Water, Crest toothpaste vs. Colgate).
- **Nonprice competition** – use of advertising, giveaways, or other promotions designed to convince buyers that a product is unique (e.g. Coke vs. Pepsi).

- Profit is maximized by producing output when **MC = MR.**



Economic Profit in Monopolistic Competition

Oligopoly

Oligopoly is a market in which:

- Few very large sellers dominate the industry and compete with one another.
- Examples: Burger King, McDonald's and Wendy's.
- When one firm acts, the others tend to follow (e.g. selling chicken nuggets)
- Firms are "**price-makers.**"

Other notes:

- **Collusion** is formal agreement between sellers to set specific prices or to otherwise behave in a cooperative manner (For example, OPEC = Organization of the Petroleum Exporting Countries).
- **Price-fixing** is a form of collusion where firms establish the price of a product or service, rather than allowing it to be determined naturally through free market forces.
- The demand curve below is kinked. At higher prices the demand is elastic because if you raise your price, other firms will *not* match it. At lower prices, the demand curve becomes inelastic; if you lower your price, other firms *will* match it.