CLASS- 11
FORMS OF MARKET

Concept of Market

What is market? Ordinarily, an individual would answer this question pointing to a shopping complex. But, for a student of economics, this is not an appropriate answer. In economics, the concept of market has a special meaning. It refers to a mechanism or an arrangement that facilitates the sale and purchase of goods. This arrangement could simply be through telephonic communication or even through electronic mail. We are all familiar with tele-shopping which is marketing without any shopping complex.

In economics, market does not refer to any shopping complex. It refers to a mechanism or an arrangement that facilitates contact between the buyers and sellers for the sale and purchase of goods and services.

What is Market?

Market refers to a mechanism or an arrangement that facilitates contact between the buyers and sellers for the sale and purchase of goods and services

In the light of this definition, size of the market is not to be viewed as the size of some geographical area where sale and purchase of goods is conducted. Instead, it is to be viewed in terms of the volume or value of sale and purchase of goods and services. Thus, size of the market expands when the volume or the value of the sale and purchase expands.

1. Forms of Market

Depending on the degree of competition or number of firms in the market (engaged in the sale of a particular commodity), a market is often described as one of the following forms: (i) perfect competition (ii) monopoly, (iii) monopolistic competition, and (iv) oligopoly Following is a brief description of these forms of the market.

Perfect Competition

Perfect competition is said to exist when there is a large number of sellers and buyers and engaged in the sale and purchase of a commodity, and no individual buyer or seller has any control over price of the product. Price of the product is determined by the forces of market supply and market demand.

Perfect competition is a form of the market where there is a large number of buyers and sellers of a commodity. Homogeneous product is sold with no control over price by an individual firm.

Features of Perfect Competition and their Implications

A perfectly competitive market exhibits the following features. Each feature is explained with reference to its implications for the buyers and sellers of a commodity.

(1) Large Number of Small Buyers and Sellers of a Commodity: A perfectly competitive market is dominated by a large number of small buyers and sellers of a commodity. What does it mean? It means that there is no such buyer or seller in the market whose purchase or sale is so large as to impact the total sale or purchase in the market. Each buyer/seller has only a fractional share in the market demand/market supply. Since price is determined by the forces of market demand and market supply, no individual buyer or seller has any control on it. Each buyer/seller has to accept the price as it is in the market. **Therefore, it is said that a firm under perfect competition is a price taker not a price maker.**

(2) **Homogeneous Product:** All sellers sell identical units of a product. Accordingly, buyers have no reason to prefer the product of one seller compared to that of the other.

Accordingly, uniform price prevails in the market. There is absolutely no price discrimination.

(3) **Perfect Knowledge:** Buyers and sellers are fully aware of the prevailing price in the market. They are also aware of the fact that homogeneous product is being sold in the market.

Accordingly, producers cannot make extra profit by charging different prices from different buyers.

(4) **Free Entry and Exit of Firms:** A firm can enter or leave the industry any time. In order to analyse the implications of this feature we need• to focus on short period and long period situations. Short period, by definition, is too short for an existing firm to leave the industry or for a new firm to join the industry Accordingly, the significance of this feature is restricted only to long period situations.

Because of free entry and exit, firms in the long run earn only normal profits (TR = TC or AR = AC). In case extra-normal profits are earned, new firms will join the industry. Market supply will increase. Market price will fall. Extra-normal profits will be wiped out. In case of extra- normal losses, some of the existing firms will leave the industry. Market supply will decrease. Market price will increase. Extra-normal losses will be wiped out.

(5) **Independent Decision-making:** There is no agreement between the sellers regarding production-quantity and price. Nor is there any restriction regarding the sale and purchase of any commodity. All firms are free to take their own decisions. Because of this, competition prevails without restrictions and product price is driven to its lowest possible level.

(6) **Perfect Mobility:** Factors of production are **perfectly mobile**. They will move to that industry where they get best price. Accordingly, uniform factor price prevails in the market.

(7) **No Extra Transport Cost:** For one price to prevail throughout the market, it is essential that there is no extra transport cost for the consumers while buying a commodity from different sellers.

Three Vital Conclusions

Description of characteristic features of perfect competition offers three vital conclusions, as under:

(1) A Firm under Perfect Competition is a Price Taker, not a Price Maker

Under perfect competition, there is a large number of firms producing homogeneous commodity. An individual firm in such a market cannot change price of the commodity. **Price is determined by the forces of market demand and market supply. All the firms in the industry sell their output at the given price. It is therefore said that a firm under perfect competition is a price taker.** This is explained in terms of the following reasons:

(i) **Number of Firms:** The number of firms under perfect competition is so large that no individual firm, by changing its sale, can cause any meaningful change in the total market supply. Accordingly, market price remains unaffected.

(ii) **Homogeneous Product:** All firms in a perfectly competitive industry produce homogeneous product. In such a situation, if any firm fixes its price higher than the equilibrium market price, buyers would shift from this firm to the other. The policy of higher price. (higher than the equilibrium marks price) will simply fail.

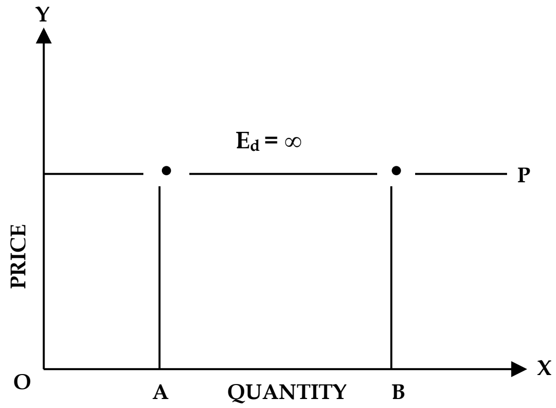
(iii) **Unnecessary Loss if Lower Price is Fixed:** Firm's demand curve under perfect competition is perfectly elastic. It means that a firm can sell whatever amount it wishes to sell at the existing price. In such a situation, the policy of attracting buyers by lowering the price would result in unnecessary loss.

Thus, it is concluded that under perfect competition, it is **neither possible nor desirable for an individual firm to change price of the product. The firm is simply a price taker, not a price maker.**

(2) Demand Curve of the Firm under Perfect Competition is Perfectly Elastic

Demand curve of the firm is perfectly elastic (Ed = ∞). **It means that the firm can sell any amount of the commodity at the prevailing price**. Even a fractional rise in price would wipe out entire demand for the firm's product. Firm's demand curve is indicated by a horizontal straight line parallel to X-axis. This shows that the firm is to accept the price as determined by the **forces of market supply and market demand;** it can sell whatever amount it wishes to sell at this price. This is illustrated in

Firm's Demand Curve Under Perfect Competition



Firm's entire output is demanded at the price OP. This price is determined by the forces of market supply and market demand. An individual firm cannot change it.

The above chart shows that at the given price OP, the firm can sell any quantity of the commodity it produces. **Price remains constant** her quantity demanded is OA or OB, or even zero.

(3) **A Firm under** P**erfect Competition earns only Normal Profits in the Long Run**

This is owing to the fact that there is freedom of entry and exit under perfect competition. In situations of extra-normal profits, new firms will be induced to join the industry. This increases market supply and lowers market price to finally wipe out extra - normal profits. In situations of extra-normal losses, marginal firms will quit the industry, lowering market supply and raising market price to finally wipe out extra-normal losses.