

Market

According to J.C. Edwards, "A market is that mechanism by which buyers and sellers are brought together. It is not necessarily a fixed place."

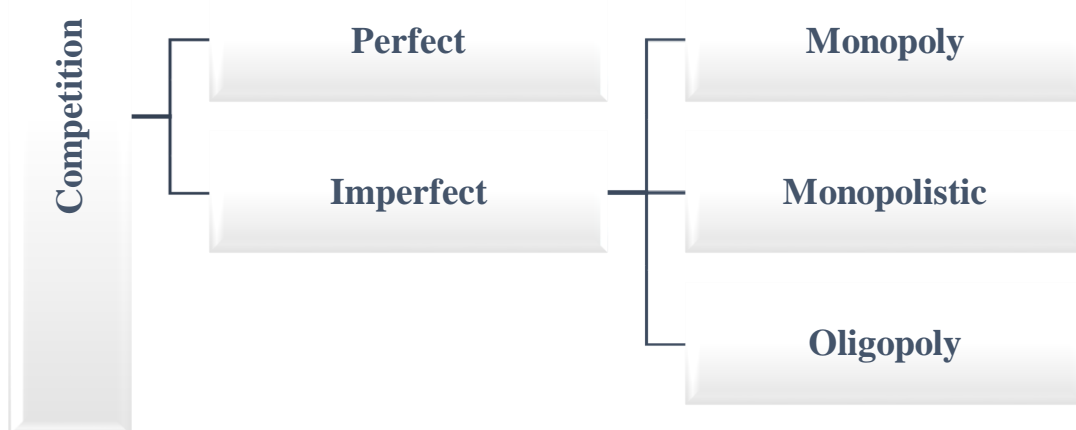
Market is a place where parties can gather to facilitate the exchange of goods and services. The parties involved are usually buyers and sellers. The market may be physical like a retail outlet, where people meet face-to-face, or virtual like an online market, where there is no direct physical contact between buyers and sellers.

Beyond that broad definition, the term "market" encompasses a variety of things, depending on the context. For instance, it may refer to the place where securities are traded—the stock market. Alternatively, the term may also be used to describe a collection of people who wish to buy a specific product or service in a specific place, such as the Brooklyn housing market. Or it could refer to an industry or business sector, such as the global diamond market.

Markets may be represented by physical locations where transactions are made. These include retail stores and other similar businesses that sell individual items to wholesale markets selling goods to distributors. Or they may be virtual. Internet-based stores and auction sites such as Amazon and eBay are examples of markets where transactions can take place entirely online and the parties involved never connect physically.

Market Structure

Market structure, in economics, refers to how different industries are classified and differentiated based on their degree and nature of competition for goods and services. It is based on the characteristics that influence the behaviour and outcomes of companies working in a specific market.



Perfect competition

Perfect competition occurs when there is a large number of small companies competing against each other. They sell similar products (homogeneous), lack price influence over the commodities, and are free to enter or exit the market.

Consumers in this type of market have full knowledge of the goods being sold. They are aware of the prices charged on them and the product branding. In the real world, the pure form of this type of market structure rarely exists.

According to Leftwich, "Perfect competition is a market in which there are many firms selling identical product with no firm being large enough relative to the entire market so as to be able to influence market price."

Characteristics of perfect competition

- (1) Large number of buyers and sellers:** There is a large number of buyers and sellers of a commodity under perfect competition but each buyer and each seller is so small in comparison with entire market of product that he cannot influence the market price by changing the quantity of the product sold by him. Hence a uniformity of price is there under perfect competition and as a consequence of uniform price prevailing in the market average revenue (AR) or the price of the product is equal to the marginal revenue (MR).
- (2) Homogeneous Product:** The second important characteristic of the perfectly competitive market is that the product sold by the various firms are homogeneous. The products are homogenous in the sense that they are perfect substitutes from the buyer's point of view. The sellers do not spend on advertisement and publicity etc. because all the firms sell homogeneous product.
- (3) Absence of artificial Restrictions:** The third major characteristic of the perfect competition is the non-existence of any artificial restrictions on the demands, supplies, prices of goods and factors of productions in the market. There must not be any external intervention in price fixation and any controls on the product.
- (4) Free entry and exit:** The fourth characteristic of perfect competition is free entry and free exit for the firms under perfectly competitive market. The firms are free to enter or to exit from the industry whenever they want to do so. Any firm can enter or leave the industry at any time as there is no legal restriction.
- (5) Perfect knowledge about the market:** There is perfect knowledge on the part of buyers and sellers about market conditions. The buyers and sellers are fully aware of the price prevailing in the market. Due to this awareness all the firms charge on price from the buyers.

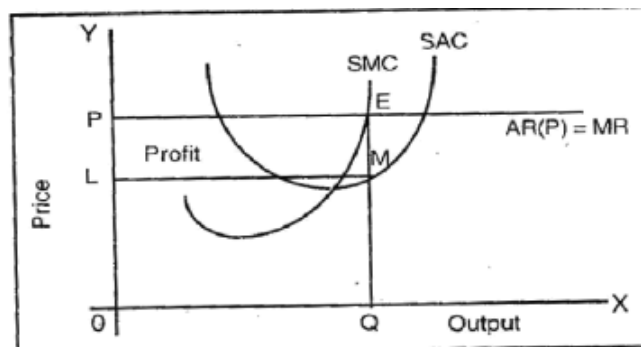
A. PRICE AND OUTPUT DETERMINATION UNDER SHORT PERIOD:

A firm is said to be in equilibrium in short period where marginal cost (MC) is equal to marginal revenue (MR) and the curve MC cuts MR from below. This also determines the level of output. A short period is the period in which all factors of production cannot be changed, only variable factors like labour, raw material etc. can be changed for the change in the level of output. Hence, short period is such a period in which no firm enters or leaves an industry.

Under equilibrium position, a firm in short period can have the following situations:

- 1) Super Normal profit or Profit situation.
- 2) Normal profit situation.
- 3) Loss situation.
- 4) A case of shut down point.

(1) Super normal profit or a profit situation: As depicted in the diagram 8.1 average revenue (AR) is equal to marginal revenue (MR) which is shown by horizontal line parallel to the x-axis and short run average cost (SAC) and short run marginal cost (SMC)



According to the condition of equilibrium of a firm the equilibrium will be at E where SMC equals MR from below and also cuts SAC at its minimum. Hence the price and output are determined at point E. The price is OP and the level of output is OQ.

Average cost = OL or MQ

Then profit per unit = EQ-MQ = EM or PL

Hence,

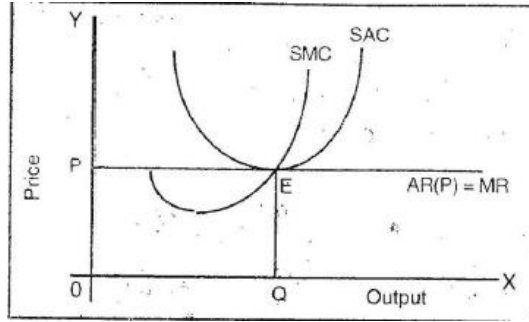
Total profit of the firm = PLME

(2) Normal profit situation: Next possible situation in short period can be of a normal profit. When there is no profit i.e. average cost equals the average revenue or price per unit. In diagram 7.2 OP is the price given by the industry and SMC also cuts MR from below and at its point E, SMC and SAC, AR and MR are all equal. Hence, the level of output is determined equal to OQ and the price charged by the firm is OP or EQ.

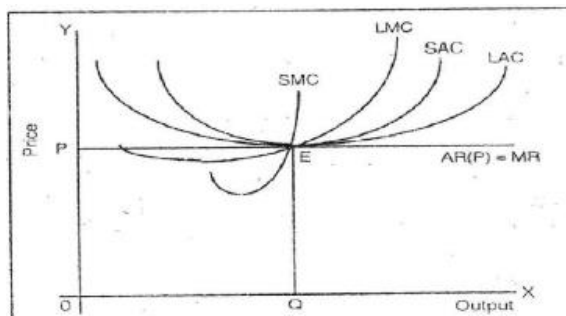
Average Cost = EQ

Profit per unit = EQ-EQ = Zero

Hence, at this point of equilibrium E the firm is has normal profit Normal profit situation is a situation in which a firm neither makes a profit nor makes a loss. Normal profit is a minimum revenue a firm must get to continue in the industry.



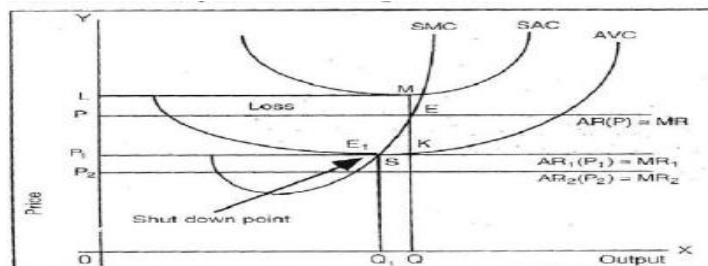
- (3) **Loss situation:** Third possibility in short period under perfect competition may be loss situation where the prevailing market price may be less than the average cost of the firm that is to say that AR is less than its AC. In such situation the firm will be incurring losses.



Here in equilibrium at a point E and output is determined equal to OQ and OP is the price charged by the firm. At point E, SMC cuts MR from below and SAC at its minimum.

$$\begin{aligned} \text{Per unit price} &= OP \text{ or } EQ \\ \text{Per unit cost} &= OL \text{ or } MQ \\ \text{Per unit Loss} &= ME (=MQ-EQ) \\ \text{Hence, total loss} &= LP \text{ ME} \end{aligned}$$

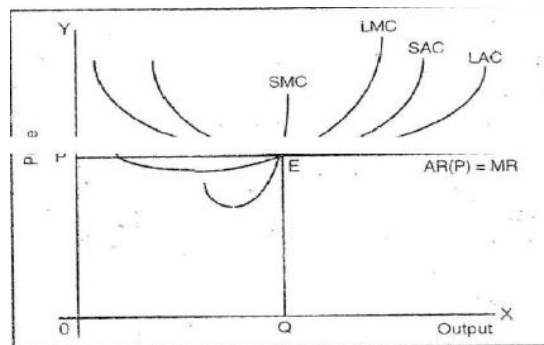
- (4) **A case of shut down point:** Firm will continue production up to a particular level if it is able to meet its variable cost of production but if AR is less than its average variable cost (AVC) then it will close its doors and stop production.



The shutdown point arises at that point where the price is below the variable cost. Thus, in short period when the price is less than the variable cost then it will stop production. When the price is OP then the level of output is OQ and firm is incurring losses equal to LP ME at equilibrium point E. When the price is OP then output will be less as before equal to OQ1 and the equilibrium is at E1. Here the firm is meeting its average variable cost and if the price reduces beyond this to OP2 then it will close its doors. Thus, E is the shutdown point of the firm where price is equal to average variable cost ($P=AVC$).

B. PRICE AND OUTPUT DETERMINATION UNDER THE LONG PERIOD

Long run is that period in which all the factors of production, production as well as technique, size of the plant etc can be adjusted for production according to its demand and any firm can enter or exit. Thus, in the long run every firm is enjoying the normal profit. If in long run the firms make super normal profit then other firms will enter the industry and start production which will increase the supply side and lower down the price. Hence, there will be normal profits. On the other hand if the firms are incurring losses then the firms will exit from the industry and the supply will decrease so as to increase the price, the losses will disappear and the situation of normal profit will prevail under perfect competition in the long run



Here in long run the firm will be in equilibrium at E, OP is the price and OQ is the level of output. In long run the equilibrium will be where

$$\begin{aligned} \mathbf{MR} &= \mathbf{MC} \\ \mathbf{AR} &= \mathbf{AC} \\ \mathbf{or\ AR} &= \mathbf{MR} = \mathbf{AC} = \mathbf{MC} \end{aligned}$$

and at point E this condition is fulfilled. The long run equilibrium equation in perfect competition is. (SAC = SMC = LAC = LMC = AR = MR = P) Per unit price (AR) = OP or EQ
 Average cost (AC) = EQ
 Output = OQ
 Profit = AR-AC i.e. EQ-EQ = 0.

