

# *The Flattened Firm: Not as Advertised*

**Thecasesolutions.com**

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# Introduction

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In this project, we are going to discuss and evaluate the four most common market structures today - Perfect Competition, Oligopoly, Monopolistic (Imperfect) Competition and Monopoly.

We will evaluate each market structure under different headings, in order to breakdown the information into a more accessible format.

Our aim for this project is to learn more about market structures, teamwork and hopefully help others to study this area of economics.

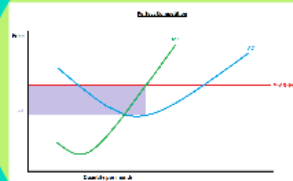
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## Characteristics:

- 1 Goods are Homogenous:**  
All goods on a perfectly competitive market are identical.  
They can be easily substituted and so they are called perfect substitutes.  
Due to these goods being perfect substitutes the firm does not engage in competitive advertising.
- 2 There is a large number of buyers and sellers:**  
There are many buyers and no one individual can influence the selling price of the good.  
The sellers in this market are price takers. This means the market sets price where supply equals demand.
- 3 Free entry and exit into industry:**  
There are no barriers to entry in this market meaning firms are free to enter and leave the market as they wish.
- 4 Perfect knowledge of markets:**  
Perfect knowledge exists in this market meaning that consumers are fully aware of the prices being charged by suppliers and firms are aware of the profit levels being made by other firms in the industry.

## Perfectly Competitive Graph



D = Demand  
 MR = Marginal Revenue  
 MC = Marginal Cost  
 AC = Average Cost  
 Profit = Supernormal

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## PERFECT COMPETITION

"A market structure where competition is at its greatest possible level" - The economic times

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**Demand curve of a firm under perfect competition**  
Firms in a perfectly competitive market face a perfectly elastic demand curve. This means that if a firm increases its price at all then it will lose their price to the same and due to the goods being homogenous consumers will switch to the lowest substitute causing demand for the firm goods to fall to zero.

## Advantages:

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- No Advertising:**  
As the goods in this market are homogenous firms do not engage in competitive advertising. This in turn means no resources are wasted on advertising and there is no extra cost borne by the consumer as a result of advertising.
- Consumers are not exploited:**  
Due to the firm earning normal profits consumers are not being exploited as they are being charged the minimum price possible.
- Efficiency Encouraged:**  
Only those firms who are efficient will survive in the long run. Firms in the industry produce at the lowest point on the AC curve which is the point of maximum efficiency.

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## Why Firms in Perfect Competition Don't Engage in Advertising

- Goods are Homogenous:**  
All goods produced are identical and are perfect substitutes and so no individual firm cannot differentiate their product and so there would be no benefit to advertising as differences cannot be created in the mind of the consumer.
- Increase in Production Costs:**  
If the cost involved in the advertising of goods where the profits currently firms under perfect competition and this advertising will not yield any extra revenue due to the goods being homogenous and advertising being pointless in the market.
- Benefits Entire Industry:**  
As the goods are homogenous if one firm were to increase the selling of other firms in the market would also benefit and the cost would be borne by one producer only.

## Disadvantages

- No scope for economies of scale:**  
This market is made up of many small firms all operating on a small scale basis meaning no one individual firm can achieve economies of scale.
- Little choice:**  
Due to the goods in this industry being homogenous consumers have little choice as the goods are identical and undifferentiated.
- No research and development:**  
Due to firms only earning normal profits, they do not have the capital needed to invest in research and development.
- No incentive to develop new technology:**  
If one firm were to develop new technology it would be shared with all other firms as perfect knowledge exists.

## Examples

- UK Agricultural Market:**  
UK Milk Farmers who sell standardised milk without brands etc.
- UK Market of wheat and barley:**  
UK Farmers of wheat and barley have to sell their crops at the same price as others, which makes the price inelastic.
- Unbranded Consumer Goods:**  
UK Tea Culture

## Generic advertising

As outlined in the previous slide firms under perfect competition do not engage in competitive advertising however firms do engage in what is known as generic advertising.  
The aim is to not just promote one firm or brand in the industry but rather to promote the industry as a whole in the hope of raising aggregate demand in the industry.  
An example of this was when Irish rugby star Paul O'Connell campaigned and advertised for the National Dairy Council. The aim here was to increase demand for dairy and not one brand of dairy in particular.

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***Demand curve of a firm under  
perfect competition***

*Firms in a perfectly competitive market have a perfectly elastic demand curve. This means that if a firm increases price all other firms will leave their prices the same and due to the goods being homogenous consumers will switch to the cheaper substitutes causing demand for the firms goods to fall to zero*



## *Advantages:*

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### **No Advertising:**

As the goods in this market are homogenous firms do not engage in competitive advertising. This in turn means no resources are wasted on advertising and there is no extra cost borne by the consumer as a result of advertising.



### **Consumers are not exploited:**

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### **Efficiency Encouraged:**

Only those firms who are efficient will survive in the long run. Firms in the industry produce on the lowest point on the AC curve which is the point of maximum efficiency.



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## *Why Firms in Perfect Competition Don't Engage in Advertising*

### **Goods are Homogenous:**

☒ All goods produced are identical and are perfect substitutes and so each individual firm cannot differentiate their product and so there would be no benefit to advertising as differences cannot be created in the mind of the consumer

### **Increase in Production Costs:**

☒ The cost involved in the advertising of goods reduces the profits earned by firms under perfect competition and this advertising will not yield any extra revenue due to the goods being homogenous and advertising being pointless in the market.

### **Benefits Entire Industry:**

☒ As the goods are homogenous if one firm were to invest in advertising all other firms in the market would also benefit and the cost would be borne by one producer only.