Lecture Notes:

- The questions “what gets produced”, “how much gets produced”, “how it gets produced” are determined by **markets**.
- Markets are a bunch of activities, not a place.
- **Market:** The interaction of buyers and sellers exchanging information about products.
- In **market economies**:
    - Private individuals have the right to start a business and try to sell their goods/services and have a chance to make a profit.
    - Consumers have the choice to buy and have a chance to shop around.
- Market vs Planned:
    - If the government owns or controls all the factors of production and if the government provides all the goods & services, then consumers lack choice.
    - In market economies, we think choice is good.
- Not all markets are the same. Some markets have lots of sellers, which is good for buyers as they have more choice, while others have few sellers, meaning there are fewer choices and some markets have only one seller, meaning that there is no choice. **Note:** If the government is in charge, it is the only seller.
- **Market Structure/Degree of Competition** is the combination of the numbers of buyers and sellers in a market.
- The number of sellers in a market determines the:
    1. Variety of choice buyers have.
    2. Negotiating power sellers have.
- We commonly recognise 4 market structures:
    1. **Perfect Competition:**
    - Lots and lots of competitors.
    - No **barriers to entry**. Barriers to entry is anything that makes an industry difficult, time consuming or expensive to enter. In perfect competition, there are no barriers to entry.
    - All have a small **market share**. Market share is the revenue made by a single business as a percentage of total revenue of all competitors.

$$\frac{\text{Business x revenue}}{\text{Industry revenue}} = y\%$$

In a perfectly competitive market, there are dozens or even hundreds of competitors and each one has a small market share. No single competitor is dominant. Therefore, each must charge more or less the same.

$$\frac{\text{business x revenue}}{\text{industry revenue}} = \text{not significant}$$

- All are more or less the same.
  I.e. All, more or less, are **undifferentiated**.
  E.g. No street vendor can claim their hot dogs are different or special.
- All must sell at more or less the same price.
- An example of perfect competition is a barbershop.

2. **Oligopoly:**

- Small number of suppliers. (3, 4 or 5)
- Small number of suppliers.
- All are large. Oligopoly businesses are large, meaning that there are a large number of employees, a large amount of capital is needed and each business has large market share.
- They watch each other closely.
- They follow each other closely.
- They **differentiate**. Competitors try to appear different to attract and retain customers.
- E.g.:
  - Canadian banking industry
  - Mobile phone service providers
  - Airline industry
  - Breweries
- Oligopolies exist because of barriers to entry.
  E.g.
  Airlines → High start up costs
  Banks → Government regulation
  Breweries → **Economies of scale** (Capacity to reduce costs when producing large quantities)
- E.g. (Banks)
  A small number, 5, of very large, 100s of branches, 1000s of employees, compete for each other's customers. They differentiate through distinctive, different coloured logos.

3. **Monopoly:**

- Only one supplier.
- By definition, it has 100% market share and sets whatever price it likes.
- E.g. LCBO
- **Legislated Monopoly:**
  - Is a market with only one seller, because a government has passed a law giving it exclusive right to sell a good or service.
  - While we prefer to give consumers choice, it is not always possible because it may be difficult or expensive.
  - E.g. local cable

4. **Monopolistic Competition:**

- Lots of sellers.
- No barriers to entry.
- Most are small, but a few are big.
- Most, more or less, are the same.
- Most sell at the same price, but a few big sellers can charge more.
- Few big sellers differentiate.
- Few big sellers create brands.

  - **Branding** is using name recognition, colours, logo, or slogan, to differentiate from competitors.
  - E.g. Coffee shops. There are many small ones, but there are some big ones, like Tim Hortons and Starbucks.
- As the owner/manager of a business you must understand:
  - Who are my competitors?
  - How big are they?
  - How many are they?
  - How can they/will they react if I raise or lower my price or if I launch a new product?
  - How can/should I react if they raise or lower their price or if they launch a new product?
- A product's market structure can change.
- Every exchange between a seller and a buyer will be affected by:
  - The buyer's budget.
  - Time that a buyer has to shop around.
  - The buyer's emotional investment in the product.
  - Location
  - Season

Textbook Notes (Chapter 5):

- **Market - A Bunch of Activities, Not a Place:**
- The word market does not refer to the physical place or part of a town. Rather it refers to the activities that occur in those places.
- A **market** is the interaction of buyers and sellers, exchanging information about goods and services for sale.
- There are 4 different markets:
  1. **Perfectly competitive market:** Many sellers and lots of choice
  2. **Oligopoly:** Few sellers and limited choice
  3. **Monopoly:** Only one seller
  4. **Monopolistically competitive market:** Combination of the 3 above
- **How Prices Are Set in a Market:**
- Market prices are set by hundreds of buyers and sellers making thousands of transactions every minute of every day.
- Sellers want to maximize the revenue they get while buyers want to pay as little as they can.
- Since Canada is a market based economy, the Government of Canada takes a back seat when it comes to deciding what Canadians buy and allows us to choose from whom we buy and the price we choose to pay. Sellers can charge what they want, if they can get away with it and buyers will decide whether a price seems appropriate and fair.
- The market system is intended to have several advantages:
  1. Entrepreneurs are permitted and encouraged to start a business.
  2. Consumers are able to have some choice between alternate suppliers.
  3. Sellers are entitled to seek a profit.
  4. When buyers and sellers agree, both parties get what they want.
- **Identifying Your Customers - Who is in Your Market:**
- A **target market** is a particular group of people who share a number of similarities, for example age, gender, income, location, and who have similar needs and wants and are identified by the seller as being most likely to buy a business' products.

- **Note:** When entering into a market, businesses must recognize that the vast majority of people will have some reason not to buy a product.
  E.g. Vegetarians don't buy meat.
- **Market Structure - Not All Markets are the Same:**
- Not all markets are the same. Some markets have very many buyers and sellers. Others have few buyers and sellers. Some markets only have 1 seller. Furthermore, there may be markets where there are a lot of sellers but very few sellers.
- **Degree of competition/Market structure** is the various combinations of numbers or buyers and sellers, in a market.
- **Perfect Competition - Many Sellers and lots of Choices:**
- A perfect competitive market is characterized by a large number of small sellers.
- In a perfect competitive market, the buyer has a good deal of choice regarding from whom they make their purchases. Furthermore, all of the sellers are selling more-or-less the same products for more-or-less the same price.
- A **perfect competition** is a market characterized by a large number of small sellers. All sellers offer more-or-less the same product, for more-or-less the same price, and buyers have lots of choice.
- The key element of a perfectly competitive market is that the customers feel that they have a great deal of choice as to from whom they purchase what they need.
- One characteristic of perfect competition is that all the sellers are said to be small so no producer enjoys a large **market share**. **Market share** is the percentage of an individual firm's sales relative to the total sales within a given market.
- Sellers in a perfectly competitive market know that buyers can shop around. It is unlikely that any vendor will attempt to convince you that the milk they sell is somehow "special" or "better" than the milk sold by the store across the road. They know you won't believe them, because it isn't likely to be true, Therefore, individual businesses in a perfectly competitive market should charge what all of their competitors charge. This is called the **market price**. At any particular time, the market price is the prevailing price to which buyers and sellers agree.
- Note that in a perfectly competitive market all vendors charge "more or less" the same price. In theory, of course, they should all charge exactly the same price.
- **Oligopoly - Few Sellers and Limited Choices:**
- An **oligopoly** is a market with only a small number, 3 or 4, of large sellers. In this type of market buyers have a limited number of choices and limited ability to shop around.
- Markets become oligopolies primarily because of the existence of **barriers to entry**. **Barrier to entry** means that, for one or more reasons, a business or industry has become difficult, time consuming, and expensive to enter, or the product is difficult, time consuming, and expensive to make, so few are tempted to do so.
- There are a number of reasons why barriers to entry may exist in an industry:
  1. A few competitors might have developed processes or technologies that drastically reduce their costs. Without the knowledge or expertise to develop comparable technologies, new entrants will find it hard/impossible to compete.
  2. Entries to scale. Some industries require a lot of capital and energy, which would-be competitors don't have. Hence, they can't compete with existing businesses.
  3. Even if the technology required to make a product isn't complex, there are products which are cheaper to produce in very large quantities. This is called **economies of scale**. Would-be competitors don't have the resources to produce

the products at these large quantities, meaning that their costs will be higher than existing businesses.

- If an industry is characterized by barriers to entry, new entrants will be rare.
- Oligopoly firms are usually described as large. By definition, if there are few or limited competitors, then each enjoys a large market share.
- These characteristics (size, capital intensity, labour intensity) mean that once a business in an oligopoly is up and running. it is hard for it to shut down. For example, an airline may have entered into contracts stretching months, or even years into the future. The airline will have to give lay-off notices to hundreds or thousands of employees, and negotiate severance and retirement packages. The airline will need to honour existing passenger tickets, some booked up co a year in advance. It will then need to sell its fleet of aircraft, All of this means that, in addition to barriers to entry, oligopoly businesses tend to face **barriers to exit**. Barriers to exit are any reason why a business or industry is difficult, time consuming or expensive to leave.
- Because the number of sellers is small, each will be keenly aware of the others' products and services. Each will closely monitor the tactics that rivals use to attract customers. Finally, firms in an oligopoly will tend to set similar prices.
- An example of an oligopoly is the airline industry.
- **Monopoly:**
- A **monopoly** is a market where there is only one available supplier.
- In a monopoly, buyers have no choice but to buy from the sole supplier or do without. Thus, all transactions are done on the seller's terms.
- **Natural Monopoly:**
- A monopoly may exist for the following reasons:
    1. A business has discovered a new or highly-specialised technology that no rival can duplicate.
    2. A business has bought up exclusive control of all of the raw materials, parts or supplies needed to produce a product.
    3. A business is so much more efficient and cost effective at producing a product that no rival can effectively compete.

  The above characteristics describe what is a **natural monopoly**.
- A **natural monopoly** is a business that for reasons of size, greater efficiency or exclusive access to resources or technologies, will always be cheaper than any of its rivals.
- A natural monopoly can produce its products more cheaply and sell it more cheaply than its rivals, while yielding the same or greater profits.
- In an industry that has a natural monopoly, rivals will eventually fail, leaving the monopolist alone.
- Natural monopolies are discouraged, or sometimes broken up, by legislation because the government policy tends to favour competition and choice over the potential efficiency offered by a single monopoly seller.
- **Legislated Monopoly:**
- Most often, monopolies exist because of government legislation which permits, or even dictates, that only one supplier should have the exclusive right to produce and sell a product or service in a given territory.
- A **legislated monopoly** is a business that enjoys the exclusive right to sell a product or service in a given market because the government has given it that right, through the passing of a relevant legislation.

- Legislated monopolies exist because governments recognize that there are some industries which, because of high barriers to entry, could not efficiently deliver products or services at low cost, unless one big supplier was given exclusivity. The most common examples of such industries are suppliers of electricity, gas, water, telephone and cable TV services.
- Examples of legislated monopolies are LCBO, and Rogers (in the GTA).
- **Monopolistic Competition:**
- Similar to a perfectly competitive market, a monopolistically competitive market is characterized, first, by lots and lots of sellers. The large number of sellers suggests that there are few barriers to entry.
- Like perfect competition, in a monopolistically competitive market, most of the many suppliers are small. That is, they do not have a big share of the market.
- However, in a monopolistically competitive industry, a small number of sellers (4 or 5) are much larger than the rest.
- These few sellers are distinct from all of their rivals because through time, they have managed to open more outlets, spend more on marketing, develop a well-known name and convince buyers that their products are better than those offered by their competitors. This activity, convincing potential customers that your product is different or better in some way is known as **differentiation**. **Differentiation** is business activities designed to convince potential customers that your product is different or better than your competitors' products.
- The larger suppliers in a monopolistically competitive market will devote a large amount of effort to get potential customers to recognize their particular name, colors, logo and slogan. This recognition is known as **branding** and is one of the principal methods of differentiating ones product. **Branding** is the efforts by a supplier to get potential customers to recognise its name, colours, logo, or slogan, and therefore differentiate its products from those of all its competitors.
- If a supplier can successfully brand its product, then potential customers will be more aware of it than the offerings of the many smaller suppliers.
- Examples of monopolistically competitive markets are:
    1. **Coffee shop:** Tim Hortons, Starbucks, and Second Cup are larger and better known.
    2. **Hamburger restaurants:** McDonalds, Harvey's, Wendy's, and Burger King are larger and better known.
    3. **Sports clothing:** Nike, Adidas, and Ralph Lauren have recognizable logos.

- **Degrees of Competition - Summary Tables:**

Perfect Competition	Monopolistic Competition
Features: Large number of buyers Large number of sellers No "barriers to entry" All sellers have small market share All sellers more or less the same Products are not differentiated All sellers charge (more or less) the same	**Features:** Large number of buyers Large number of sellers No "barriers to entry" Most of the sellers are "small" A few sellers are "large" and better-known Larger sellers can differentiate Differences highlighted through "branding" Most sellers charge (more or less) the same Larger, "branded" sellers can charge more.
Examples: Cartons of milk Newspaper vendors Fruit and vegetables	**Examples:** Coffee shops (Starbucks vs. the rest) Hamburgers (McDonalds vs. the rest Sports clothes (Nike vs. the rest) Laptops (Apple vs. the rest)

Oligopoly	Monopoly
Features: Large number of buyers Small number of sellers Barriers to entry The few sellers are "large" Sellers very aware of each other, match prices Competitors differentiate through branding	**Features:** Only one seller Barriers to entry (natural or legislated) Consumers have NO choice
Examples: Airlines Banking (RBC, BMO, TD, Scotia, CIBC) Cell phone services (Bell, TELUS, Rogers)	**Examples:** Many utilities (electricity, gas, water supply) LCBO

Textbook Definitions:

- **Barrier to entry:** The characteristic which makes a business or industry difficult, time-consuming or expensive to enter, or a product difficult, time consuming, or expensive to make.
- **Barrier to exit:** Anything that makes an industry difficult, time-consuming or expensive to exit due to contractual obligations, large investment, specialised equipment.
  I.e. Barriers to exit are any reason why a business or industry is difficult, time consuming or expensive to leave.

- **Branding:** The efforts by a supplier to get potential customers to recognise its name, colours, logo, or slogan, and therefore differentiate its products from those of all its competitors.
- **Degree of competition/Market structure:** The various combinations of numbers or buyers and sellers, in a market.
- **Differentiation:** Business activities designed to convince potential customers that your product is different or better than your competitors' products.
- **Economies of scale:** The capacity to reduce costs when producing a good or service in very large quantities.
- **Legislated monopoly:** A business that enjoys the exclusive right to sell a product or service in a given market because the government has given it that right, through the passing of a relevant legislation.
- **Market:** The interaction of buyers and sellers, exchanging information about goods and services for sale.
- **Market price:** At any particular time, the prevailing price to which buyers and sellers agree.
- **Market share:** The percentage of an individual firm's sales relative to the total sales within a given market.
- **Monopoly:** A market where there is only one available supplier.
- **Natural monopoly:** A business that for reasons of size, greater efficiency or exclusive access to resources or technologies, will always be cheaper than any of its rivals.
- **Oligopoly:** A market with only a small number, 3 or 4, of large sellers.
- **Perfect competition:** A market characterized by a large number of small sellers. All sellers offer more-or-less the same product, for more-or-less the same price, and buyers have lots of choice.
- **Target market:** A particular group of people who share a number of similarities, for example age, gender, income, location, and who have similar needs and wants and are identified by the seller as being most likely to buy a business' products.