UNIT-3

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Introduction to markets & Pricing Policies

Meaning of market :—

The term "market" refers to a particular place where goods are purchased and sold.

In Economics, the term "market" does not mean a particular place but the whole area where the buyers and sellers of a product are spread.

Definition :—

According to prof. R. chapman, "the term market refers not necessarily to a place but always to a commodity and the buyers and sellers who are indirect competition with one another".

According to Benham, "Any are over which buyers and sellers are in such close touch with one another, either directly or through dealers, that the prices obtainable in one part of the market affect the prices paid on other parts".

According to Edwards " Market as a mechanism by which buyers and sellers are bought together.

Exchange of goods and services (i.e; buying and selling) take Place in a market. Market helps to determine the price of goods and services.

Market Structure :—

Market structure refers to all characteristics of a market that influence the behaviour of buyers and sellers when they come together to trade.

Determinants of Market Structure :—

(a). Short-run and long-run objectives of buyers and sellers in the market.

(b). Beliefs of buyers and sellers about the ability of themselves and others to set prices.

(c). Degree of product differentiation.

(d). Technologies employed by agents in the market.

(e). Amount of information available to agents about the good and about each other

(f). Degree of co-ordination or non coordination agents may exhibit.

(g). extent of entry and exit barriers.

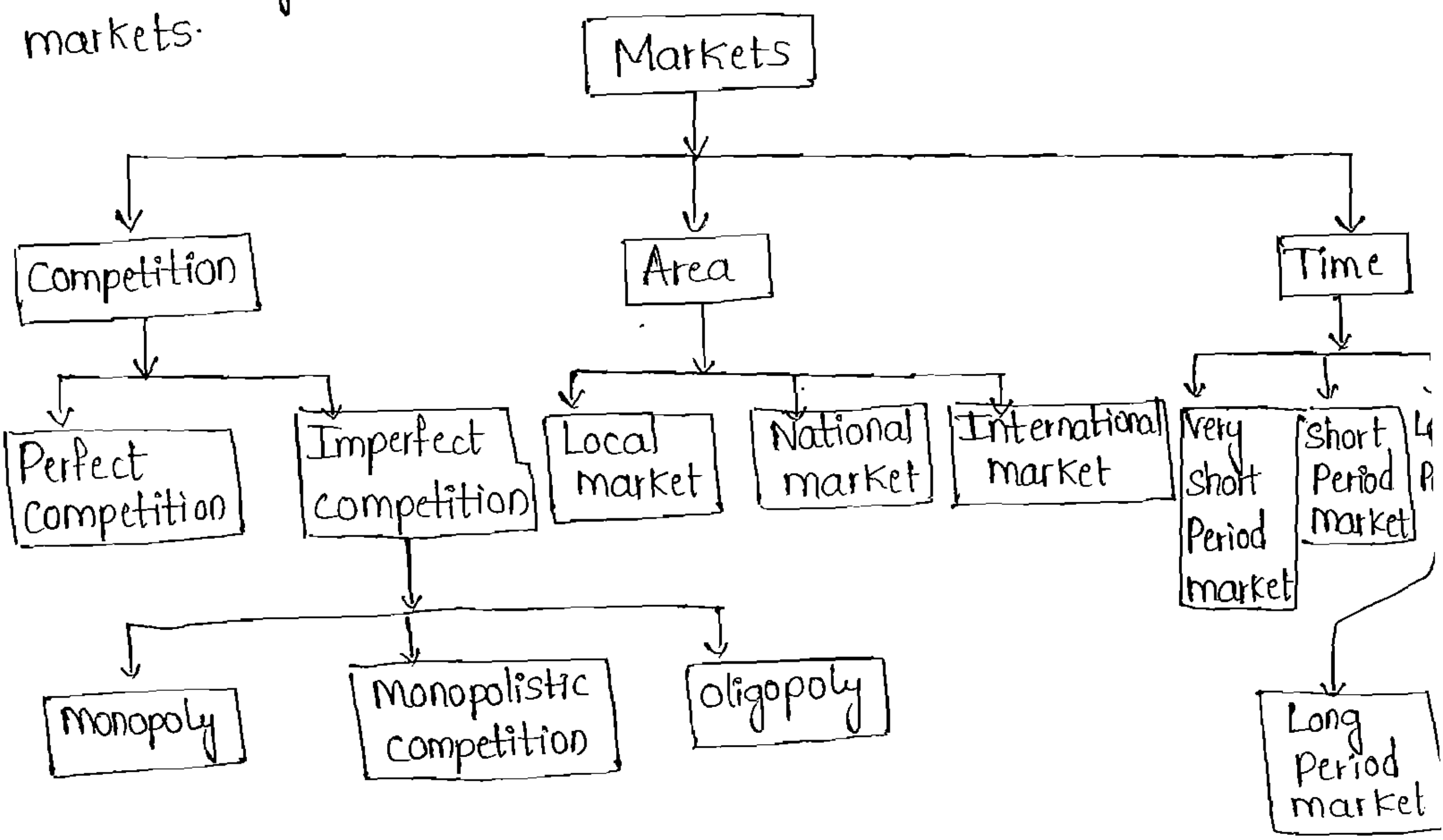
Classification of markets:—

There are 3 important factors in classification of markets

1. The first aspect is the number of buyers and sellers in a market are important.
2. The second aspect is the area coverage of a commodity.
3. The third important factor is how supply adjusts to the demand in a market. This depends on different time periods.

Thus, classification of markets brodly depends on 3 aspects They are competition among producers, area covered by a commodity and the time periods to adjust the supply in the market

The following chart helps us to understand the classification of markets.



I On the basis of competition:—

Markets are classified on the basis of nature of competition into perfect competition and imperfect competition.

Perfect competition:—

It is a market with a very large number of buyers and sellers. Market conditions are favourable to promote competition.

Imperfect competition:—

Markets with a limited number of buyers and sellers come under imperfect competition. Based on no.of producers, these markets are broadly monopoly, Duopoly, monopolistic & oligopoly competitic

II. On the basis of Area:—

Markets may be classified on the basis of area into local, national and international markets

Local market:—

If the buyers and sellers are located in a particular locality, it is called as Local market.

Eg:— Fruits, vegetables. These are perishable..

National market:—

When a commodity is demanded and supplied over the country is known as national market.

International market:—

When a commodity command into national market (or) buyers & sellers all over the world, it is called international market.

→ whether the market will be local, national or international in character will depend upon the following factors such as

a. Nature of commodity
b. Taste and preference of the people
c. Availability of storage
d. Method of business
e. Political stability at home & abroad
f. Profitability of the commodity.

III on the basis of time:—

Time element has been used by marshall for classifying the market. On the basis of time market has been classified into very short period, short period & long period and very long period

Very short period:—

It refers to the market in which commodities that are fixed in supply. Since supply is fixed, only changes in demand influence the price.

short period:—

The short period markets are those where supply can be increased but only to a limited extent

Long period:—

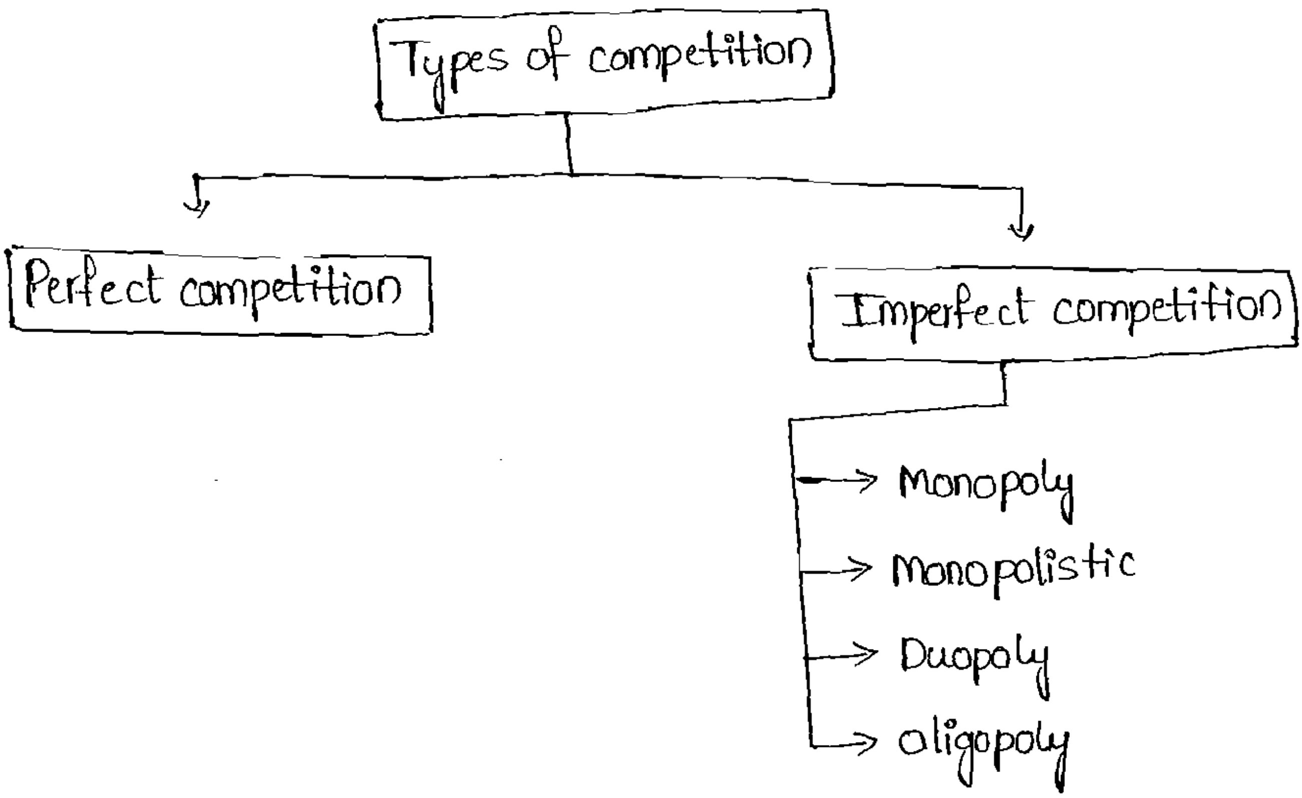
Long period market refers to a marked where adequate time available for changing the fixed factors of production.

Types of competition & Features:—

On the basis of competition, the markets can be classified into two ways such as

1. Perfect competition
2. Imperfect competition

This can be shown in the following diagram



I. Perfect competition:—

→ A market structure in which all firms in an industry are price takers and in which there is a freedom to entry into and exit from the industry is called perfect competition.

→ The market with perfect competition conditions is known as perfect market.

→ It is a market with a very large number of buyers and sellers market conditions are favourable to promote competition.

Features of perfect competition:—

1. Large number of buyers and sellers
2. Homogenity of products
3. Free entry and exit
4. Perfect mobility of factors of production
5. Perfect knowledge of markets
6. Each firm is a price taker.
7. Absence of transport cost.

1. Large number of buyers and sellers:—

There will be a large number of sellers and buyers for a good in this market. It means the output of a buyer or a seller is a small part of the total output.

A single producer or seller cannot influence the price by his actions

Eg:— A wheat farmer alone cannot change the price of wheat by selling less or more. Therefore, a seller takes the price decided by the market. The producer is a price taker.

2. Homogeneity of products:—

Products in this market are similar in every respect. A consumer gets the same good wherever he purchases. As a result, there will be one price all over the market

Eg:— Incase of metals like gold and silver standards are maintained. Thus products will be the same in the market and they have the same price through out the market.

3. Free entry and exit:—

There is no barrier to entry or exit from the industry. Any firm can enter into the production as per its desire. Similarly, it can leave the production at any time. This helps new firms to enter into business when conditions are favourable. It keeps competition at a higher level. If the industry earns abnormal profits, new firms will enter the industry competing for excess profits. Similarly, if firm in the industry are incurring losses some of them will leave the industry.

4. Perfect mobility of factor of production:—

The factor of production are free to move from one firm to another. This is also useful for free entry and exit of firms. Factors (Land, Labour, capital) move to the production activities where they get higher incomes.

5. Perfect Knowledge of markets:—

Buyers and sellers in this market will have a clear knowledge about market conditions, so that there will be one price throughout the market. Lack of knowledge leads to different prices for the same product. Because of the perfect knowledge sales and purchases of commodity take place at one price.

6. Each firm is a price taker:—

An individual firm can alter its rate of production/sales without affecting the market price of the product. A firm in a perfect market cannot influence the market by its own individual actions.

II Imperfect Competition:—

A competition is said to be imperfect when it is not perfec

Markets with a limited number of buyers and sellers come under imperfect competition.

Based on the number of buyers and sellers, the imperfect markets are classified as:

1. Monopoly
2. Monopolistic
3. Duopoly
4. Oligopoly

1. Monopoly:—

→ Monopoly is totally a different market compared to perfect competition.

→ The word monopoly means a single producer.

→ It is a market where one producer or a firm supplies the commodity to the market.

→ Monopoly market is a market in which a single producer control the entire supply of a single commodity, which has no close substitutes.

→ There will be only one producer or one seller.

→ Monopoly can exit only when there are strong barriers for other producers to enter into the market

→ The reasons of the barriers may be:

- huge investments
- Lack of technology
- Patents etc;

that prevents new firms from entering.

As a result, producers under monopoly has no competition in the market

Eg:— Maruthi-suzuki, enjoyed all the government protection for a long time when it enjoyed monopoly in respect of small cars. When several automobile manufacturer were allowed to enter the India.

Industry with the new industrial policy, Maruthi- suzuki's monopoly came to an exist.

* Most of the state electricity Boards enjoy monopoly interms of the generation & transmission of power.

Features of Monopoly:—

1. A single firm produces the commodity in the market.
2. Consumers will not find close substitutes for this product in the market.
3. New firms do not enter into production due to certain barriers. Hence there is no competition in the market
4. Firm and industry are the same.
5. Supply of the good is under the control of the firm and produce is a 'price maker'

2. Monopolistic:—

Monopolistic competition is said to exist when there are many firms and each one produces such goods and services that are close substitutes to each other. They are similar but not identical.

→ Monopolistic competition is a blend of perfect competition & monopo

"There is competition which is not perfect, between many firms making very similar products.

Features of Monopolistic competition:—

1. A considerable number of producers
2. Product differentiation
3. entry and exit
4. Selling costs
5. Imperfect Knowledge

(1). Considerable number of producers:—

A commodity is produced by a considerable number of producers. No one controls a major portion of the total output. Hence each firm has a very limited control over the price of the product. Competition will be high among the producers.

(2). Product differentiation:—

The commodity of each producer will be different from that of other producers. Sometimes the difference may be very small. But consumers feel that one product is different from other The difference may be due to material used, colour, design, smell, packing, trademark etc., Because of this, each product will have specific identification in the market.

(3). Entry and exit:—

Another feature of monopolistic competition is the freedom of entry and exit of firms. Firms are allowed to enter into market and leave the market. When profits are high new firms will join. In case of losses, inefficient firms will leave.

④ Selling costs:—

It is an important feature of monopolistic competition. In this market every firm makes expenditure to sell more output. Advertisements through newspapers, journals, electronic media, sales representation, exhibitions, free sampling help to promote the sales. Lot of expenditure is made on these items under this market.

⑤ Imperfect knowledge:—

Buyers will have an imperfect knowledge about competition commodities. They are influenced by advertisements and other methods in the market. Sometimes products may be the same but consumers think that a particular product is superior than other.

3. Duopoly:—

→ If there are two sellers, duopoly is said to exist

→ If pepsi and coke are the two companies in soft drinks, this market is called duopoly.

→ In otherwords, if there are two sellers who share the monopoly power then it is called duopoly

→ It may be of two types - duopoly without product differentiation and duopoly with product differentiation.

4. Oligopoly:—

Another variety of imperfect competition is oligopoly. If there is competition among a few sellers, oligopoly is said to exist. The examples are the car manufacturing companies such as (Maruthi suzuki, Hindustan motors, Daewoo, Toyota & soon) Newspapers (such as, The Hindu, Indian express, Times of India, Economic times, Eenadu and soon.

→ In oligopoly, each individual seller or firm can affect the market price.

Features of oligopoly:—

1. small number of large sellers.
2. Interdependance
3. Price rigidity
4. Monopoly element
5. Advertising
6. Group behaviour

* Pricing:—

Pricing means to fix or determine an accurate price or appropriate price to the products produced by the manufacturer.

→ The pricing should be accurate or appropriate. It is should not be overloaded or underloaded.

Features of pricing :—

1. Max. of profit
2. To regulate the market share
3. Customer satisfaction
4. Survival of the firm
5. Prevention of entrance of new firms
6. sales maximisation & not profit max.
7. stability in prices + profit
8. To avoid price wars.

Methods of pricing :—

The following are the methods or types of pricing

1. Limit pricing
2. Market skimming
3. Flate rate pricing
4. Time/ usage sensitive pricing
5. Transaction - Based Pricing

①. Limit pricing :—

A limit price is the price set by a monopolist with a view to discourage others from entering into a market. The limit price is often lower than the average cost of production or just low enough to make entering into profitable. With limit price in operation, those entering the market with a view to compete with monopolist will find it totally unattractive to survive.

② Flat Rate Pricing:—

Where the price is charged at a flat rate or single fixed rate for a particular product or service irrespective of the usage, flate rate pricing is said to exist. Take the case of internet service providers. You pay a flat rate to access internet at all hours and days of the year. For internet broad band connections, charging flat rate is common practice across the world.

③ Time/usage sensitive pricing:—

Service providers such as internet, electricity companies or mobile communication companies offer their customer time sensitive, or time of use, pricing plans. These plans reflect the actual cost providing service at the time it is needed. They are designed to encourage customers to lower their consumptions during times when the cost of providing the service is high.

④ Transaction Based pricing:—

This is technology-based pricing (TBP) model that allows to acquire enterprise-wide case management solution including all the services require in terms of support, maintenance, version upgrades and training at one go. Normally all these means a large capital expenditure. But when these are associated with the main transaction, the charges for all these services could be factored into the price of the main transaction. Transaction based pricing is viewed as the best alternative in such a case.

5. Market skimming:—

When a product is introduced for the first time in the market, the company fixes a very high price for it. The main idea is to charge the maximum possible. This strategy is mostly found in the case of technology products.

Eg:—When sony introduces a particular TV model, it fixes a very high price. A new series of pentium is priced very high when it is realeased into the market. Initially everyone cannot affor to buy it. But with time, the price comes down and more people can afford to the product.

This method can be followed only when

(i) the demand for the product is inelastic.

(ii) there is no threat from competition.

(iii) high price is coupled with high technology or quality.

Priority pricing:—

In this model the user choose the quality of services th they want and pay a fee for the same. Users can prioritise their sending or receiving packets. This pricing allows the ISPs to charge more for important items by depends on the paying capacity of users.

Williamson's approach:—

Oliver E. Williamson states that the firms exist because of certain assets they hold for production. These assets are such that their specific to each other such that their value is much less in a second-best use. Where the ownership of these assets is distributed, the firms find it difficult to negotiate with their owners for better and optimum usage and this is one of the deciding factors for determining the gains from the trade or business.

Where the usage of the asset extends over a long period, this may lead to increase in transaction costs. Particularly where the gains from trade look attractive, renegotiation becomes necessary and this further increases the transaction costs. Depending upon the market condition, the user of the asset may propose for take over or merger to overcome the continual conflict of interest. Asset specificity ma even imply human capital also. The labour threatens to call for a strike because there is no viable human capital alterna -ve but the firm also can resist this problem by issuing notice to fire.

While negotiating, the firm should rely more on tact and smart methods of protecting their own reputation rather than resorting to legal means including writing and enforcement of contracts. One cannot take chance about the firm's repulation particularly if the dealings with the agents endup in violation of code of business ethics. Transaction costs vary with the size of the firm.

According to williamson, the normal tendency is that the size of the firm gets limited because of increasing costs of deligation and there will not be any incentive for the entrepreneur to increase the size of the firm beyond a particular level as the residual income decreases as the number of owners increase.

In general, most of the entrepreneurs find small is beautiful and feel expanding the size of the firm upto a particular point may be feasible and beyond that it is not. There are also entrepreneurs consider they cannot really do big business if the size of the business is kept limited. They are very passionate about spreading their business activities across the boundaries and get the work done through competent workforce at different levels of management. Here, it is not easy to say which approach is right. The deciding factor in all the cases is the competance of the entrepreneur and his ability to translate the vision into action.

Marris Growth Maximisation Theory:—

According to Marris, the growth rate is determined by growth rate for firm's product interms of demand (GD) and growth rate of capital (GC) supply to the firm. These two growth rates are translated into two utility functions:

ⓐ· Utility function for managers (Um) and

ⓑ· Utility function for owners (Uo) as give below:

* Um = f(S, P, JS, P, S), Where S is salary, P is power, JS is Job security, P is Prestige and S is Status

* OUo = f(O, Cl, Msh, P, PE), Where O is output, C is capital, Ms Market share, P is Profit and PE is Public Esteem.

The utility for managers (Um) is governed by salary, power, job security, prestige and status associated with their respective jobs. They want to show to the owners that they have added value at different stages of production or rendering the services and ultimately increased the revenue. The utility for the owners (Uo) is determined by the output, capital introduced, market share, profit and public esteem. In other words, they are interested to know whether their investments and value of the firm have multiplied or not.

The Um and Uo are positively coorrelated with size of firm i.e; as the firm size increases, the Um and Uo also will increase and vice versa. Therefore, managers seek to maximise the size of firm which in turn depends on maximisation of its growth rate. Marris states that the managers seek to maximise a steady growth rate.

This theory fails to deal satisfactorily with oligopoli interdependence and also ignores issues relating to price determination. There could be several constraints also interms of managerial and financial issues. The firm may face the problem of shortage of competent managerial workforce. In the absence of qualified finance experts, balancing liquidity, solvency and profitability issues could be a major constrainst.

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