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CLASSIFICATION OF MARKETS

Various criteria have been suggested for the classification of markets. The basic criteria are the existence and closeness of substitutes (substitutability of products criterion) and the extent to which firms in the industry take into account the reactions of competitors (interdependence criterion). The latter criterion is closely related to the number of firms in the industry and the degree of differentiation of the product. If there are many firms in the industry each one of them will tend to ignore its competitors and act atomistically. If there are few firms in the industry each one will be conscious of its interdependence with the others and will take into account their reactions. Bain has suggested a third criterion for market classification, namely the 'condition of entry' which measures the 'ease of entry' in the various markets.

Traditionally the following market structures are distinguished:

Perfect competition

In perfect competition there is a very large number of firms in the industry and the product is homogeneous. Competition is perfect in the sense that every firm considers that it can sell any amount of output it wishes at the going market price, which cannot be affected by the individual producer whose share in the market is very small. Thus

although competition is perfect, there is no rivalry among the individual firms. Each one firm acts atomistically, that is, it decides its level of output ignoring the others in the industry. The products of the firms are perfect substitutes for one another so that the price-elasticity of the demand curve of the individual firm is infinite. Entry is free and easy.

Monopoly

In a monopoly situation there is only one firm in the industry and there are no close substitutes for the product of the monopolist. The demand of the monopolist coincides with the industry demand, which has a finite price elasticity. Entry is blockaded.

Monopolistic competition

In a market of monopolistic competition there is a very large number of firms,but their product is somewhat differentiated. Hence the demand of the individual firm has a negative slope, but its price elasticity is high due to the existence of the close substitutes produced by the other firms in the industry. Despite the existence of close substitutes each firm acts atomistically, ignoring the competitors' reactions, because there are too many of them and each one would be very little affected by the actions of any other competitor. Thus each seller thinks that he would keep some of his customers if he raised his price, and he could increase his sales, but not much, if he lowered his price: his de- mand curve has a high price elasticity, but is not perfectly elastic because of the attach- ment of customers to the slightly differentiated product he offers. Entry is free and easy in the industry.

Oligopoly

In an oligopolistic market there is a small number of firms, so that sellers are con-scious of their interdependence. Thus each firm must take into account the rivals' re- actions. The competition is not perfect,

yet the rivalry among firms is high, unless they make a collusive agreement. The products that the oligopolists produce may be homogeneous (pure oligopoly) or differentiated (differentiated oligopoly). In the latter case the elasticity of the individual market demand is smaller than in the case of the homogeneous oligopoly. The sellers must 'guess' at the rivals' reactions (as well as at the consumers' reactions). Their decisions depend on the ease of entry and the time lag which they forecast to intervene between their own action and the rivals' reactions. Given that there is a very large number of possible reactions of competitors, the behaviour of firms may assume various forms. Thus there are various models of oligopolistic behaviour, each based on different reaction patterns of rivals. From the above brief description of the characteristics of the various markets we may present a scheme of market classification using the following measures for the degree of product substitutability, sellers' interdependence and ease of entry.