Calicut University

COURSE
BBA

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SUBJECT
BUSINESS ECONOMICS

MODULE
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Profit Maximization

14 Alternative Market Structures: Perfect, Monopoly, Monopolistic and Oligopoly Markets

Market Structure

Market structure refers to the characteristics of a market that influence the behavior of firms and the level of competition.
The main factors that determine market structure are the number of firms, nature of products, control over price, and barriers to entry.

A.Perfect Competition

Perfect competition is a market structure with a large number of buyers and sellers where firms sell identical products.
No individual firm can influence market price.
Firms are price takers and must accept the price determined by market demand and supply.
There is free entry and exit of firms.
Examples are agricultural markets and basic commodity markets.

B.Monopoly

A monopoly exists when a single firm controls the entire market for a product with no close substitutes.
The monopolist has strong control over price and output.
High barriers to entry prevent new firms from entering the market.
Examples include public utility services in certain regions.

C.Monopolistic Competition

Monopolistic competition is a market where many firms sell similar but differentiated products.
Product differentiation may occur through branding, quality, packaging, or advertising.
Firms have some control over pricing because products are not identical.
Competition remains high due to the presence of many sellers.
Examples include clothing brands, restaurants, and cosmetic products.

D.Oligopoly

An oligopoly is a market dominated by a small number of large firms.
The actions of one firm affect the decisions of other firms in the market.
Firms may compete aggressively or cooperate indirectly.
Barriers to entry are usually high.
Examples include automobile, airline, and smartphone industries.

15 Profit Maximization under Perfect Competition and Monopoly: The Short-run and Long-run equilibrium of the firm

Profit Maximization

A firm aims to maximize profit by producing the level of output where marginal revenue equals marginal cost.

MR = MC

Perfect Competition in the Short run

Under perfect competition, firms are price takers.
Market price remains fixed for individual firms.
A firm may earn:
Normal profit
Supernormal profit
Losses in the short run
The firm continues production as long as it can cover variable costs.

Short-run Equilibrium under Perfect Competition

Short-run equilibrium occurs where marginal cost equals marginal revenue and marginal cost is rising.

MC = MR = AR = P

Since average revenue is equal to price in perfect competition, marginal revenue and price are also equal.

Long-run Equilibrium under Perfect Competition

In the long run, firms can freely enter or leave the market.
Supernormal profits attract new firms, increasing supply and reducing prices.
Losses force inefficient firms to leave the market.
Long-run equilibrium is reached when firms earn only normal profit.

Monopoly in the Short run

A monopolist has control over price and output because there are no close substitutes.
The monopolist chooses output where marginal revenue equals marginal cost.
Unlike perfect competition, price is greater than marginal revenue.
P > MR = MC
The monopolist may earn high profits if demand is strong.

Monopoly in the Long run

A monopoly can continue earning supernormal profits even in the long run because barriers prevent new firms from entering the market.
There is no automatic pressure forcing monopoly profits to disappear.

16 Economies and Diseconomies of Scales

Economies of Scale

Economies of scale refer to the advantages a firm gains when production increases on a large scale.
As output increases, average cost per unit may decrease.
Large firms often benefit from better technology, specialization, and efficient resource use.

Types of Economies of Scale

Internal Economies

Internal economies arise within the firm itself.
Examples include technical efficiency, managerial specialization, and bulk purchasing.

External Economies

External economies arise due to growth of the entire industry.
Examples include improved transport facilities, skilled labor availability, and supporting industries.

Importance of Economies of Scale

Economies of scale reduce production costs and improve competitiveness.
They allow firms to offer products at lower prices while maintaining profitability.

Diseconomies of Scale

Diseconomies of scale occur when a firm becomes excessively large and average costs begin to rise.
Management difficulties, poor coordination, communication problems, and delays in decision making are common causes.
Very large firms may lose efficiency because operations become difficult to control.

17 Profit Maximization under Imperfect Competition: Monopolistic, Oligopoly and its Types

Imperfect Competition

Imperfect competition exists when firms have some degree of control over price.
Products may be differentiated and competition is not entirely based on price alone.

Profit Maximization under Monopolistic Competition

Firms under monopolistic competition maximize profit where marginal revenue equals marginal cost.

MR = MC

Because products are differentiated, firms can influence price to some extent.
Advertising and branding play an important role in attracting consumers.
In the long run, new firms entering the market reduce excess profits.

Profit Maximization under Oligopoly

In oligopoly markets, firms are interdependent.
A firm's pricing or production decision affects competitors.
Firms may compete through price, advertising, technology, or product quality.
Profit maximization becomes more complex because firms must consider competitors' reactions.

Types of Oligopoly

Pure Oligopoly

Firms sell identical or homogeneous products.
Example: steel or cement industries.

Differentiated Oligopoly

Firms sell products that are similar but not identical.
Example: smartphone and automobile industries.

Collusive Oligopoly

Firms cooperate to reduce competition and increase profits.
They may form agreements related to pricing or output.

Non-collusive Oligopoly

Firms compete independently without formal agreements.
Competition may involve pricing wars and aggressive advertising.

18 Game Theory - Single-move games, Multiple-move games

Game Theory

Game theory studies strategic decision making where the actions of one participant affect others.
It is widely used in economics and business to analyze competition between firms.
Firms consider possible reactions from competitors before making decisions.

Single-move Games

In single move games, players make decisions only once without future interaction.
Each player chooses a strategy based on expected outcomes.
Example:
Two firms deciding whether to reduce prices during a festival season.

Multiple-move Games

In multiple move games, players interact repeatedly over time.

Past decisions influence future strategies.

Firms may cooperate indirectly to maintain stable profits and avoid destructive competition.

Importance of Game Theory

Game theory helps firms understand competitive behavior and strategic planning.

It is useful in pricing decisions, advertising strategies, negotiations, and market competition.

Businesses use game theory to predict how rivals may respond to changes in price, output, or product strategy.