

## Market Power

News

In Most Markets, Buyers and Sellers Are Not Price Takers.

Sources of Market Power.

Price Setters Face a Tradeoff when They Decide How Much to Sell.

Market Power diminishes Economic Efficiency

What Have We Learned?

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The New York Times  
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### It's American Brandstand: Marketers Underwrite Performers

By **ROBERT LEVINE**

The hip-hop and R&B producer Jermaine Dupri has discovered best-selling acts like Kris Kross and Da Brat, has produced hits for Mariah Carey and Jay-Z, and now runs the urban music division of the Island Def Jam Music Group. He's also looking for fresh talent for a new label financed by a company new to the music industry.

The new player? Procter & Gamble.

The consumer goods giant is part of a wave of companies getting into the music business to promote their own products, essentially becoming record labels themselves.

Procter & Gamble, for example, is joining Island Def Jam in a joint venture called Tag Records, a label that will sign and release albums by new hip-hop acts. It is named after a brand of body spray that P.&G. acquired when it bought Gillette.

## Perfect Competition is the Absence of Market Power

In a perfectly competitive market, the price of a good is determined by supply and demand.

No seller can influence price. If a seller's price is above the market, buyers go elsewhere.

No buyer can influence price. If a buyer seeks a discount, sellers refuse.

The best examples of competitive markets are commodities markets.

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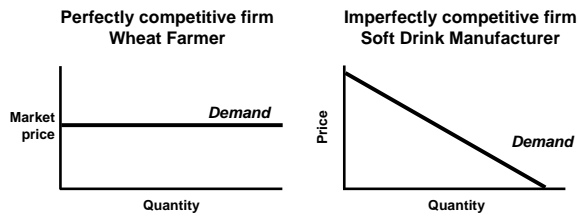
## Most Markets Are Not Perfectly Competitive.

Some buyers do not think that Coke™ and Pepsi™ are close substitutes. They are brand conscious.

Because of buyer brand loyalty, sellers have some latitude to set the price of their products.

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In the Soft Drink Market, Firms Face Downward Sloping Demand Schedules.



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Market Power Is...

The ability of a seller  
to raise its price relative to its rivals  
without losing all of its sales.

Use Your Clicker To Answer  
The Following  
Graded Question.

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Which of the following soft drink  
sellers is likely to have the most  
market power?

- A. Concession Area at the Smith Center.
- B. Franklin Street Snack Shop.
- C. Lenoir Dining Hall.
- D. Food Court at A Shopping Mall Like Streets of South Point

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The Concessionaire at the Smith Center has the most market power.

Smith Center policy prohibits fans from bringing any food or drink into the Center.

Fans have very few substitutes available for Smith Center Fizzy Drinks.

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Market Power is inversely related to the availability of substitutes.

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## Sources of Market Power

Exclusive control over inputs.  
Patents and Copyrights.  
Government licenses or franchises.  
Economies of scale.  
Network economies

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## Sources of Market Power Exclusive control over inputs



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## Sources of Market Power Patents and Copyrights



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## Sources of Market Power Government Licenses or Franchises

From New York Times Archive

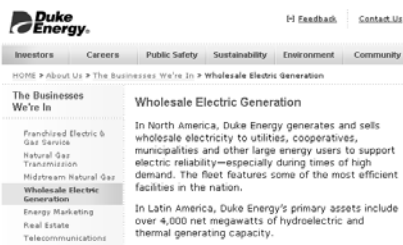
### Sharing the Riches of War in Iraq

(NYT) 365 words  
Published July 24, 2006

If there's been one American entity that found Baghdad to be Far City, it's the Halliburton Company, the oil services behemoth that was awarded the major contract for supplying all manner of logistics and support services to soldiers at war, from meals to morale. The contract proved to be worth more than \$15 billion as the company became a ubiquitous player in Iraq — and a symbol of cozyism in Washington for its old ties to Vice President Dick Cheney.

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## Sources of Market Power Economies of Scale



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## Sources of Market Power Network Economies

From New York Times Archive

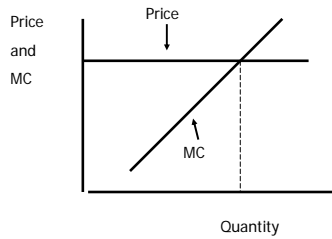
### MEDIA TALK; Interactive Netscape Site Gets Some Sour Responses

By MARIA ASPAN (NYT) 354 words  
Published July 17, 2006

Netscape may be known now for losing the so-called browser war to Microsoft Explorer. But Netscape.com, the default home page for users of the fading browser, continues to have its following -- so much so that when its owner, AOL, tried to update it last month, it received some surprisingly angry feedback.

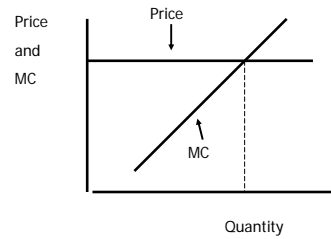
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In a perfectly competitive industry, a firm will adjust quantity supplied until marginal cost equals market price.



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When the firm raises quantity by one unit,  
 Marginal Benefit = Market Price  
 Marginal Cost = Marginal Cost of Production and Sales



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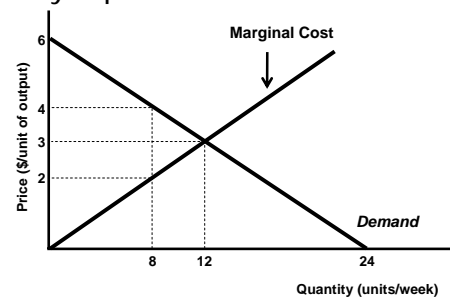
In an imperfectly competitive industry, a firm faces two consequences when it increases quantity supplied.

It must pay the marginal cost of the increased production.

It must lower price to sell the increase production.

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A firm with market power faces two consequences when it increases the quantity it produces.



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## Marginal Revenue

Marginal revenue is the change in a firm's total revenue that occurs when the firm increases output and sales by one unit.

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To Answer The Following  
Graded Question.

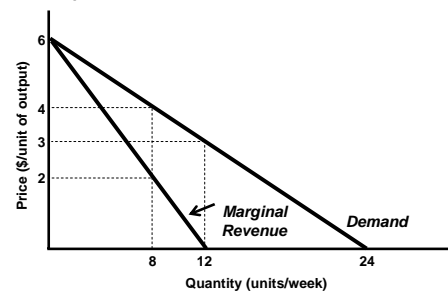
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If a firm faces its own demand schedule and can choose its price, then its marginal revenue...

- A. Is less than its price.
- B. Is negative at quantities where demand is elastic.
- C. Is zero at the quantity that the firm chooses to produce.
- D. Remains constant as long as price remains above marginal cost.

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Marginal revenue is less than price because raising the quantity sold requires the firm to decrease price.



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How should a firm choose its price and quantity when it has market power?

Carla supplements her income as a TA by editing term papers for undergraduates.

Carla can set her price but charges the same price to all her customers.

There are eight students (A-H) for whom she might edit, each with a reservation price as given by the following table.

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The Marginal Revenue Schedule Shows How the Firm's Revenue Changes with Quantity.

Student	Reservation Price	Total Revenue	Marginal Revenue
A	40	40	40
B	38	76	36
C	36	108	32
D	34	136	28
E	32	160	24
F	30	180	20
G	28	196	16
H	26	208	12

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Use Your Clicker To Answer  
The Following  
Graded Question.

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Suppose Carla's opportunity cost for editing a paper is \$29 and that she charges the same price to all customers. How many papers will she edit?

Quantity	Marginal Revenue
1	40
2	36
3	32
4	28
5	24
6	20
7	16
8	12

- A. One
- B. Two
- C. Three
- D. Eight

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Suppose Carla's opportunity cost for editing a paper is \$29. How many will she edit?

Quantity	Marginal Revenue
1	40
2	36
3	32
4	28
5	24
6	20
7	16
8	12

Carla will edit 3 papers.

For papers 1-3,  $MR > MC$

For paper 4,  $MR < MC$

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## Profit Maximization Rule For a Firm with Market Power

When  $MR > MC$ , increase output.

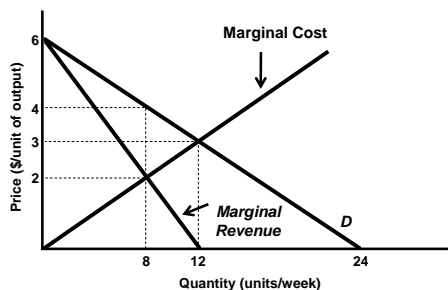
When  $MR < MC$ , decrease output .

Profits are maximized at the level of output for which  $MR = MC$ .

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Profit Maximization Rule for a Firm with Market Power:

Choose Quantity such that  $MC = MR$



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## The Impact of Market Power on Economic Efficiency

In a Competitive Industry, the market price of a good...

Equals the reservation price of the "last" consumer to buy the good.

Equals the marginal cost of the "last" producer to supply the good.

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## The Impact of Market Power on Economic Efficiency

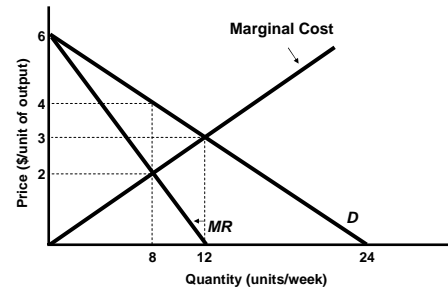
In an Imperfectly Competitive Industry...

The market price of a good is greater than the marginal cost of the last unit produced.

There are consumers who are willing to pay the marginal cost of producing another unit of the good who are not able to purchase it.

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## The Impact of Market Power on Economic Efficiency



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What Have We Learned?

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Today, We learned that

Market power is the ability of firms to raise their price without losing all their customers.

There are several sources of market power including brand consciousness and restrictions on entry.

A firm with market power will choose an output level where  $MC = MR$ .

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