1. Details of Module and its structure

Module Detail	
Subject Name	Economics
Course Name	Economics 03 (Class XII, Semester - 1)
Module Name/Title	Forms of Market: Part – 1
Module Id	leec_10401
Pre-requisites	Knowledge about Economics Process and Basic accounting terms
Objectives	After going through this lesson, the learners will be able to understand the following: 1. Meaning of Market 2. Determinants of Market Structure 3. Meaning of Perfect Competition 4. Features of perfect Competition 5. Perfect and Pure Competition 6. Perfect Competition is the foundation of Market
Keywords	Market, Price, Perfect Competition, Perfect knowledge

2. Development Team

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1. Introduction

Look at the picture below:

Figure 1

Figure 2

What do both these pictures represent? Do they make you think of a market place?

Since both these markets differ a lot from each other, what exactly is market?

2. Forms of Market

The moment one hears the word ‘market’ a picture of big malls, big shopping complexes, or local markets appears in our mind. If one asks for the student’s opinion, they might suggest Chandani Chowk in Delhi, Lakkad Bazar in Shimla etc. This is the general presumption that comes to the mind of the student, but in economics market is much more than just a place. First of all, one should know the difference between “market” used in common language and in Economics. The market in Economics is much larger than that we generally mean in common parlance. In economics, market refers to **the mechanism in which buyers and seller of a commodity come into contact with each other, and the commodity is bought and sold.** There is no geographical boundary which determines the length and breadth of the market. A market can emerge over telephone. Every day we get numerous telephone calls to buy insurance policies, to take credit cards, to join any club membership for spending holidays with families and friends etc. This is also included in the notion of the market. Door to door selling also comes under the same concept. How can one forget the vendors selling their products on the street? The small vendors like vegetables vendor, Kulfi Wala, Tikki, Golgappe sellers etc. and the list is never ending.

In the recent years a new type of market has also emerged. We know it by different names like e-marketing or online marketing. The moment we think of online market, flipkart, amazon, myntra, naaptol etc. flash in our mind.

3. Features of a market

Important features of market are:

(a) Mode of Contact

In economics, a market does not mean a particular place but the mechanism where buyers and sellers of a product interact. It can be over telephone, internet, door to door selling, etc. Modern modes of transportation and communication have made market area for a product very wide.

(b) Commodity

In economics, a market is not related to a place but to a particular product. Hence, there are separate markets for various commodities. For example, there are separate markets for electronics items, clothes, grains, jewelry, etc.

(c) Buyers and Sellers

The presence of buyers and sellers is necessary for the sale and purchase of a product in the market. In the modern age, the physical (face to face) presence of buyers and sellers is not necessary in the market because transactions of goods can take place through letters, telephones, business representatives, internet, etc.

(d) Price

The product must have a price at which it is bought and sold. If a product is distributed free as charity, it does not come under the market. For example, Langar is served in Golden Temple or any other temple is not a food market because price which is an essential component of a market is missing.

4. Structure of a Market

Market structure refers to the number, and size, of buyers and sellers in the market for particular commodity. Economists have classified market structure on the basis of the following factors:

a. Number of Buyers and Sellers of the Market: The power of the buyers / sellers to influence the market depends upon their share in total market demand / total market supply. If each buyer or seller buys or sells a small proportion of the total market output of a product, they cannot affect the price, total demand or total supply in the market. On the other hand, if they have significant share in total demand or total supply, they can influence the prevailing price of the commodity in the market.

b. Nature of Commodity: If the commodity is homogeneous, a uniform price prevails in the market, other things remaining the same. On the other hand, if it is differentiated, firms may be able to charge different prices for each different variety of the commodity.

c. Freedom of Entry and Exit from the Market: Nature of entry or exit of new firms determines different forms of market. If entry into the market is easy, it is likely to have a large number of firms. On the other hand, if entry is restricted, the number of firms is likely to be small. In the extreme, there may be only one firm selling in the market.

d. Knowledge about Market: Perfect knowledge about prices and costs in the market creates competition, leading to uniform price. If buyers know what different firms are charging and firms know what buyers are paying, the scope of different prices is eliminated. Due to lack of knowledge, consumers may be ignorant about different commodities existing in the market. This may result in different prices being charged for the good.

On the basis of above criterion, the market structure is broadly classified as follows:

- Perfect competition
- Monopoly
- Monopolistic Competition
- Oligopoly

5. Perfect Competition

Perfect Competition is a market structure in which there are very large numbers of buyers and sellers, sellers selling homogenous products at a single price. It is a market structure characterised by a complete absence of rivalry among the individual firms where all firms in an industry are price- takers and in which there is freedom of entry into, and exit from the industry.

Characteristics of Perfect Competition

a) Very Large numbers of buyers and sellers: In this market there are very large numbers of buyers and sellers. A single buyer can not affect market demand Nor can a single seller influence market supply. Each firm has an insignificant share in the total market supply. For instance, suppose a vegetable seller thinks if he doesn't go to a particular locality, people in that locality would not be able to prepare vegetables for their lunch or dinner then he is mistaken, since there are many sellers like him who are selling in that locality and meet the demand of the people over there. On the other hand, if a buyer thinks that if he doesn't buy from a particular seller that vendor will not be able to sell in the market, the buyer is mistaken. There are hundreds of buyers like him who will buy from that particular seller.

Implication: Since no single seller can have significant share in the market. He can't fix the price of the commodity on his own. We can say a ***firm is price taker*** in this type of market. Whatever is the price fixed by the industry, firm has to follow it. The ***Industry is the price maker***. The market price is determined at where market demand is equal to market supply.

b) Homogenous Product: In this type of market, the products sold are homogenous. In other words all the firms are selling products identical in every aspect. There is no difference on the basis of colour, quality etc. Suppose all the sellers are selling potatoes, we assume that all are of same quality. As buyers can not differentiate the products of different sellers, they do not have preference to purchase the commodity from any particular seller.

Implication: As all the sellers are selling identical products so they have to sell their products at a uniform price fixed by the industry. The reason is if any firm tries to sell its product at a price higher than the market price, it will not be able to sell at all. On the other hand, if any particular seller sells his product at a price lesser than the market price, one is likely to make losses and may be forced to exit.

c) Freedom of Entry and Exit: Another important feature of this type of market is the freedom of entry and exit from the market. Any firm can enter or leave the industry any time.

Freedom of entry ensures that there is a very large number of firms in the market. We have already seen that this is an essential feature of PC. If entry is restricted, the existing firms may block other firms from entering and try to ‘capture’ a large share of the market. Incumbent firms will then no longer be price takers. Freedom of exit is necessary to allow loss- making firms to leave the market and shift resources to better uses if normal profits have been defined earlier.

d) Perfect knowledge: Perfect competition implies perfect knowledge on the part of buyers and sellers regarding the market conditions. In other words perfect knowledge about prices and costs in the different parts of the market creates competition leads to establishment of uniform prices.

Implication: If buyers know what the firms are charging and firms know what buyers are paying, the scope of charging different prices is eliminated. We can say both buyers and sellers have prefect knowledge about the product at which it is being bought and sold in the market. Such perfect knowledge of market conditions forces the sellers to sell their product at the prevailing market price and the buyers to buy at that price. As a result, no buyer will be prepared to pay a price higher than the prevailing price. Similarly, sellers will not charge a price higher or lower than the prevailing price.

Example: A consumer goes to buy potatoes in the market. He argues with the seller that he is charging @ Rs. 20 per kg while the others are selling @ Rs.15 per kg. If the seller does not have perfect knowledge of the price at which potatoes are sold by other shopkeepers, he may ~~be~~ agree to sell at Rs.15. Since under perfect competition we are assuming that all the sellers have perfect knowledge, so the seller knows at what price the same product is sold by others. He will not be ready to sell it at Rs.15.

e) Perfect mobility of factors of production

Another requirement of perfect competition is the perfect mobility of goods and factors of production between industries. Factors can also move from a low-paid to a high-paid industry. Land, labour and capital are three major factors of production. Perfect mobility of factors of production allows free entry and exit of firms.

Under perfect competition, there are many buyers and sellers, and prices reflect supply and demand. All buyers and sellers are price takers. The commodity is homogeneous. New firms can easily enter the market, generating additional competition. Firms earn just enough profit to stay in business and no more, because if they were to earn excess profits, other companies would enter the market and drive profits back down to the bare minimum.

Real-world competition differs from the textbook model of perfect competition in many ways. In real life firms produce differentiated products, they advertise their product to gain market share. They compete with each other in different ways to attract customers towards their own products. Hence, Perfect Competition is a theoretical market structure. It is primarily used as a benchmark against which other, real-life, market structures are compared. The industry that most closely resembles perfect competition in real life is agriculture.

6. Perfect Competition vs Pure Competition

Several economists have distinguished between perfect competition and pure competition. Perfect competition has broader connotation than pure competition. Pure competition has the following characteristics / features:

(a) Large number of buyers

(b) Homogenous product

(c) Free entry and exit

If we add the following conditions in addition to the above conditions, we will have market situation of perfect competition:

(a) Perfect knowledge among buyers and sellers

(b) Perfect mobility

(c) Absence of transactions costs

The following figure can illustrate the difference between Perfect competition and pure competition:

No money or time or effort need to be spent to conduct any transactions

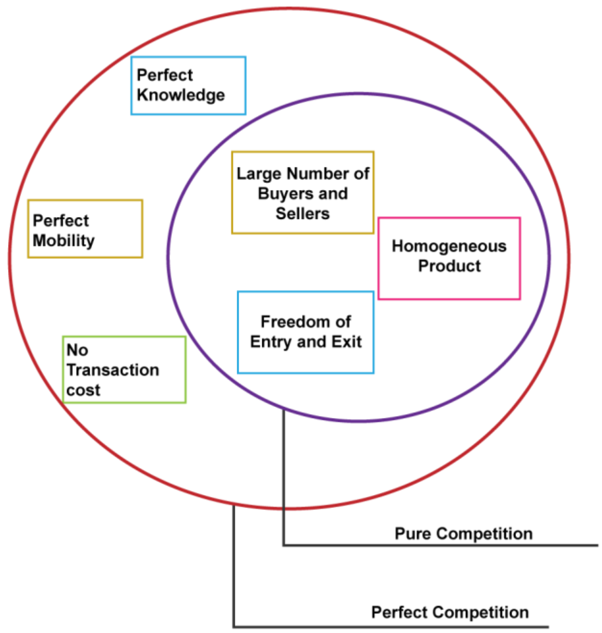

Figure 3

Chamberlin says that "perfect competition is a rare phenomenon."

Though the real world does not fulfill the conditions of perfect competition, yet perfect competition is studied for the simple reason that it helps us in understanding the working of an economy, where competitive behaviour leads to the best allocation of resources and the most efficient organisation of production. Best / optimum allocation of resources means to use the resources in such a way that with least usage of resources, maximum benefits are provided to the society as a whole. A hypothetical model of a perfectly competitive industry provides the basis for appraising the actual working of economic institutions and organisations in any economy.

6. Summary

Market in economics is a wider concept than the one which is used in common language. Perfect Competition is one such market. Though in present scenario, it is difficult to find such market but it is the backbone of modern market structure. After studying the features of perfect competition one can come to the conclusion that the most of its features are not applicable in real world.