Monopoly

It is a type of market structure where there is only **one producer and many buyers**. The monopolist produces an **industry's entire output**. In contrast to perfectly competitive firms, which are price takers, a monopolist sets its own prices, this is why it is considered as a **price maker**. The demand curve for the monopolist (and for any imperfectly competitive seller) is quite different from that of the pure competitor. Because the pure monopolist *is* the industry, its demand curve *is* the market demand curve.
And because market demand is not perfectly elastic, the monopolist's demand curve is down sloping. A monopoly firm must charge a single price for its output; it will produce less, charge a higher price, and earn greater profits than do firms operating in perfect competition. It may charge different prices to different customers **(price discrimination) to** get maximum profit.

There are few other important features of monopoly. For instance, there are **barriers on the entrance of new firms**, secondly, monopolist produces **unique product** which does not have any close substitute therefore demand curve which is faced by a monopolist is **relatively inelastic**, thirdly, and monopolist can make **abnormal profit even in the long run**.

How is monopoly formed?

Monopoly has to use effective trade barrier to create or maintain monopoly. These barriers may be natural or artificial.

Natural barriers are those which are not created deliberately, for instance, if a firm has achieved ***economies of large scale*** and producing at the least possible cost, new firms cannot compete and monopoly is maintained. Secondly, firm has a ***complete control on the supply of raw material***, therefore no other firms can produce that product. Thirdly, due to new invention, ***by law*** firm create monopoly for a certain period of time. Fourthly firm may enjoy monopoly power because of ***high set up cost***, new firms are reluctant to compete because huge funds are required to set up the business.

Artificial barriers are those which are created by monopolist deliberately. He may achieve his objective by ***predatory pricing***, where he deliberately lowers his prices temporarily. New entrance cannot afford to reduce their prices and driven out from the market. Sometimes monopolist ***restricts his suppliers*** that if they supply any new firm, the monopoly will take its custom to another supplier. New firms cannot obtain raw material and, therefore, no production. Thirdly a firm maintains its monopoly through ***exclusive dealing***, where he restricts his buyers if any of them sell any other company's product, monopolist will no longer supply them with its well established and popular brand. Fourthly, sometimes monopolist uses ***advertisement*** to restrict his buyers, although it is costly to use this method.

Firm's equilibrium

We assume main objective of a firm is profit maximization therefore firm is in equilibrium at that point where ***MR=MC*** as is shown in the following figure. The firm's equilibrium output is ***OQ.***

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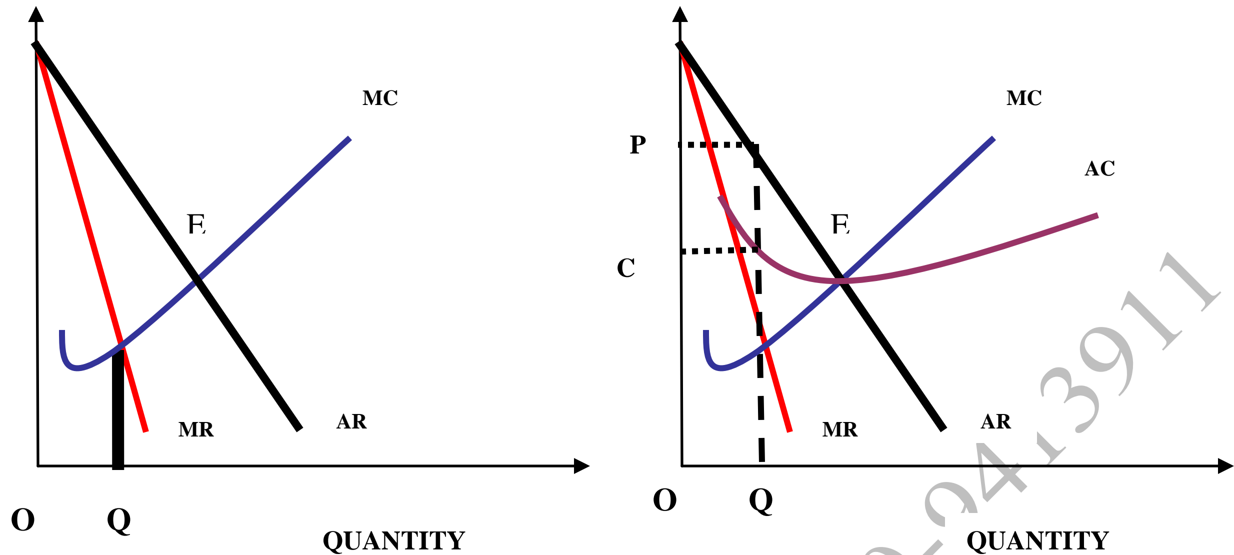

Monopoly is a type of market structure where producer not only make abnormal profit in the short run but also in the long run.
In the above figure firm's average cost is OC where as its AR is OP per unit, therefore firm makes abnormal profit CP per unit. The monopolist seeks maximum *total* profit, not maximum *unit* profit.

A monopolist will never choose a price-quantity combination where price reductions cause total revenue to decrease (marginal revenue to be negative).The profit-maximizing monopolist will always want to avoid the inelastic segment of its demand curve in favor of some price-quantity combination in the elastic region. To get into the inelastic region, the monopolist must lower price and increase output. In the inelastic region a lower price means less total revenue. And increased output always means increased total cost. Less total revenue and higher total cost yield lower profit.

Does monopoly suffer in loss?

Monopoly may suffer in loss but only in the short run. Pure monopoly does not guarantee profit. The monopolist is not immune from changes in tastes that reduce the demand for its product. Nor is it immune from upward-shifting cost curves caused by escalating resource prices. If the demand and cost situation faced by the monopolist is far less favorable then monopolist will incur losses in the short run despite its dominance in the market. Yet it continues to operate for the time being because its total loss is less than its fixed cost. In certain cases monopolist incurs loss due to predatory pricing to drive out new firms.

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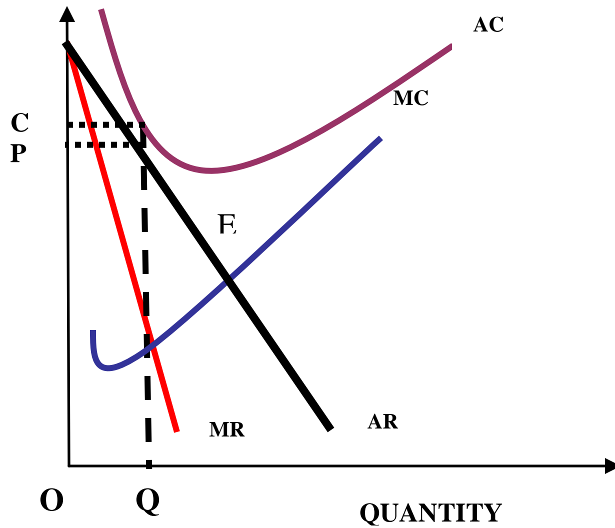
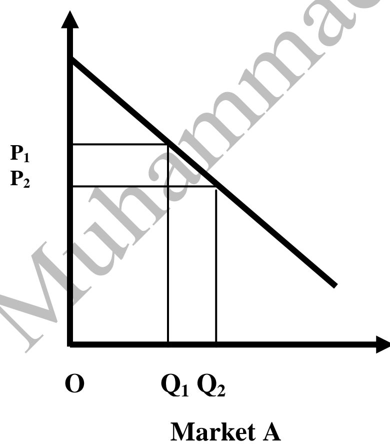


In the above fig. AC is OC where as AR is OP, therefore firm suffers in loss CP per unit.

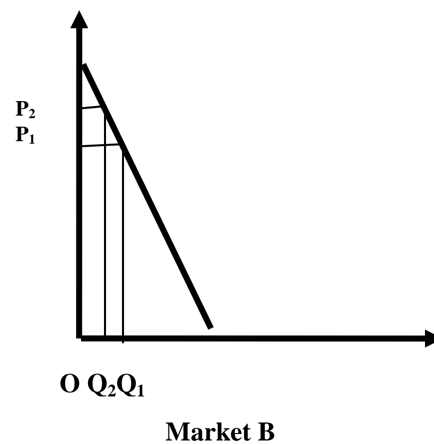
Price discrimination

Another important feature of a monopolist is price discrimination. Price discrimination means to charge different prices to different customers for the same service. Price discriminates under the following circumstances.

a) Where market is segmented on the basis of region, gender, income, age etc.
b) There must be only one seller
c) Where consumers are restricted in to their respective market
d) Where it is not allowed to buy goods from the low price market and sell them in the high price market
e) Monopolist should face different elasticities of demand in different markets.



Market A



Market B

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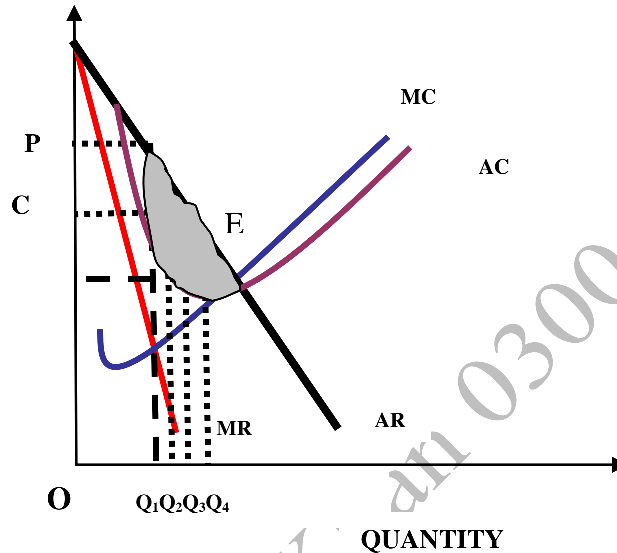
in market A demand is relatively elastic, monopolist can increase its total revenue by reducing prices from **P_1 to P_2**, where as in market B demand is relatively inelastic therefore monopolist increases prices, although there is a fall in quantity demanded but total revenue increases.

Is price discrimination advantageous?

Price discrimination allows firm to increase its total revenue as was mentioned before. With the help discrimination producer can increase its surplus by decreasing ***dead weight loss***.



In the above fig. firm produces at OQ1, where as it can produce to that point where AR equals to AC. By price discrimination it produces to OQ4 and reduces dead weight loss which is shown in grey area.

Price discrimination enables monopolist to convert consumer surplus into producer surplus. Therefore sometimes a monopolist who is suffering in loss can make profit by charging different prices to different customer according to their ability to pay. For instance if a firm produces 20 units at the cost £6 per unit and total cost is £120. On the other side it can generate £100 at the price of £5, there is a loss of £20. When firm discriminates and charge different prices to different customers, let us say, £8 for 5 units, £7 for next 5 units, £6 for next five units and £5 for last five units. It can generate revenue of £130 and makes a profit of £10.

With price discrimination monopolist can spread its risk. Since monopolist operates in different markets hence if it incurs loss in one market it may concentrate on other markets.

Price discrimination is advantageous to consumers too. Due to price discrimination there is an increase in buying power of a group of consumers, though there is a fall in buying power of another group due to increase in prices. Practically, monopolists try to capture the ‘niche market’, therefore now there is a wider choice for consumers of better quality product. Price discrimination encourages competition. It leads to increase efficiency as well as a fall in prices.

However it may be disadvantageous for consumers. For instance, monopolist charges high prices to certain income groups and covert consumers’ surpluses to producers’ surpluses. Secondly monopolist may create monopoly even in ‘niche market’ to drive out small firms.

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Is monopoly always disadvantageous?

some monopolies benefit from economies of scale that might not be obtainable in a highly competitive industry. And, these economies of scale continue on as the firm becomes larger and larger. For instance, suppose that a monopolist is less concerned with finding the absolute lowest cost way to produce a good. But this firm is also so large that it achieves unit production costs that are below that achievable by a small highly competitive firm.

Conclusion: Unregulated monopolies are generally considered bad. They often charge higher prices than would exist in a more competitive industry, they are often less efficient, and they often sell less than a competitive industry would sell. Further, it appears that most monopolies fail to achieve dynamic efficiency.

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