An Introduction to Microeconomics
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Lecture – 113
Market environment

So, let us talk about Market Environment.

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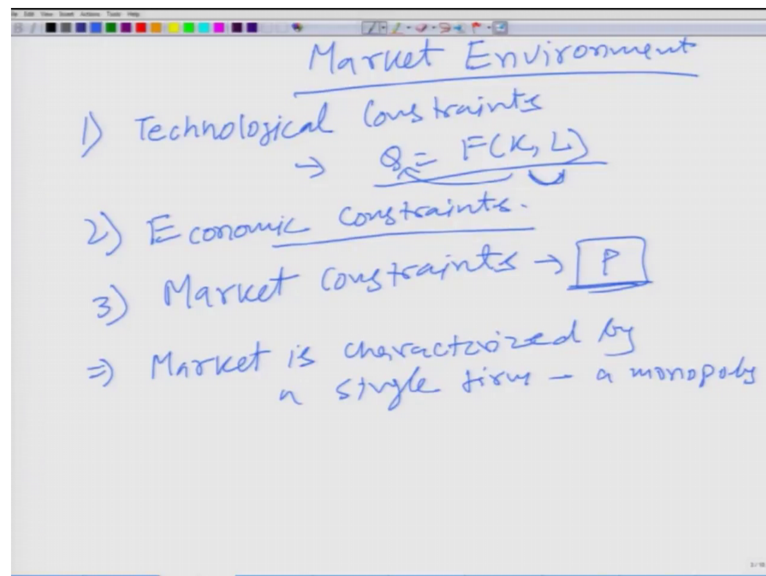

And to talk about market environment we will summarize part of what we have done earlier and that is the production side. And on production side we have seen we have firms and what they do? They take input and convert it into output.

So, let us say a firm faces multiple constraints in the market, and first constraint is technological logical constraint. What is technological constraint? Of course, we have emphasized that technological constraint is summarized by production function. The second kind of constraint that a firm faces is economic constraint. What do we mean by economic constraints? Of course, if we look at the production function what we have that firm can use different combination of K and L to produce Q. Given the market condition firm uses different combination of K and L to produce Q, ok. So, if just for example, and we have done it in the past that if price of capital goes up firm would like to use more of labour and price of labour goes up firm would use more of capital. So, that is covered by the economic constraint.

Third which is of course, related to economic constraint is market constraints. So, firm let us say produces Q given the market condition uses the least cost way to produce Q, but how should it price its product ok, how the P is decided. And while doing the profit maximization we talked about it in certain way. And the way P is decided is coming from what kind of market environment that the firm gets to operate in, ok.

So, we can some extreme cases that we have already considered that when market is market is characterized by a single firm and you must know that what is it called it is a monopoly. And we have seen in the earlier lecture that what happens when this how this firm determines its price. We should also before we proceed any further we should also look at it from different angle and that different angle is starting from the individual demand.

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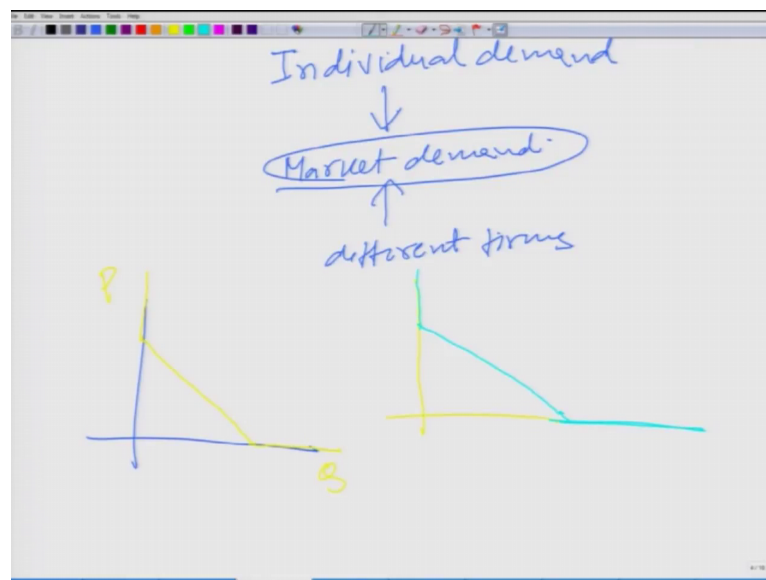

So, of course, in the consumer theory we calculated individual demand and by horizontally summing up all individual demand we got market demand for that particular good nd of course, market demand is catered by different firms and of course, as we talked about in monopoly there is only one firm. So, whole market demand is catered by that particular firm. So, in other word for if market demand is given by let us use a different colour market demand is given by this yellow colour, then the monopoly firm will also see exactly the same demand that it will face that it will cater to, ok. So, that is the case with monopoly.

So, of course, no one would like to go to the firm which is selling its product at higher price. So, it will lose all the market. So, of course, we saw it from the firm side that there is only one firm in the market and that is monopoly. Just very related to monopoly is something called monopsony.

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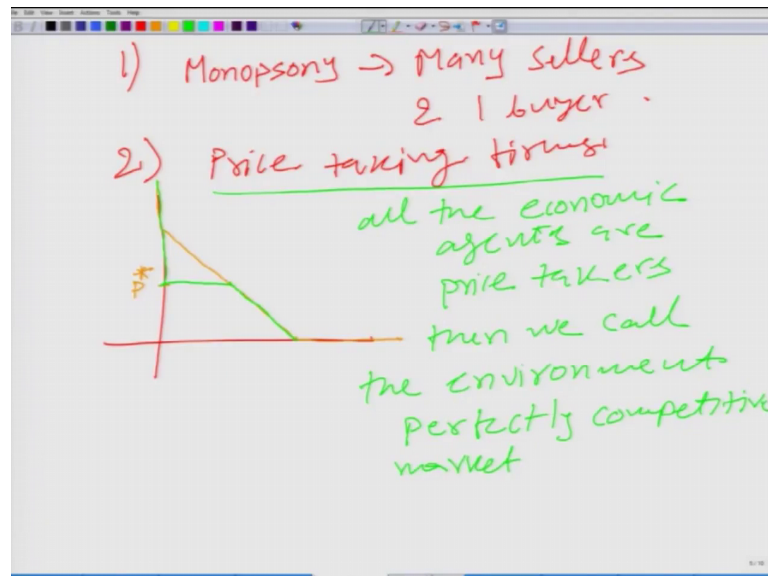

And what happens in monopsony that there are many sellers in the market, but there is only one buyer, many seller and sellers and one buyer. The other extreme that we discussed was that when all the firms in the market where price taker. So, price taking firm and what do we mean that all the firms where price taker like they were not able to influence the price in the market they take price as given.

So, what happens in this case let us consider that here is the market demand, the market demand is given by this yellow colour line and a particular firm let us say market price is this P star a firm which raises its price above the P star is not able to sell any product. So, we can say that demand facing firm a price taking firm is given by this green colour curve, ok. So, there is a difference there is a difference between the market demand and demand facing a firm ok.

Third this when this is the case when all the economic agents all the economic agents agents are price taker takers then we call the environment perfectly competitive competitive market. We should also consider the third example.

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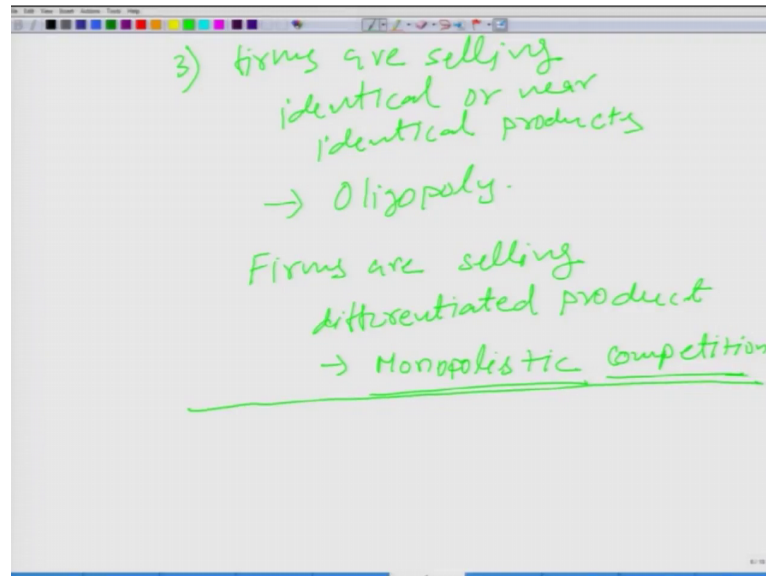

What happens we have we have few firms operating in the market and there are of course, many buyers. So, there are two condition we can think about, one that firms are selling identical or near identical products in this case the market is called oligopoly. And what is the characteristics of this particular market that a firm has to think about not only market demand while deciding its price, but also this firm needs to think about how other firms in this particular market are pricing their product.

So, we will come to it towards the end we will talk about it that strategical the strategy becomes very important the pricing strategy. The other example is that firms are selling differentiated product. And what do we mean by differentiated product; that a product of a particular firm is slightly different from products of other firm. For example, car, we can see that Maruti selling car, Hyundai is selling car, Honda is selling car they all are selling cars, but each have different kind of cars. The Alto is very different from I 10. So, they are selling they all are selling car, but they are different from each other. So, we call them differentiated product.

And so in here in this particular case let us say that if someone has affinity for I 10, then this the Hyundai should be able to exploit it in the market. Exploit in the sense that Hyundai would get little leeway in setting up the price of its product in the market, and when this is the case we call it monopolistic competition. It is monopolistic in the sense that its selling a very specific kind of a car which is unique only Hyundai is making I 10

and it is a competition that it is not it is not just one particular firm selling the car there are many firms in the market. So, they are competing against each other.

So, this is about market environment. Now, we are going to focus on perfectly competitive market.

Thank you.