Market Structure: is the term used to define how economists have classified different types of markets in categories to help us understand how ***different markets behave and operate.***

All markets are classified in 4 categories to helps us better understand how different markets operate:

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

For each of these market structures we will discuss their features/characteristics and look at their graphs to better understand how each one operates.

Market is a physical space or virtual platform through which producers and consumers make transactions.

Perfect Competition

Is a market where there is a lot of competition because of many firms.

1. Many firms in the market
2. These firms produce homogeneous/identical products like agricultural products like vegetables, apples etc for which there is no branding
3. There are no entry and exit barriers
4. The firms are price takers which means they sell their output at the prevailing market price, and no firm can charge a price higher than that.
5. Consumers have complete information.

Market Supply: is the aggregate (combined) supply from all producers producing a certain product in the market

Market Demand: is the aggregate (total) demand for a certain product by all the consumers in a market.

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Types of Profit

a) Normal Profit -- P = ATC
b) Abnormal Profit / Supernormal profit---------------------- P > ATC

Unlike accounting definition of cost which does not include the opportunity cost, economists include the business opportunity cost in the cost calculation and therefore **if price is equal to ATC then it means that a business is making just enough profit as much it would have made by investing this amount in some other venture.**

On the other hand, if a business is making abnormal profit then it means that the current level of profit is higher than what you could have achieved in an alternate use of investment.

Whenever a market / sector is making abnormal profit that is an incentive for new firms to enter. On the other hand, if a market / sector is making normal profit then no other firm will wish to join that market.

Online teaching platform = Rs 5 million / annum

Restaurants = Rs 15 million / annum

Monopoly

Market Structure in the spectrum of Competition

Most Competition ***Least Competition***

Perfect Competition ***Monopolistic Competition*** ***Oligopoly*** ***Monopoly***

MEGA LECTURE

Characteristics are of a Monopoly

1. Single firm or one dominant firm with high market share
2. There are high entry and exit barriers. Sometimes these barriers are legal like patents and copyrights, or government imposed like government owned monopolies in airline, railway and utility companies (like electricity and gas producing).
3. The firm is price-maker which means being a single producer the firm can set whatever price it wishes to.
4. The monopolist’s demand curve is less elastic.

The Short and Long Run Equilibrium of Monopoly

Since the entry barriers are quite high in a monopoly therefore no new firm is able to enter, hence the monopoly graph will look the same both in short and long run. And monopoly would continue to make abnormal profit even in the long run.

In markets where entry barriers are relatively low the new firms are able to entry in the long run which drives the profit of firms from abnormal to normal profit.

Points to Remember

In case of a downward sloping demand curve the marginal revenue would lie to the left of the demand curve because downward sloping demand curve shows that price per unit is always decreasing with increase in output and therefore each additional unit of good would contribute less in revenue.

Monopolistic Competition

1. Many firms operate in the market but not as many as in perfect competition
2. These firms are producing similar products but there is a lot of emphasis on branding and marketing. Monopolistic competition usually exists in consumer markets like clothing, cosmetics, processed food and so on.
3. There are relatively low entry barriers except for competition from well-established firms that have very popular and trusted brands
4. Firms in Monopolistic Competition are both price-maker and a price -taker because there are other firms making similar products which means that you cannot charge very high

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prices since it is a unique brand therefore consumers might be willing to pay a higher price

Short and Long Run Equilibrium in Monopolistic Competition

Due to the limited number of firms in the short run, each firm has relatively higher market share and therefore every firm is making abnormal profit. However, this attracts more firms in the market in the longer run causing a leftward shift in every firm's demand curve and so the abnormal profit comes down to normal profit.

Oligopoly

Markets where the product is complicated and / or expensive to produce and therefore there are few large firms only.

Markets like telecommunication, airline industry, ***oil and gas*** industry are the ones that would be classified as Oligopoly.

Characteristics of Oligopoly

1. Few large firms which have captured a big market share
2. There are ***relatively high entry barriers*** in terms of producing a technologically complicated product and the amount of investment needed to set up the operations.
3. Most of the times, the nature of the good produced by firms in Oligopoly is ***homogeneous (similar).***
4. There is ***price rigidity*** which prevents a single firm to change the product price.
5. To overcome the problem of price rigidity the firms in Oligopoly markets are very likely to form a **collusion.**

Price Rigidity is when a single firm in an Oligopoly market cannot increase or decrease price and therefore prices stay constant at the initial level.

If for example, a firm raises its price then there is a high chance that other firms would not increase their price and as the result the first firm's customers are likely to switch to its competitors to benefit from lower prices.

On the other hand, if a company reduces the price then other firms will also follow to stay competitive and therefore there is a chance of price war where all firms in the market make lower profits due to lower prices.

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Therefore the solution to price rigidity is Collusion. Collusion is basically when a number of firms come together to make an agreement as to act as a single producer by mutually deciding their prices and output. The collusion agreement is always illegal and therefore companies make every effort to ensure that regulatory bodies do not find out their agreement.

Types of Collusion Agreements

1. ***Price Leadership / Implicit Collusion:*** out of the firms that are part of collusion one firm is selected as the leader and therefore whatever price that firm charges, other firms follow. In price leadership it is difficult for regulatory bodies to identify collusion.
2. **Cartel / Explicit Collusion:** is when there is publicly known agreement between the companies that they will collectively set their prices and output.

Business Objectives

- Survival
- Expansion / growth
- Higher Market Share
- Profit maximization
- Output Maximization
- Sales Revenue / Revenue Maximization
- Profit Satisficing

Survival - it is major objective for firms that are just starting in an already ***saturated*** and ***competitive*** markets like monopolistic competition. For firms that are just aiming for survival would initially focus more on product quality, they might try to cut their competitors on the basis of prices and would try reaching out to as many customers through promotion as much they can.

In the short run a firm is aiming to have its price above average variable cost however in the long run a firm has to have its price above average total cost to be profitable.

Expansion / growth: after survival a firm would wish to increase its customer base by entering new market segments so as to increase their sales.

Higher Market Share: market share is the percentage of total market sales that is captured by one business.

Firm Sales / Market Sales * 100 = Market Share

MEGA LECTURE

Profit Maximization: this is when a business wants to maximize the return of its shareholders.

Profit = ***Revenue*** - ***Cost***

Output Maximization: is when the quantity produced is to be maximized and there are different reasons why businesses want to do this for instance to benefit from economies of scale, to reach out to larger number of customers for brand popularity etc and so on.

Sales Revenue Maximization: is useful when a business is such that it has zero marginal costs associated with a new customer and therefore whatever amount a new customer pays would directly increase the business profits given its fixed cost is already covered.

Profit Satisficing: is when a business tries making a decent level of profit and along with that its aims to keep its major stakeholders happy like customers by providing higher quality product for them to stay loyal, employees by ensuring their decent salaries so that they work harder and so on.

MEGA LECTURE

Past Paper Practice

Q1) Discuss whether profit maximisation is the best strategy in the long run for firms in different market structures.

- Definition of Profit
- Different business objectives (sales revenue maximization, survival, higher market share)
- ***Perfect Competition:*** yes most firms in perfect competition would aim for profit maximization but they face a major constraint of not being able to influence product price.
- ***Monopolistic Competition:*** yes it is a good strategy because with higher profits the investors will get a better return on their investments and therefore they will be willing to invest more in the business, secondly more retained profit of a business would allow it to expand to other markets and segments.

- But on the downside, strict profit maximization can also be harmful because that might mean lower salaries for workers which can reduce their incentives to work, less or no discounts for customers,
- ***Oligopoly:*** yes, especially when they have formed in collusion. But in case there is no collusion in the oligopoly market then it could for any firm to strictly maximize profit for that can be at the risk of losing your customers.
- ***Monopoly:***

Principal Agent Problem - Is when managers of a business are not strictly about profit maximization but instead they try to maximize their benefits in terms of higher salaries, more output if they receive commission based on business production etc.

Past Paper Practice

Large organisations face no competition. There is, therefore, no choice. Small competitive businesses are a better means of providing for consumers' needs.

Do you agree with this argument? [25]

How do larger organizations compare with smaller organizations in terms of providing for consumer needs?

Larger Organizations are generally found in markets with lesser competition and vice versa. Simply speaking Oligopoly and Monopoly markets have fewer firms compared to Perfect Competition and Monopolistic COmpetition.

Benefits of Smaller Organization / Perfect Competition / Monopolistic Competition

Versus

Benefits of Larger Organization / Monopoly / Oligopoly

Smaller Organizations:

1. More companies meaning more brands for consumers to choose between
2. There is more intense competition when there are multiple firms and therefore consumers can expect lower prices

3. Another advantage of markets with smaller firms like perfect competition (PC) is that such markets are more economically efficient. ***Explain how PC is both productively and allocatively efficient***
   Productive Efficiency refers to producing at lowest possible cost and benefit of which is then transferred to consumers in terms of lower prices.
   Allocative Efficiency refers to producing goods / services that are most wanted in optimal quantities. And when businesses are allocatively efficient that means they produce at the level which is desirable for an economy (meaning no over or under-production).

Larger Organizations:

1. With more investment larger companies can produce more expensive and technologically sophisticated products which smaller companies cannot produce.
2. Larger companies benefit from economies of scale which means their average total cost decreases as they produce more quantities of the good and therefore this can benefit consumers in terms of lower prices.
3. Moreover, larger companies with more funds can invest in research and development which is often needed in many industries to make new and innovative products like pharmaceutical products.

In the end, students would be expected to summarize their arguments and end their answer.

There are benefits of both smaller and larger organizations and therefore we cannot always refer to either one as more beneficial than the other one.

Some markets demand firms' size to be larger as they require more investment, more technology and therefore larger firms with more investments are a better fit to those markets whereas on the other hand smaller companies are better for some markets where products are relatively simple and homogenous like agricultural markets and therefore with more smaller firms consumers get more choice and lower prices.

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Large firms necessarily become monopolistic. Monopolies adopt practices that are undesirable. Therefore, large firms should be regulated by governments.

Discuss whether there is any truth in this argument. [25]

1. ***Do large organizations always become Monopolistic?***

Yes, if they have captured a lot of market share then they would get unfair power over consumers like they can manipulate market supply and through that they can influence market price of the products.

But perhaps not always larger organizations form a monopoly since there could be smaller firms operating along with larger firms and therefore they can provide more choice to consumers.

2. ***Do monopolies always adopt undesirable practices?***

For this section, a student is expected to comment on how monopolies are economically efficient and how through that they can exploit consumers.

Explanation of how monopolies are productively and allocatively inefficient. A diagram could help. Then linking it to how being economically inefficient is a problem for consumers like charging higher prices for products, not producing at optimal level and therefore there would always be less products available compared to what are demanded by the consumers.

3. ***Should governments regulate monopolies?***

Yes, with regulations around how much prices monopolies can charge would limit their ability to exploit consumers as then they would be able to overcharge consumers. Similarly, having regulations related to product quality and the quantity which has to be produced would bring monopoly's output closer to economically efficient output level.

No, because larger organizations are beneficial to consumers in terms of able to invest more in research and development and can offer lower prices in terms of economies of scale.

MEGA LECTURE

There are often reports in the press that company profits have not risen as much as in previous years. As a result the company receives adverse criticism.

(a) Explain what a company might do if it wished to try to increase its profits. [13]

(b) Discuss what alternative objectives a company might have apart from profit maximisation. [12]

a) Profit = Revenue - Costs

Revenue is the total amount of money a business receives from the sales of its products.

Costs are total expenses incurred in producing the products.

How do businesses maximize their profits?

Regardless of business size or the market in which it operates, the profit maximizing behavior of firms is the same which is producing at the output level where their MC is equal to their MR.

Definition of MR
Definition of MC

When a business produces at the levels where its MC is equal to its MR the difference between total revenue and total costs for that business is highest and therefore it helps the business to maximize its profits.

b) Even though profit maximization is any private business ultimate goal, it would also pursue other goals from time

1. ***Survival:*** means to compete with well established firms which already exist in the market. Make at least enough revenue to pay for its running expenses otherwise the business will be forced to exit the market.

Short run Survival = P > AVC (the business will still not be profitable but at least it will be covering its running expenses)
Long Run Survival = P > ATC (so that the business is earning some profit and therefore it can sustain itself)

2. ***Growth / Expansion:*** after survival the next thing a business would wish to pursue is attracting more customers so that it can sell larger quantities of goods and therefore can expand.
    - More advertisement
    - More promotional offers like discounts and awareness campaigns

3. ***Economies of Scale:***
4. ***Achieve Productive Efficiency:***
5. ***Brand Loyalty:*** is when a customer has a strong preference for your brand and therefore he / she would have a repeat purchase.
    - Unique selling points

MEGA LECTURE

(a) Explain the difference between price leadership and price discrimination. [12]

(b) Discuss whether firms always want to maximise profits and are able to do so in the way suggested by economic theory. [13]

Price Leadership: is when a firm in the Oligopoly market is selected as the leader and whatever prices it charges all other firms follow that.

Price Leadership is a form of collusion which eliminates the competition between firms in Oligopoly markets and therefore helps all firms earn higher profits.

2 types of collusion:

1. ***Implicit Collusion / Price Leadership***
2. ***Explicit Collusion / Cartel***

Price Discrimination: is when for the same product different consumers are charged different prices.

3 types of Price Discrimination

a. ***First Degree Price Discrimination:*** it is when a producer knows exactly know how much a consumer can pay and therefore producer charges each consumer according to his/ her ability to pay. For instance, lawyers are well suited to use first degree price discrimination as they are vert likley to be aware of their client's financial position.

b. ***Second Degree Price Discrimination:*** it is when price of a product varies with the quantity of the good consumed. For instance, the first few units of electricity are charged lower compared to later units of electricity which also discourages people from wasting electricity. Another example of this type of discrimination could be bulk discounts where the price per unit decreases with more quantity purchased.

c. ***Third Degree Price Discrimination:*** when consumers are classified in different categories based on their price elasticity of demand (ability to pay) and then people with less price elasticity of demand are charged higher than people with lower price elasticity of demand.

MEGA LECTURE

(a) Some firms have power over their market. Explain what this means and consider why this power might change in a contestable market. [12]

(b) Discuss the different aims a firm might have in order to continue with production. [13]

a) *Power over a market refers to a firm's ability to control the market outcome*. For instance, a monopolist can control the output produced to artificially increase product prices.

Similarly, in Oligopoly if the firms form a collusion then they can collectively reduce market output and therefore can increase product prices and control market outcome.

Collusion is when firms in an oligopoly market form an agreement that they will collectively decide on product prices and product output.

A contestable market is where there are NO entry and exit barriers WHICH MEANS THAT NEW FIRMS CAN EASILY ENTER THE MARKET. Entry barriers are any constraints that restrict entry of new firms in the market. For instance, high investment requirements, legal restrictions like patents and copyrights etc, competition from well-established brands.

Since the contestable market has no entry barriers therefore we would expect more firms to enter the market hence diluting the market share of existing firms.

A perfect example of a contestable market is perfect competition where we see that a new firm can easily enter the market and can capture some of the market share.

When new firms enter a market then competition for the existing firms increase, and therefore they would respond to this competition by offering lower prices, better quality etc.

b) Different Aims of a Firm

At different stages of the life, a business has different objectives some of the more common ones are listed below:

1. Survival
2. Break Even
3. Increase in Market share / expansion
4. ***Brand Loyalty:*** when a customer is not indifferent between different brands but instead prefers a certain brand over all other brands.
5. Brand recognition etc.
6. Increased efficiency (reducing production costs) to boost business profitability

MEGA LECTURE

Discuss the similarities and differences between a firm's behaviour in perfect competition and oligopoly. [25]

Define perfect competition and lists its characteristics
Define oligopoly market and lists its characteristics

Perfect Competition

1. A lot of firms and many buyers
2. No entry and exit barrier
3. The nature of goods is homogenous
4. Firms are price takers - they sell the goods at the price prevailing in the market
5. Consumers have complete knowledge about product prices and quality of the goods.

Oligopoly

1. A market with few big firms
2. The firms have high market share
3. The entry barriers are high
4. The nature of goods is homogenous (similar)
5. The firms are likely to form a collusion - when firms mutually decide on product prices and output (collusion is always illegal no matter what country it is)

Similarities

1. Both market produce homogenous natured good

MEGA LECTURE

There are often reports in the press that company profits have not risen as much as in previous years. As a result the company receives adverse criticism.

(a) Explain what a company might do if it wished to try to increase its profits. [13]

(b) Discuss what alternative objectives a company might have apart from profit maximisation. [12]

a) Define profit

Profit is the amount a company saves from its revenue after paying all of its expenses.

How can a company maximize the profits?

1. Maximize revenue
2. Minimize costs

Maximizing revenue requires a company to evaluate the nature of its product and then by estimating the product's PED the company can set its prices such that they maximize the revenue.

For instance, if a product's demand is inelastic then producers can set high prices which will help in increasing total revenue.

For cost minimization a firm needs to be productively efficient. Productive efficiency is when a business produces its output at the lowest possible average cost.

Productive efficiency is achieved by introducing new technology, methods and processes that eliminate unnecessary and inefficient processes and therefore helping the business achieve higher efficiency. For instance use of Just In Time approach as opposed to conventional inventory management systems reduce business fixed costs as it does not need to spend a lot on warehouse and therefore it would overall decrease the business average total cost.

b) Market Share
Brand loyalty
Unique selling point
Sales maximization

The market price of a company's share is basically a measure of how well a company is doing for instance if a company has become more profitable or is expected to be more profitable in the future then the share price will increase and vice versa.

CA LECTURE

Gillette, the world's largest razor maker, announced in August 2003 that its annual profits had risen by 15%. In the same period, its sales increased by 11% as there was increased demand for its Sensor3 and Mach3Turbo razors and a reduction in the price of Duracell batteries, which Gillette produces. However, Gillette faces strong competition from Energizer Holdings, which sells batteries and Schick razors. Energizer introduced a new four-blade razor in September 2002 and increased its advertising and product promotion. Gillette lost US market share and announced it planned to increase expenditure on marketing.

Explain how firms are said to behave in oligopolistic markets and discuss how far this is supported by the above statement. [25]

First of all a student would be expected to talk about Oligopolistic markets.

Collusion is when firms form an agreement that they will collectively set prices and output. This way the firms in oligopoly markets form a monopoly and therefore it gives complete control over the market.

As per the information in the passage the 2 firms are not colluding as it is evident that they are aggressively competing with each other.

Firms in Oligopoly markets have kinked demand curve.

Another common characteristic of Oligopoly market is price rigidity. Without collusion, the firms in an Oligopoly market have 2 options namely to increase the price or to reduce the price. If they try increasing the price the fear is that the competitors would not follow and therefore the company would lose its customers to its competitors.

On the other hand, if a company decides to reduce its price then it fears to start a price war in which each firm is trying to offer the most competitive price and in the process all companies experience a decrease in their profits.

Large organisations face no competition. There is, therefore, no choice. Small competitive businesses are a better means of providing for consumers' needs.

Do you agree with this argument? [25]

Economists have classified markets in different categories based on their characteristics. The categorization divides markets into one of the 4 categories namely monopoly, monopolistic competition, oligopoly and perfect competition.

Large organizations usually exist in market structures of monopoly, duopoly and oligopoly. On the other hand, smaller organizations exist in monopolistic competition and perfect competition.

If we compare smaller and larger organizations in terms of providing goods for consumers, both firms have their own advantages and disadvantages for consumers.

Benefits of Larger Organizations	***Benefits of Smaller Organizations***
Larger organizations benefit from economies of scale due to their huge size and therefore they can benefit consumers in terms of lower per unit of price.	More small sized organizations exist in market structures where there are entry and exit barriers. So its easier for the new firms to enter the market.
They can offer more variety of goods which	More small sized firms will aggressively

MEGA LECTURE

some consumers might prefer.	compete amongst themselves and therefore they are likely to provide better deals and service to consumers.
With mass customization companies like Ikea and Toyota can slightly modify their products to better suit different segments of the market.	Smaller firms are more flexible to offer customized products and services to their customers and therefore even a small market segment is not left unexploited.
Larger firms can invest more in research and development and therefore products which do require R and D are better produced by larger rather than smaller firms. Products like medicines, military goods, production machinery are better produced by larger than smaller firms.	More personalized services, which some consumers might like a lot.
With availability of more funds larger firms can produce more innovative goods which could not be produced by smaller firms.	Larger organizations can use unfair practices like predatory pricing which is setting prices so low to drive the competitors (mainly smaller firms) out of the market. Once smaller firms are driven out of the market like this then in the longer run the large firm can form a monopoly.
	Due to their ability to afford expensive marketing, larger firms might not focus a lot on productive efficiency.
	Firms in perfect competition are allocatively and productively efficient which larger firms in monopoly and monopolistic competition are not.

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For smaller and simpler consumer products like food items, clothes, basic home accessories smaller firms are a better fit since they offer more competitive prices, personalized products and personalized services.

On the other hand larger firms are better at producing products which are more technological and require more research and development and therefore it would be better if larger firms produce these more technologically sophisticated and expensive products.

Airbus, a large aircraft manufacturing company, announced in 2007 that its goal was to increase its $475 million research budget by 25% in order to try to develop a more environmentally friendly aircraft that had lower fuel consumption.

(a) Explain why Airbus is likely to be in an imperfect rather than a perfect market structure. [10]

(b) Economics textbooks sometimes criticise firms in imperfect competition as being against the public interest. What does this mean, and how far does the Airbus announcement prove the textbooks wrong? [15]

a) Define perfect and imperfect market structures

Perfect market structure or as we call perfect competition exists when there are a number of firms and many buyers that are willing to buy homogenous goods, at the price prevailing in the market and there are no entry and exit barriers. And consumers have complete information.

On the other hand, in imperfect markets there are a limited number of firms, there are high entry and exit barriers, products are often not homogenous and firms can charge consumers prices as per their own wishes and therefore prices of all firms in the market are not necessarily the same.

Airbus is one of the few firms in the world that is part of aircraft manufacturing business. The entry barriers to aircraft manufacturing business are high including huge investment requirement, a lot of technical expertise, patents and copyrights etc.

Since entry barriers in the aircraft manufacturing business are high we would obviously expect few firms. Secondly, the research fund available to Airbus is too huge for a small firm to have. Secondly, if a company like Airbus is one of the few firms producing a huge product like an aircraft then obviously the product price is inelastic.

Another reason for Airbus to be part of imperfect market is that consumers / buyer (like the airline business) would not have complete information about the nature of the good and how much it actually costs to produce an aircraft therefore violating the assumption of perfect competition which is that consumers have complete information.

b) Are firms in imperfect competition always harmful for general public (consumers, government, society as a whole, employees etc)?

MEGA LECTURE

Argument in favor of large firms being harmful for public

1. Due to the limited number of firms in imperfect markets, they can have huge bargaining power against consumers and therefore they can exploit the situation to charge higher prices making airline business less profitable and therefore making air travel less affordable for general public.
2. Secondly, these companies can form a collusion to form a monopoly through which they could further exploit the consumers.
   Collusion is when firms in a market sign an agreement through which they fix product prices and limit their output. Therefore this gives firms more control over the market.
3. The firms operating in imperfect markets are often found to be producing less than allocatively efficient level. Allocatively efficient output level refers to the optimum level of output that firms should produce. Any quantity less than P = MC is defined as underproduction and is therefore undesirable for the society.

Argument in favor of large firms being beneficial for the society

1. Large firms in imperfect markets have huge amounts of research funds as also mentioned in the question and so with these funds these companies can constantly innovate and improve the quality of their products which would eventually benefit the consumers.
2. Secondly large companies benefit from economies of scale. Economies of scale is when a firm produces a product in large quantities and therefore it reduces its per unit cost hence resulting in cheaper production.And therefore lower prices for consumers.
   - Bulk Buying Economies
   - Technical Economies
   - Financial Economies: is when large companies can raise funds at lower cost because they have less default risk and so can produce at a lower average total cost (ATC)
   - Managerial Economies
   - Marketing Economies
3. Large companies make huge profits and therefore they can contribute more amount of taxes to government revenue rather than what smaller firms can do.

Evaluation: not always large firms or imperfect markets are harmful for the public as they can provide some unmatched benefits which smaller firms cannot offer. So depending upon the exact situation we should evaluate whether a large firm is against public interest or not.

MEGA LECTURE

Large firms necessarily become monopolistic. Monopolies adopt practices that are undesirable. Therefore, large firms should be regulated by governments.

Discuss whether there is any truth in this argument. [25]

Define monopolies

Monopoly is a market structure where there is either only one player or one major player with a huge market share. For instance, Pakistan Railway is the company that provides railway services in Pakistan.

Though it is likely that large firms can have monopolistic powers but not always are large firms monopolistic. With a high market share a firm gets control over the market, which means it can influence the market supply and therefore can influence the market price. By controlling the market supply and charging higher prices a monopoly tries to maximize its profits which companies in other market structures do not have the option of doing.

Furthermore, monopolies are also not economically efficient. They are neither allocatively nor productively efficient.

Monopolies are less likely to be productively efficient, since they do not face much competition in the market and therefore they do not have the need to compete for customers through lower prices and therefore even if monopolies cost of production is higher, they can charge higher prices to cover up their higher costs and therefore will still make abnormal profit.

Profit = Revenue - Cost

Another problem with monopolies is that they can prevent entry of new firms in the market to avoid new entrants creating competition for them.

(a) Discuss whether it is always advantageous for a firm to grow in size. [12]

(b) Explain the economic theory of profit maximisation for a firm and consider whether firms are likely to follow this theory in fixing their price and output. [13]

MEGALECTURE

a) Advantages

1. Benefit from economies of scale and explanation of how a firm benefits from economies of scale as it grows in size.
   With lower per unit cost of production these larger firms can attract more customers by offering lower per unit prices.
2. Get to capture more market share and it allows to firms to get more brand recognition helping them with more sales and marketing
3. With more funds available, these larger companies can invest more in research and development allowing them to constantly innovate their products and develop unique selling with which they could capture even larger market share.

Disadvantages

1. Being part of a larger corporation oftentimes employees feel alienated and so could become demotivated and therefore would result in lower labor productivity causing per unit costs to rise.
2. Government might set up competition commission investigations if a firm is too large and is satisfying a big chunk of the total market demand.
3. Higher taxes
4. Difficulty in managing a large firm effectively

b) Explain in detail how firm maximize their profits which is basically the difference between its revenue and costs

Profit is the money a business makes from the sale of its products which is basically the amount of revenue left with the business after paying all of its expenses / costs.

How do firms maximize profit?

To maximize profits firms need to maximize their revenue and minimize their costs which is achieved by producing at the level where the firm's marginal revenue is equal to its marginal cost.

For revenue maximization a firm needs to devise suitable pricing policies based on the product's price elasticity of demand.

MEGA LECTURE

With less / inelastic goods <> higher the price higher the revenue

With more elastic goods <> higher the price, lower the revenue

MEGA LECTURE