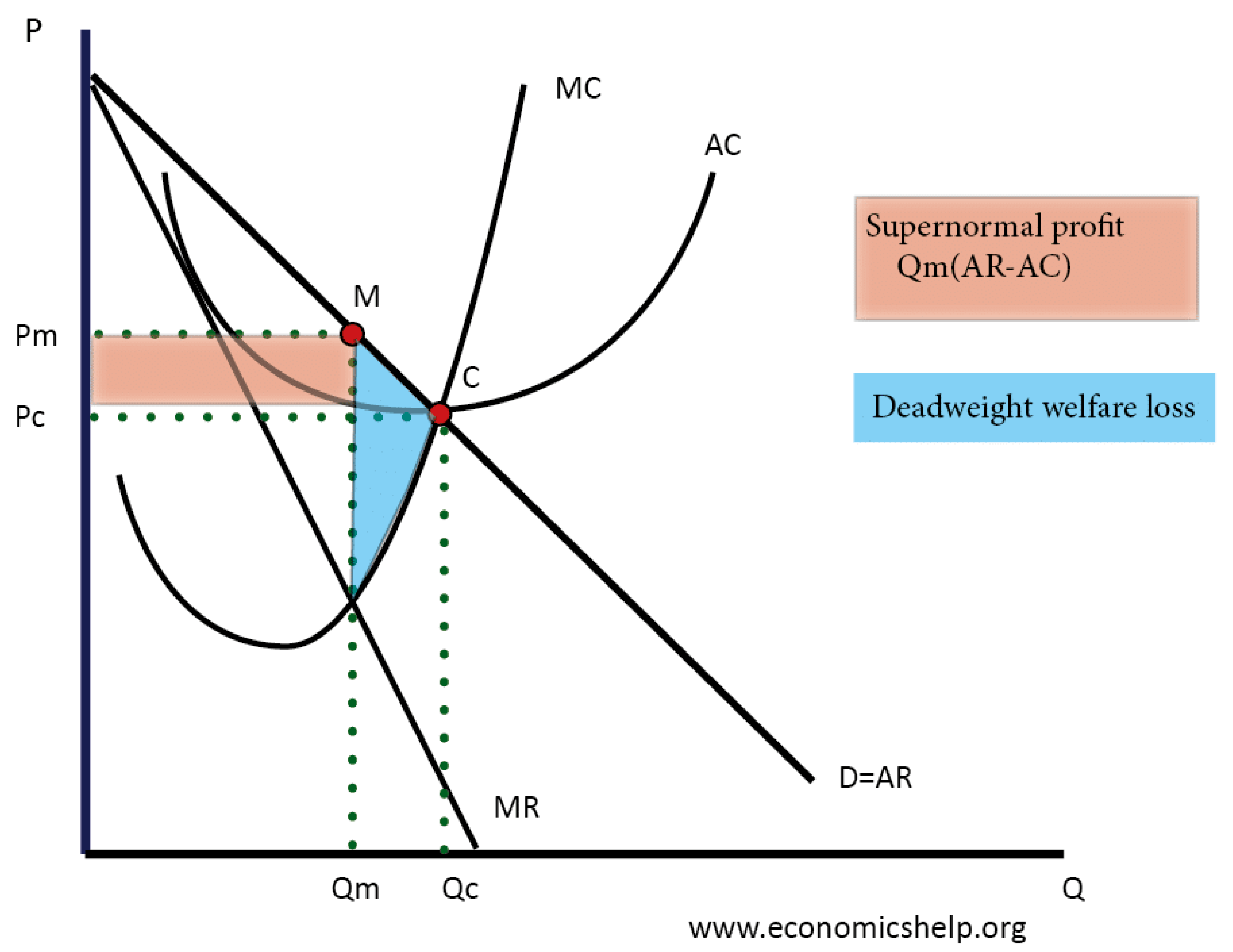
MONOPOLY

GROUP 3

Monopoly

A market structure characterized by a single seller, selling a unique product in one locality. In a monopoly market, the seller faces no competition, as he is the sole seller of goods with no close substitute. (ex. Meralco supplying electricity in one city).



A monopoly is a specific type of economic market structure which exists when a specific person or enterprise is the only supplier of a particular good. As a result, monopolies are characterized by a lack of competition within the market producing a good or service.

Characteristics of Monopoly

PROFIT MAXIMIZERS

A monopoly maximizes profits. Due to absence of competitors in the market, a firm can charge a price above what is charged in the competitive market in order tomaximize its revenue.

PRICE MAKER

The monopoly decides the price of the good or product being sold. The price desired is set by the monopolists themselves to maximize revenue.

HIGH BARRIERS TO ENTRY

Sellers are unable to enter the market of the monopoly due to high capitalization and other barriers to entry.

SINGLE SELLER

In a monopoly one seller or producer sells or produce a particular product or service. The entire market is dominated by a single firm. For this reason, the firm is the same as the industry.

Characteristics of Monopoly

PRICE DISCRIMINATION

In a monopoly, price discrimination exists since they can make it possible to separate the two markets and still beprofitable. They can charge different prices for the product or service in each of the market. For example, in a concert, people who watch the concert can be charged different prices depending on their location. Price discrimination is possible because the monopolist can keep the markets apart and elasticities of demand at each price level must be different among the markets (Pagoso, 2010).

ADVANTAGES OF MONOPOLY

1 STABILITY OF PRICES

In a monopoly market structure, the prices are pretty stable. This is because there is only one firm involved in the market that sets the prices since there is no competing product. In other types of market structures prices are not stable and tend to be elastic as a result of the competition

ADVANTAGES OF MONOPOLY

2 ECONOMIES OF SCALE

Since there is a single seller in the market it leads to economies of scale because big scale production which lowers the cost per unit for the seller. The seller may pass this benefit down to the consumer in terms of a lower price.

ADVANTAGES OF MONOPOLY

3 RESEARCH AND DEVELOPMENT

Since the monopolist is making abnormal or supernormal profits, the firm can invest that money into research and development. Customers may get better quality products at reduced prices leading to enhanced consumer surplus and satisfaction.

DISADVANTAGES OF MONOPOLY

1 HIGHER PRICES

The monopolistcould set a very high price for the product leading to the exploitation ofconsumers as they have no option but to buy it from the seller due to the lackof competition in the market.

DISADVANTAGES OF MONOPOLY

2 PRICE DISCRIMINATION

Monopolists can sometimes use price discrimination, where they charge different prices on the Same product or services for different consumers. This depends on market conditions.

DISADVANTAGES OF MONOPOLY

3 INFERIOR GOODS AND SERVICES

The lack of competition may cause the monopoly firm to produce inferior goods and servicesbecause they know the goods will sell.

MONOPOLY VS COMPETITIVE MARKET

Monopolies and competitive markets mark the extremes in regards to market structure.

monopoly

- the cost functions are the same
- both minimize cost and maximize profit
- the shutdown decisions are the same
- both are assumed to have perfectly competitive market factors

competitive market

MONOPOLY VS COMPETITIVE MARKET

However, there are noticeable differences between the two market structures including: marginal revenue and price, product differentiation, number of competitors, barriers to entry, elasticity of demand, excess profits, profit maximization, and the supply curve. The most significant distinction is that a monopoly has a downward sloping demand instead of the "perceived" perfectly elastic curve of the perfectly competitive market.

BARRIERS TO ENTRY

RESOURCE CONTROL

Control over natural resources that are critical to the production of a good is one source of monopoly power. Single ownership over a resource gives the owner of the resource the power to raise the market price of a good over marginal cost without losing customers to competitors. In other words, resource control allows the controller to charge economic rent. This is a classic outcome of imperfectly competitive markets.

BARRIERS TO ENTRY

ECONOMIES OF SCALE AND NATURAL EXTERNALITIES

Economies of scale and network externalities are two types of barrier to entry. They discourage potential competitors from entering a market, and thus contribute to the monopolistic power of some firms. Economies of scale are cost advantages that large firms obtain due to their size. They occur because the cost per unit of output decreases with increasing scale, as fixed costs are spread over more units of output.

BARRIERS TO ENTRY

ECONOMIES OF SCALE AND NATURAL EXTERNALITIES

Economies of scale are also gained through bulk-buying of materials with Long-term contracts, the increased specialization of managers, ability to obtain lower interest rates when borrowing from banks, access to a greater range of financial instruments, and spreading the cost of marketing over a greater range of output. Each of these factors contributes to reductions in the long-run average cost of production.

BARRIERS TO ENTRY

GOVERNMENT ACTION

There are two types of government-initiated monopoly: a government monopoly and a government-granted monopoly.

1. GOVERNMENT-GRANTED MONOPOLY

In a government-granted monopoly, the government gives a private individual or a firm the right to be a sole provider of a good or service. Potential competitors are excluded from the market by law, regulation, Or other mechanisms of government enforcement. Intellectual property rights such as copyright and patents are government-granted monopolies.

BARRIERS TO ENTRY

GOVERNMENT ACTION

There are two types of government-initiated monopoly: a government monopoly and a government-granted monopoly.

2. GOVERNMENT MONOPOLY

In a government monopoly, an agency under the directauthority of the government itself holds the monopoly, and the monopoly is sustained by the enforcement of laws and regulations that ban competition or reserve exclusive control over factors of production to the government. The state-owned petroleum companies that are common in oil-rich developing countries (such as Aramco in Saudi Arabia or PDVSA in Venezuela) are examples of government monopolies created through nationalization of resources and existing firms.

LEGAL BARRIERS

The government creates legal barriers through patents, copyrights, and granting exclusive rights to companies.

In some cases, the government will grant a person or firm exclusive rights to produce a good or service, enabling them to monopolize the market for this good or service. Intellectual property rights, including copyright and patents, are an important example of legal barriers that give rise to monopolies.

COPYRIGHT

Copyright gives the creator of an original creativework (such as a book, song, or film) exclusive rights to it, usually for a limited time, with the intention of enabling the creator to be compensated for his or her work. The intent behind copyright is to promote the creation of new works by providing creators the opportunity to profit from their works.

PATENT

A patent is a limited property right the government gives inventors inexchange for their agreement to share the details of their invention with the public. During the term of the patent, the patent holder has the right toexclude others from making, using, or selling the patented invention.

GOVERNMENT GRANTED MONOPOLY

It is also possible that there is a monopoly because the government has granted a single company exclusive or special rights.

MONOPOLY PRODUCTION, PRICING DECISIONS AND PROFIT OUTCOME

Market Differences Between Monopoly and Perfect Competition

Monopolies, as opposed to perfectly competitive markets, have high barriers to entry and a single producer that acts as a price maker.

A market can be structured differently depending on the characteristics of competition within that market.

At one extreme is perfect competition. In a perfectly competitivemarket, there are many producers and consumers, no barriers to enter and exit the market, perfectly homogeneous goods, perfect information, and well defined property rights. This produces a system in which no individual economic actorcan affect the price of a good – in other words, producers are price takersthat can choose how much to produce, but not the price at which they can sell their output. In reality there are few industries that are truly perfectlycompetitive, but some come very close.

For example, commodity markets (such as coal or copper) typically have many buyers and multiple sellers. There are few differences in quality between providers so goods can be easily substituted, and the goods are simple enough that both buyers and sellers have full information about the transaction. It is unlikely that a copper producer could raise their prices above the market rate and still find a buyer for] their product, so sellers are price takers (Pagoso, et.al., 2010).

A monopoly, on the other hand, exists when there is only one producer and many consumers. Monopolies are characterized by a lack of economic competition to produce the good or service and a lack of viable substitute goods. As a result, the single producer has control over the price of a good – in other words, the producer is a price maker that can determine the price level by deciding what quantity of a good to produce.

MONOPOLY VS. PERFECT COMPETITION'

Monopoly and perfect competition mark the two extremes of market structures, but there are some similarities between firms in a perfectly competitive market and monopoly firms. Both face the same cost and production functions, and both seek to maximize profit. The shutdown decisions are the same, and both are assumed to have perfectly competitive factors markets (tutor2u, 2020).

MONOPOLY VS. PERFECT COMPETITION'

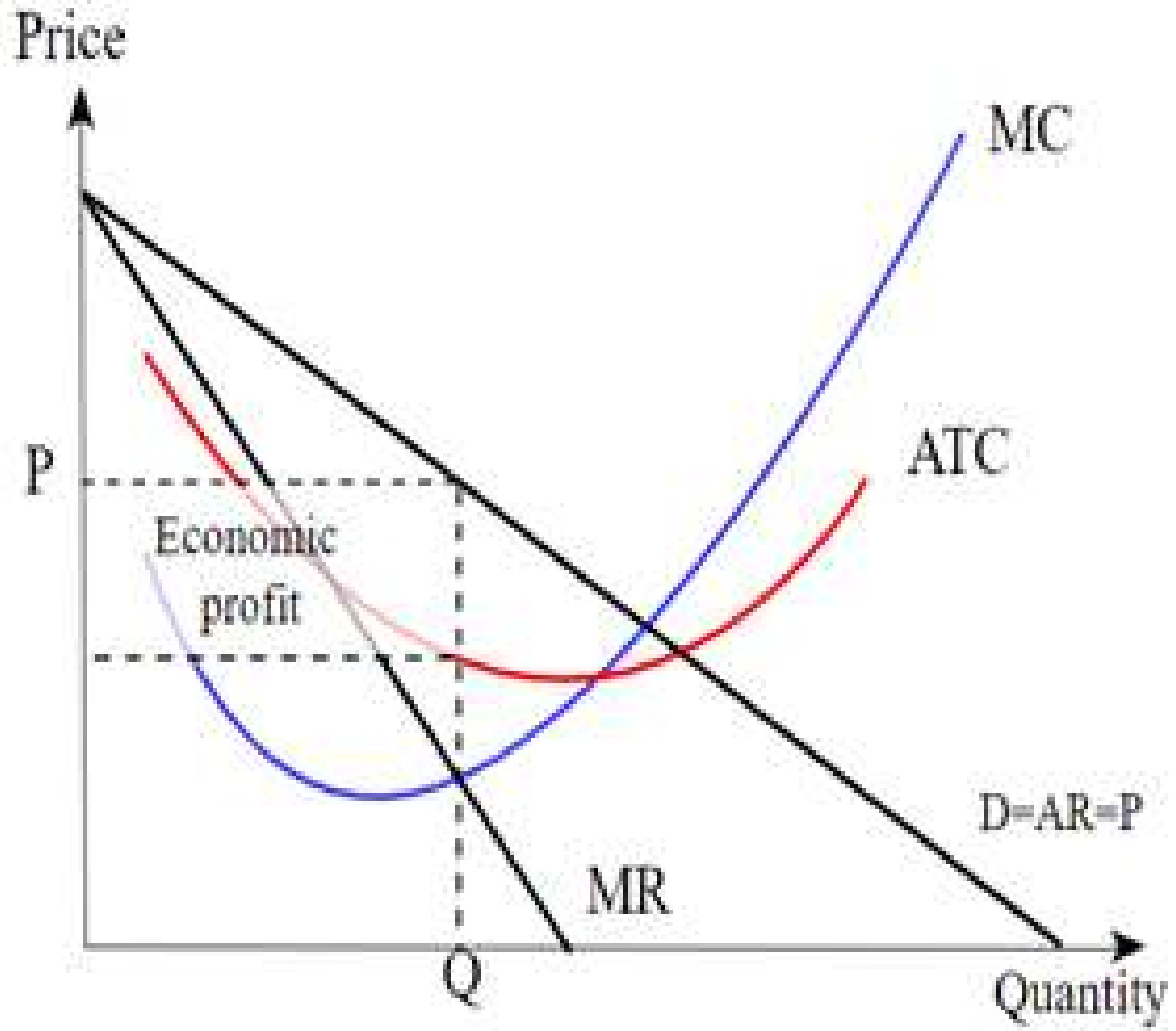
However, there are several key distinctions. In a perfectly competitive market, price equalsmarginal cost and firms earn an economic profit of zero. In a monopoly, the price is set above marginal cost and the firm earns a positive economic profit. Perfect competition produces an equilibrium in which the price and quantity of a good is economically efficient. Monopolies produce an equilibrium at which the price of a good is higher, and the quantity lower, than is economically efficient. For this reason, governments often seek to regulate monopolies andencourage increased competition (tutor2u, 2020)..

Profit Maximization for Monopoly

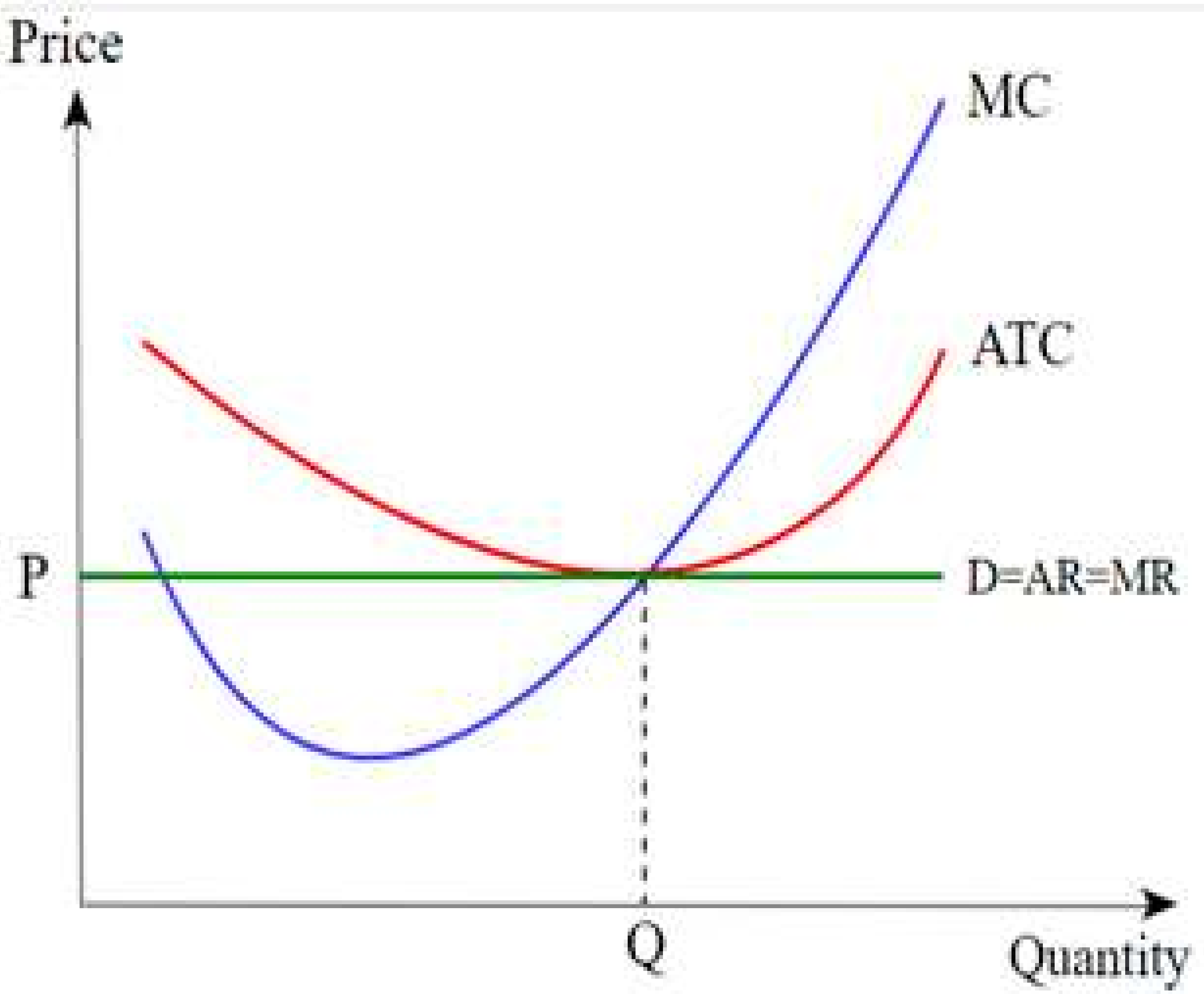
In traditional economics, the goal of a firm is to maximize their profits. This means they want to maximize the difference between their earnings, i.e. revenue, and their spending, i.e. costs. To find the profit maximizing point, firms look at marginal revenue (MR) which is the total additional revenue from selling one additional unit of output and the marginal cost (MC) which is the total additional cost of producing one additional unit of output. When the marginal revenue of selling a good is greater than the marginal cost of producing it, firms are making a profit on that product. This leads directly into the marginal decision rule, whichdictates that a given good should continue to be produced if the marginal revenue of one unit is greater than its marginal cost. Therefore, the maximizing solution involves setting marginal revenue equal to marginal cost (tutor2u, 2020).

Monopoly VS Perfect Competition

MONOPOLY



PERFECT COMPETITIONS



Monopoly VS Perfect Competition

MONOPOLY

In a monopoly market, the MR curve and the demand curve are distinct and downward sloping.

PERFECT COMPETITIONS

In a perfectly competitive market, the MR curve is horizontal and equal to demand price. There is profit when MR=MC

Total Cost and Total Revenue for a Monopolist

In order to determine profits for a monopolist, we need to first identify total revenues and total costs. An example for thehypothetical Firm Z is shown in Figure 7.2.1

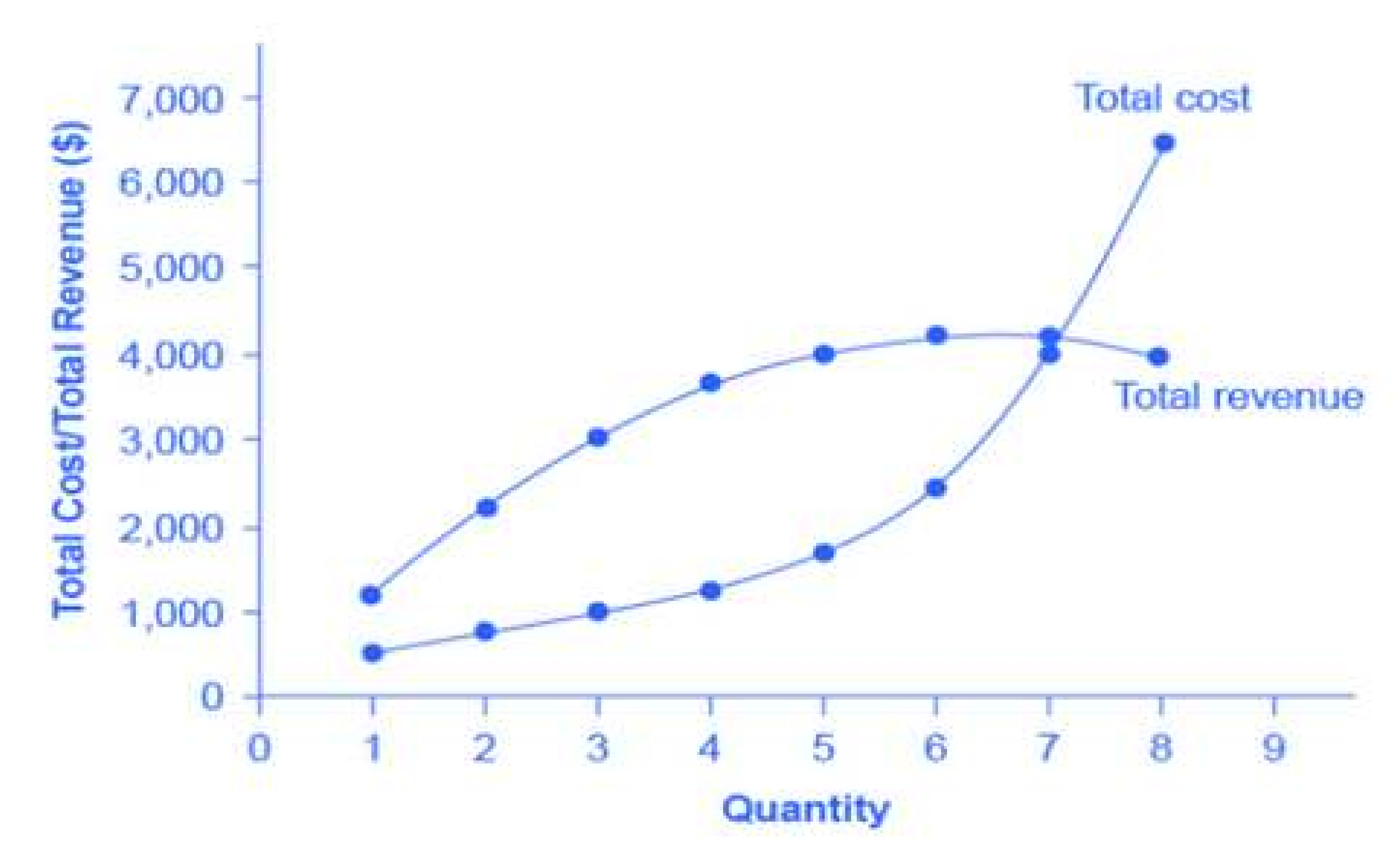


Figure 7.2.1
Total Revenue and Total Cost Curves

Total revenue for the monopoly firm (Firm Z) first rises, then falls. Low levels of output bring in relatively little total revenue, because the quantity is low. Hig hlevels of output bring in relatively less revenue, because the high quantity pushes down the market price. The total cost curve is upward-sloping. Profits will be highest at the quantity of output where total revenue is most above total cost.

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THANK YOU!

GROUP 3
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