Market Structure: Monopoly

MONOPOLY

- The Word Monopoly is a Latin Term. '**Mono**' means **Single** and '**Poly**' means **Seller**.
- Monopoly is a form of Market Organization in which there is **only One Seller** of the Commodity.
- There are **No Close Substitutes** for the Commodity sold by the Seller.
- Example : Indian Railways

DEFINITIONS

- According To **Koutsoyiannis** ,

  "Monopoly Is a Market Situation in Which There is A single Seller, There are no close substitutes for commodity it produces ,there are barriers to entry."

- According To **Baumol** ,

  " A pure Monopoly is defined as the firm that is also an industry. It is the only supplier of some particular commodity for which there exist no close substitutes."

EXISTENCE OF MONOPOLY

- True monopolies generally exist in government controlled markets.
  - ✓ Ex. : Indian railway
- Monopoly in private business is rare.
  - Private firms who have considerable market share.

  Like : Google
  Microsoft
  Apple

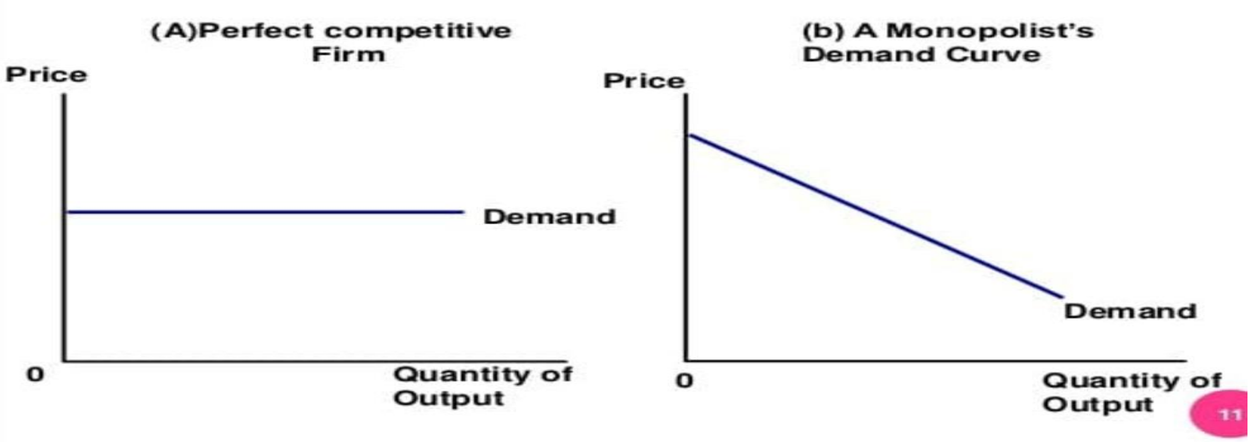
Features or assumptions of Monopoly

- One seller and large number of Buyers.
- Monopoly is also an Industry.
- Restrictions on the Entry of the New Firms.
- No close Substitutes.
- Price Maker.
- Price Discrimination.
- Downward Sloping Demand Curve.

MONOPOLY v/s PERFECT COMPETITION

Perfect competitive Firm	Monopoly
Is one of many producers	Is the sole producer
Has a horizontal demand curve	Has a downward-sloping demand curve
Is a price taker	Is a price maker
Sells as much or as little at same price	Reduces price to increase sales

Nature of Demand Curve for Perfect competitive firm and Monopolist Firm



TYPES OF MONOPOLY

- **Natural monopoly**: A monopoly that arises from economies of scale. The economies of scale arise from natural supply and demand conditions, and not from government actions.
- **Local monopoly**: a monopoly that exists in a limited geographic area.
- **Regulated monopoly**: a monopoly firm whose behavior is overseen by a government entity.
- **Monopoly power**: market power, the power to set prices.
- **Monopolization**: an attempt by a firm to dominate a market or become a monopoly.

BARRIER TO ENTRY

- Anything that impedes the ability of firms to begin a new business in an industry in which existing firms are earning positive economic profits.
- There are general classes of barriers to entry:
  - **Natural barriers**
  - **Technological barriers**
  - **Sociological barriers**
  - **Government (legal) barriers**

➢**Natural barriers** – The firm has a unique ability to produce what other firms can't duplicate.

➢**Technological barriers** – The size of the market can support only one firm.

➢**Sociological barriers** – Entry is prevented by custom or tradition.

➢**Government barriers** – Governments often provide barriers, creating monopolies. As incentives to innovation, governments often grant patents, providing firms with legal monopolies on their products or the use of their inventions or discoveries for a certain period.

PRICE DETERMINATION UNDER SHORT RUN

A Monopolist in Equlibrium may face any of Three Situations in the Short period .

1. Super Normal Profit
2. Normal Profit
3. Minimum Loss

Figure-1

SUPER NORMAL PROFIT

- In This Figure ,The Monopolist is in equilibrium at point **E .**
- Because at this point **MC=MR** .
- The Monopolist Produces **OM** Units & sell it at **AM** price
- Thus in this Situation the super normal profit of the monopolist will be **ABCD**

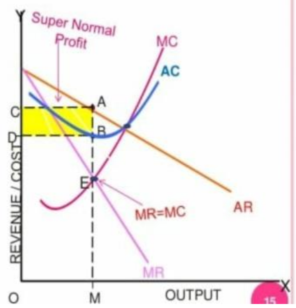


Figure-2

NORMAL PROFIT

- In This Figure ,The Firm is in equilibrium at point **E .**
- Where **MC=MR** & OM is the equilibrium output .
- At this output **AC** Curve Touches Average Revenue(AM) curve at point **A**.
- At point 'A' price OP (AM) is equal to the average Cost of the product .
- Therefore firms **earn only normal profit** in equilibrium situation as at equilibrium output its **AC=AR**

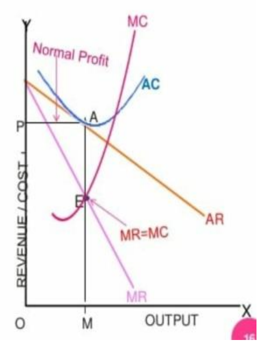
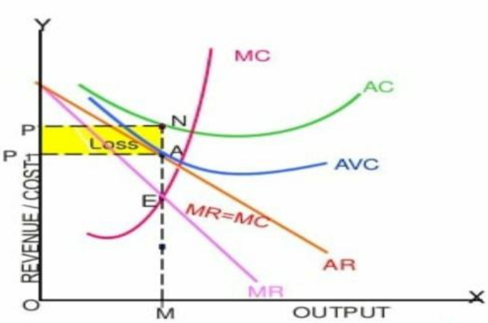


Figure-3

MINIMUM LOSS

- In this Figure , The monopolist is in equilibrium at point E , Where **MC=MR** & produces **OM** output.
- The price of equilibrium output **OM** is fixed at **OP₁** (AM).
- At this Price The **Average Variable Cost**(AVC) Curve Touches AR curve at point 'A'.
- At this situation the firm will **get only AVC** from the Prevailing Price
- .The firm will bear **the loss of fixed cost** , AN per Unit.



The firm will bear total loss equivalent to **NAP₁P** as shown by the shaded area.

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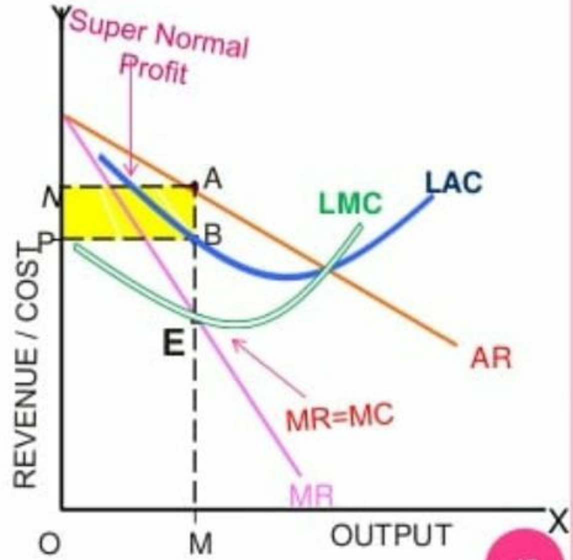
PRICE DETERMINATION UNDER LONG RUN

- In the Figure ,Point E Indicates the equilibrium of the monopolist .
- At Point E, **MR = LMC** . Hence **OM** is the equilibrium Output & **ON (=AM**) is the equilibrium Price. **BM** is the long run average cost.
- Price (Average Revenue) AM is being more than long run average cost (**AR > LAC**), the Monopolist earn (**AM –BM =AB**) Super Normal Profit Per Unit.
- The Firm's Super Normal Profit will be **ABPN** as Shown by Shaded Area



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Monopoly