FOR BBA (Hons)

1. Subject : Managerial Economics
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3. Name of the Teacher : Dr. Sudip Ghosh
4. Name of the topic : Price & Output determination under Monopoly (Short & Long run)

Monopoly

Although conditions facing a monopolist are much different from those of firms in perfect competition, the two types of firms have at least one thing in common — they do not have to compete with other individual participants in the market. Sellers in perfect competition are so small that they can ignore each other and consider the market environment as given. At the other extreme, the monopolist is the only seller in the market and has no competitors.

Characteristics

Monopoly can be described in terms of the market structure characteristics, discussed above. First, there is only one seller in the market. This means that the demand curve faced by the monopolist is the downward-sloping demand curve for the market

* competitions. At the same time, there are few good substitutes for concrete foundations. Wood, stone, and cinder block are possibilities, but they are not as strong or as easy to use as concrete.

Second, for a firm to continue as a monopoly in the long run, there must be factors that prevent the entry of other firms. Finally, the product of the monopolist must be highly differentiated from other goods. That is, there must be no good substitutes. The market structure characteristics of a monopoly are listed in the following table: Table 1.

Table 1: Market structure characteristics of monopoly

Number and size distribution of sellers	Single seller
Number and size distribution of buyers	Unspecified
Product differentiation	No close substitutes
Condition of entry and exit	Entry blocked or difficult

Consider a small, isolated community that has only one supplier of concrete. Essentially, that firm has a monopoly position. When residents want concrete for foundations of new houses, they will have to buy from this monopolist.

The high cost of transporting concrete makes it unlikely that concrete producers in other cities will be viable

Profit-maximising price and output in the short run

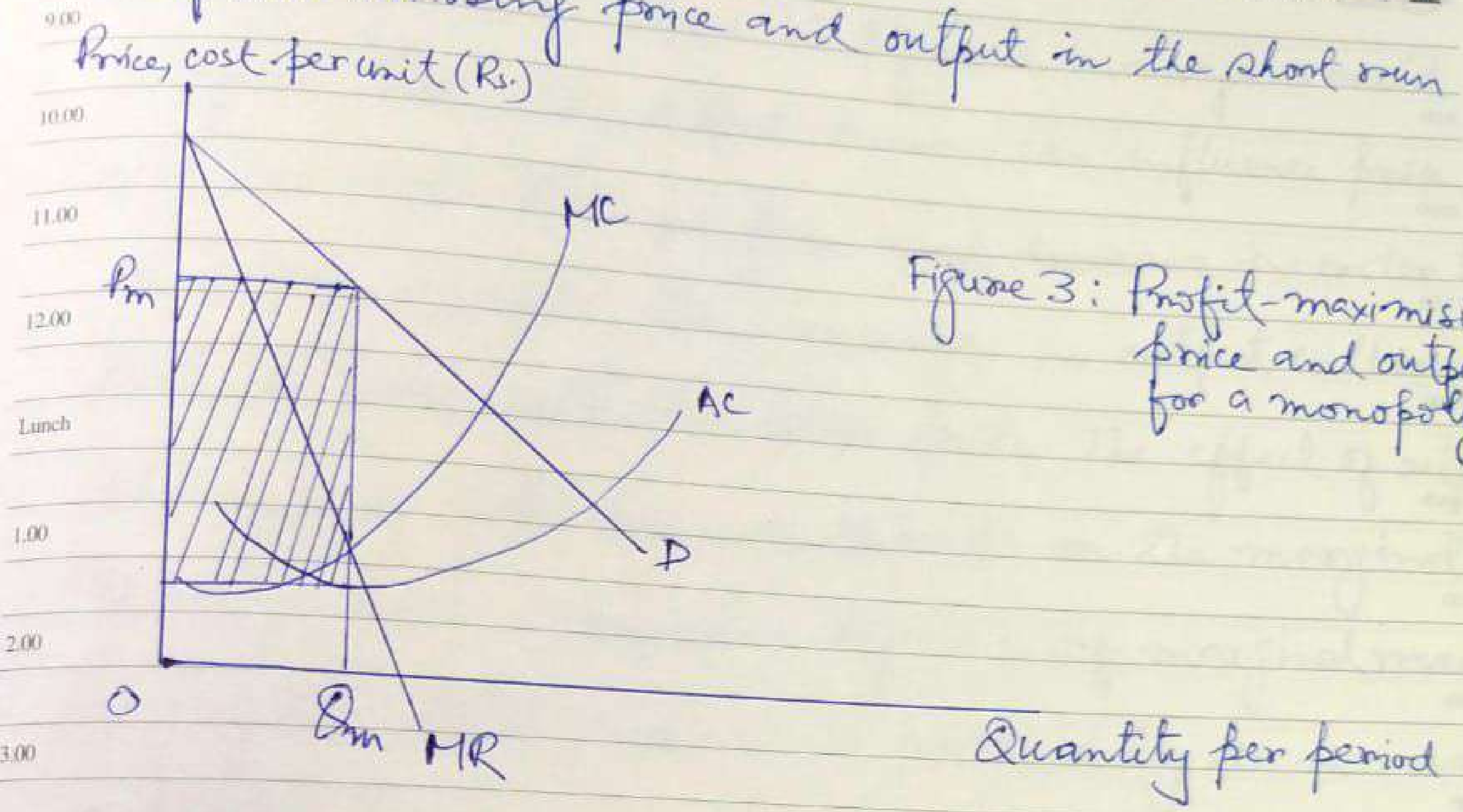

Figure 3: Profit-maximising price and output for a monopoly

Demand and cost curves for a monopolist are shown in Figure 3. As with the perfectly competitive firm, the cost curves depict first decreasing and then increasing average costs.

Because they face a horizontal demand curve, managers of firms in a perfectly competitive world have no control over price. They simply choose the profit-maximising output. However, because the monopolist has a downward-sloping

* market will allow, as indicated by the demand curve. In Figure 3, this price is Pm.

demand curve, as shown in Figure 3, managers must recognise that their output decisions can influence price and vice versa. Because price must decrease in order to increase sales, an increase in output will require that the firm sell at a lower price. The effect of output changes on total revenues depends on the marginal revenue curve shown in Figure 3. If marginal revenue is negative, total revenue is reduced by the increased output.

The criterion for maximizing profits is the same for the monopolist as for firms in perfect competition — output should be increased until the additional revenue equals the marginal cost. For the competitive firm, the price is unaffected by output, so the decision criterion is to produce until price equals marginal cost. For the monopolist, the equivalent criterion is to produce at Qm in Figure 3, where marginal revenue equals the marginal cost. At this output, the monopolist charges what the *

Profit-maximising price and output in the long run

Notice that producing Qm units of output, the monopolist is earning profit as indicated by the shaded area in Figure 3. If it were possible, other firms would enter the market to take advantage of the high rate of return. With other sellers in the market, the demand curve faced by the monopolist no longer would be the market demand curve. The firm's new demand curve would be relatively more elastic because the firm's output would represent a smaller share of the total market sales and thus have a

smaller effect on price. At the same time, part of the market and some of the economic profit earned by the monopolist would be captured by the new entrants. Ultimately, the market structure might evolve to an oligopoly (a small number of sellers)

or even approach perfect competition. However, if the firm's monopoly position is the result of its control over scarce inputs such as mineral reserves, patents, unique managerial talent, or a choice location, entry by other firms may be impossible, and the firm will maintain its monopoly position. In this case, economic profits may persist indefinitely. Thus, Figure 3 may depict both the short-run and the long-run profit-maximizing price and output for a monopoly.