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?

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.

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

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.

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
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.

Market Power is inversely related to the availability of substitutes.

Sources of Market Power

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

**Patents and Copyrights**

**Government Licenses or Franchises**

From New York Times Archive

**Economies of Scale**

From New York Times Archive

**Network Economies**

**MEDIA TALK: Interactive Netscape Site Gets Some Sour Responses**

By MARA ADAMS-JENTZ, NYT Staff

Thursday, July 17, 2008

Downloads may be the reason for using the so-called browser war to Microsoft. Explorer. But Netscape users, the default home page for users of the leading browsers, continue to have no following – so much so that Netscape owner, AOL, had to update its latest release, it seemed some improvement.
In a perfectly competitive industry, a firm will adjust quantity supplied until marginal cost equals market price.

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.

A firm with market power faces two consequences when it increases the quantity it produces:
Marginal Revenue

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

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.

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

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

<table>
<thead>
<tr>
<th>Student</th>
<th>Reservation Price</th>
<th>Total Revenue</th>
<th>Marginal Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>40</td>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td>B</td>
<td>38</td>
<td>76</td>
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<td>C</td>
<td>36</td>
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</tr>
<tr>
<td>H</td>
<td>26</td>
<td>208</td>
<td>12</td>
</tr>
</tbody>
</table>

Use Your Clicker To Answer The Following Graded Question.

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?

A. One  
B. Two  
C. Three  
D. Eight
Suppose Carla’s opportunity cost for editing a paper is $29. How many will she edit?

Carla will edit 3 papers.

For papers 1-3, MB > MC

For paper 4, MB < MC

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 $MR = MC$.

Profit Maximization Rule for a Firm with Market Power:
Choose Quantity such that $MC = MR$

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.
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.

What Have We Learned?

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.