Competitiveness Of The National Economies

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Lecture № 2

The Models of competition

Outline

1. Introduction
2. Perfect Competition
3. Monopoly
4. Monopolistic Competition
5. Oligopoly

Goal of this lecture:

- Defining the main models of competition
- Analyzing the each type of the model
- Giving examples for each type of the competition

Brainstorm!
As a class, do the following:

List a company/companies that have no real competition:

List a company/companies that have a few (one or two) competitors:

List a company/companies that have many competitors:

Which situation is best for consumers (buyers)? Why?

Which situation describes most markets?

All of the above are called Market Structures or Models of Competition. Each one exists to some degree in our economy. They are important because the model of competition determines in a large degree the availability of products, choice of product and most importantly price of products.

What is competition?

Competition

Literary meaning: a contestable situation where people fight for superiority.

In market economy, competition is a process whereby firms fight against each other for securing consumers for their products

Fair and Unfair Competition

Fair Competition	Unfair Competition
Producing quality goods Becoming cost-efficient Optimizing the use of resources Adopting the best available technology Investing in research and development, etc.	Fixing prices with the rivals Setting a price which is lower than cost in order to throw out competitors from the market Advertising that belittles others' product, etc.

Types of competition

Price Competition

Competition among suppliers to win customers **by offering lower price.** May not be an appropriate strategy for those loyal to a particular brand.

Non-price Competition

Competition to win customers not by lowering price but **by advertising, offering after-sales-service, using sales-promotion tools**, etc.

Models of Competition

HOW BUSINESSES COMPETE AND WHAT IMPACT IT HAS ON ME.

What are Models of Competition?

Def. a description of the type of market that a particular business or industry operates in.

Also known as **Market Structure.**

4 Types of Models of Competition

1. Perfect Competition
2. Monopoly
3. Monopolistic Competition
4. Oligopoly

Perfect Competition

The concept of competition is used in two ways in economics.

- Competition as a process is a rivalry among firms.
- Competition as the perfectly competitive market structure.

Competition as a Process

Competition involves one firm trying to take away market share from another firm.

As a process, competition pervades the economy.

Competition as a Market Structure

It is possible to imagine something that does not exist – a perfectly competitive market in which the invisible hand works unimpeded.

Competition as a Market Structure

Competition is the end result of the competitive process under highly restrictive assumptions.

- A perfectly competitive market is one in which economic forces operate unimpeded.

Perfect Competition

Def. a market structure in which a large number of firms (businesses) produce the same product.

Only reason to choose one firm over another is the ***PRICE***

Four Conditions for Perfect Competition

1. Many buyers and sellers

   People have lots of options to choose whom they buy from.

2. Identical Products

   There are no differences between what is sold by different suppliers. They are exactly the same!

Four Conditions for Perfect Competition (cont.)

3. Informed Buyers and Sellers

   Buyers know the <u>prices</u> and <u>quality</u> of product sold by all venders to make the best decision

4. Free Market Entry and Exit

   Businesses can enter the market when they can make money and exit when they can't.

What types of businesses are Perfectly Competitive?

Farm Markets (ex. Public Market)

- Many farmers selling their vegetables (Many buyers and sellers)
- A carrot from farmer Brown is equal to a carrot from farmer Jones (Identical Products)
- Buyers can compare prices and quality by walking the market (Informed Buyers/Sellers)
- Farmers choose to bring produce or not. Inexpensive to rent a space in the market (Free Market Entry/Exit)

Are there many perfectly competitive businesses?

NO! All 4 of the conditions must be met for perfect competition. This is very difficult in most industries.

- Often people can only buy from one supplier
- Products are rarely identical
- Buyers often do not know if a product is cheaper/better at a different supplier
- Barriers to entry prevent free market entry

Barriers to Entry

Def. Factors that make it difficult for new firms to enter a market.

Start-up Costs

The expenses that a new business must pay before the first product reaches the customer.

Ex. Rent, machines, product, labor, etc.

Technology

Some markets require a high degree of technological know-how. As a result, new entrepreneurs cannot easily enter these markets.

Ex. Software and Pharmaceutical companies

Monopoly

Def. a market dominated by a single seller.

They form when barriers prevent competitors from entering the market. This is often because of the high costs to supply a product.

They take advantage of their monopoly power and <u>charge high prices</u>.

In the United States most monopolies are illegal.

Examples of Monopolies

During the late 1800s and early 1900s Standard Oil and Carnegie Steel

From the late 1800s to the 1980s AT&T (also known as Bell Telephone) had a monopoly on phone service

Microsoft has been accused and convicted in court for having monopolistic characteristics

Natural Monopolies

Some monopolies are allowed by the government to exist. Natural Monopolies are markets that run best when one firm provides all of the supply.

Ex. Monroe County Water Authority

RG&E used to be a natural monopoly, but recently has opened to competition by sharing power lines.

Government Monopolies

Patents: Licenses that give inventors the exclusive right to sell their product for a certain period of time.

Industrial Monopolies: Rare cases where the government allows an industry to restrict the number of firms in the market. Ex. Major League Baseball.

Monopolistic Competition

Def. Many companies compete in an open market to sell products that are ***similar***, but not identical.

Four conditions of Monopolistic Competition

1. Many Firms

Mono. Comp. do not have high start-up costs and so have more firms.

2. Few Artificial Barriers to Entry

Barriers to entry are relatively low.

Four conditions of Monopolistic Competition

3. Slight Control over Price

   Firms have some freedom to raise prices because each firm's goods are a little different from everyone else's

4. Differentiated Products

   Firms have some control over selling price because they can differentiate, or distinguish, their products from other products in the market.

What types of businesses are Monopolistically Competitive?

Lots! Most markets exist in this model.

Ex. Soft Drinks

- Coke, Pepsi, RC, WPop, etc. (many firms)
- Relatively inexpensive to produce, don't need huge factories, chemicals, etc. (Few artificial barriers to entry)
- Coke is a little more expensive than WPop (Slight control over price)
- Some people like Coke more than Pepsi, etc. (Differentiated Products)

So, how do Firms in Monopolistic Competition get customers?

Through **<u>Nonprice Competition</u>**: a way to attract customers through style, service or location, but <u>not a lower price.</u>

4 types of Nonprice Competition

1. Characteristics of Goods

   Firms distinguish products through size, color, shape, texture or taste

   Ex. Coke vs. Pepsi, Lemon Pepsi, Vanilla Coke

2. Location of Sale

   A convenience store in the middle of the desert differentiates by selling it miles from competitors

4 types of Nonprice Competition (cont.)

3. Service Level

   Some sellers can charge higher prices because they offer customers a higher level of service

   Ex. Fancy sit-down restaurant vs. McDonalds

4. Advertising Image

   Advertising creates apparent differences between products in the marketplace.

   Ex. Jordans vs. Carmelo Anthony's shoes

Monopolistic vs. Perfect Competition

	Perfect Competition	Monopolistic Competition
Prices	Lower, firms have no control	Higher, firms have some control
Profits	Lower	Higher in short term, but must work hard to keep ahead of rivals
Cost and Variety	Low costs, no variety (identical products)	Higher costs for differentiation, wide variety

Oligopoly

Def. A market dominated by a few, large profitable firms

How do Oligopolies work?

Collusion:

An agreement among members of an oligopoly to set prices and production levels.

Price Fixing:

An agreement among firms to sell at the same or similar prices.

Both are Illegal in the U.S.

Cartels: An association by producers established to coordinate prices and production.

- Ex. OPEC: Organization of Petroleum Exporting Countries controls the oil supply and manipulates prices of gasoline.
- Ex. DeBeers controls 80% of world's diamonds, keeps prices high by limiting supply.

Market Power

Def. The ability of a company to control prices and output

Markets dominated by one or a few firms (monopoly or oligopoly) have higher prices and lower output. (great market power)

Markets with many sellers (monopolistic and perfect competition) have lower prices and higher output. (little or no market power)

Predatory Pricing

Def. Setting the market price below cost levels for short term to drive out competitors. Firms in Monopolistic and perfect competition do this to gain market power.

Ex. My pizza shop sells slices for $0.50 each, even though it costs me $0.75 to make. I am losing money ($-0.25), but it drives the competition out of business, so I can raise the price later.

Government and Competition

The Government keeps firms from controlling prices and supply of important goods. **Antitrust laws** are laws that encourage competition and break up monopolies/oligopolies in the marketplace

4 forms of Anti-trust Laws

1. Regulating Business Practices

   Government can intervene if a firm has too much market power

2. Breaking Up Monopolies

   Antitrust laws have been used to break up monopolies (ex. Standard Oil, AT&T)

Antitrust Laws (cont)

3. Blocking Mergers

   A **merger** is a combination of two or more companies into one firm. The government can block this if it decreases competition

4. Preserving Incentives

   In 1997, new guidelines on mergers were introduced allowing companies to merge if they show benefits to consumers.

Deregulation

Def. The removal of some government controls over a market. It is used to promote competition.

Deregulation allows more competition in a market, lowers prices and increases variety (benefits), but often can lead to layoffs and business closings (negatives) in the short term because of the change.

Ex. Airline Deregulation in the early 1980s. New, smaller, cheaper airlines emerged, but the older, larger airlines are having trouble competing and have had to cut back on flights, employees, and benefits (in-flight meals etc.)

Forms of Market Competition

Models of Competition	Number of buyers	Number of sellers	Nature of products	Barriers to entry and exit
Perfect competition	Very large	Very large	Identical products	None
Monopoly	Very large	**One**	Single product	**Very large**
Monopolistic competition	Very large	Large	Minimum differences	None
Oligopoly	Very large	**Very few**	Large differences	**Large**


Thank
you

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