Market Structures

IGCSE

Why do Firms compete?

- Firms compete amongst each other to capture more market share which is expected to lead to higher revenue and profits.
- To outperform their competitors firms create unique selling points to differentiate their products from that of their competitors.
- All competition strategies can be classified in two categories namely price and non-price strategies.

Why do Firms compete?

- Profit maximization is one of the primary motivations behind firms fiercely competing with each other. Other incentives to compete with competitors include:

1. Higher market share
2. Higher sales revenue
3. To become market leader

Price Competition

- Firms often try pricing their products at par or less than that of their competitors to attract more customers. This requires firms to be cost efficient.

- Hence firms are also conscious of their product quality and its other characteristics that are valued by customers.

Price Competition

- Price competition is not always effective especially when consumers associate high value to non-price elements like product quality, its availability, durability etc.

Pricing Strategies

- Depending upon market circumstances firms choose appropriate pricing strategies.
- Price Skimming: This is when firm initially charge high price and then over time when product's uniqueness fades price is reduced to keep product attractive for consumers. For instance pricing strategy used for consumer electronics like cell phone, cars etc.
- Price Penetration: This is when firms initially charge low prices to compete with existing competitors and after gaining decent brand recognition prices are increased to increase firm's profits.

Pricing Strategies

- **Predatory Pricing:** This is when larger firms deliberately charge very low prices to force smaller firms with high average cost to exit the market. This is illegal practice.

Non Price Competition

- Through non-price competition strategies firms strive to create unique brand image, enhancing product quality and its other features to attract larger proportion of market.
- Branding and advertisement are important elements of non-price competition.

Is Competition always beneficial for customers?

- Yes, greater competition compels firms to enhance their product quality and aggressively compete on prices. Lower prices and improved product quality are major benefits received by customers due to competition.
- Hence industries with more firms that aggressively compete among each other result in high consumer wellbeing.

Market Structures

- Market Structure refers to characteristics that determine level of competition in any industry. Two types of Market Structures that we will study are as follows:

1. Perfect Competition
2. Monopoly

Monopoly

- Monopoly refers to market structure where there is only one firm. In monopolistic markets there is either only one firm or one dominant firm that has most of market share.
- Due to absence of competition there are no incentives for monopolist to improve product quality or to lower its prices.
- Less Price Elastic demand for monopolistic goods allow monopolists to charge high prices which help them to earn exceptionally high profits called Abnormal Profits.

Perfect Competition

- Perfect Competition refers to industry where there are a lot of firms producing a product.

- The nature of product is homogenous meaning it is difficult to differentiate between products of different manufacturers as they are identical.

Perfect Competition

- There are low or no barriers to entry meaning that new firms can easily enter the industry in terms of initial investment requirement etc.

- Presence of many firms create healthy competition which results in lower prices and hence lower profits for producers.