The Features and Reasons for the Emergence of Monopoly in India

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Abstract

Monopolies are generally considered to be a bad thing in modern economics because they can corner a market. This means that the business who owns a monopoly can essentially charge whatever they want for their goods or services because they know people are forced to pay that price to get what they need. In certain situations, however, a monopoly can also have specific advantages that help the consumer as well.

Keywords: *Single seller, Oligopoly, Cartel, Patent rights, Restrictions on entry and exit, Monopoly*

Introduction

A **monopoly** (from Greek Mono("alone" or "single") and poly ("to sell")) exists when a specific person or enterprise is the only supplier of a particular commodity (this contrasts with a monopsony which relates to a single entity's control of a market to purchase a good or service, and with oligopoly which consists of a few entities dominating an industry). Monopolies are thus characterized by a lack of economic competition to produce the good or service, a lack of viable substitute goods, and the possibility of a high monopoly price well above the firm's marginal cost that leads to a high monopoly profit. The verb *monopolise* or *monopolize* refers to the *process* by which a company gains the ability to raise prices or exclude competitors. In economics, a monopoly is a single seller. In law, a monopoly is a business entity that has significant market power, that is, the power to charge overly high prices. Although monopolies may be big businesses, size is not a characteristic of a monopoly. A small business may still have the power to raise prices in a small industry (or market).

Monopolies can be established by a government, form naturally, or form by integration. In many jurisdictions, competition laws restrict monopolies. Holding a dominant position or a monopoly of a market is often not illegal in itself, however certain categories of behavior can be considered abusive and therefore incur legal sanctions when business is dominant. A government-granted monopoly or legal monopoly, by contrast, is sanctioned by the state, often to provide an incentive to invest in a risky venture or enrich a domestic interest group. Patents, copyrights, and trademarks are sometimes used as examples of government-granted monopolies. The government may also reserve the venture for itself, thus forming a government monopoly.

Characteristics

- **Profit Maximizer:** Maximizes profits.
- **Price Maker:** Decides the price of the good or product to be sold, but does so by determining the quantity in order to demand the price desired by the firm.
- **High Barriers:** Other sellers are unable to enter the market of the monopoly.
- **Single seller:** In a monopoly, there is one seller of the good, who produces all the output.Therefore, the whole market is being served by a single company, and for practical purposes, the company is the same as the industry.

- **Price Discrimination:** A monopolist can change the price or quantity of the product. He or she sells higher quantities at a lower price in a very elastic market, and sells lower quantities at a higher price in a less elastic market.

Four Reasons why there are Bad for an Economy

Monopolies restrict free trade and prevent the market from setting prices. That creates the following four adverse effects:

- Since monopolies are lone providers, they can set any price they choose. That's called price- fixing. They can do this regardless of demand because they know consumers have no choice. It's especially true when there are inelastic demands for goods and services. That's when people don't have a lot of flexibility. Gasoline is an example. Some drivers could switch to mass transit or bicycles, but most can't.
- Not only can monopolies raise prices, but they also can supply inferior products. That's happened in some urban neighborhoods, where grocery stores know poor residents have few alternatives.
- Monopolies lose any incentive to innovate or provide "new and improved" products. A 2017 study by the National Bureau of Economic Research found that U.S. businesses have invested less than expected since 2000 due to a decline in competition. That was true of cable companies until satellite dishes and online streaming services disrupted their hold on the market.
- Monopolies create inflation. Since they can set any prices they want, they will raise costs for consumers. It's called cost- push inflation.

When Monopolies are good

Sometimes a monopoly is necessary. It ensures consistent delivery of a product or service that has a very high up-front cost. An example is electric and water utilities. It's very expensive to build new electric plants or dams, so it makes economic sense to allow monopolies to control prices to pay for these costs. Federal and local governments regulate these industries to protect the consumer. Companies are allowed to set prices to recoup their costs and a reasonable profit.

Market Structures

In economics, the idea of monopoly is important in the study of management structures, which directly concerns normative aspects of economic competition, and provides the basis for topics such as industrial organization and economics of regulation. There are four basic types of market structures in traditional economic analysis; perfect competition, monopolistic competition, oligopoly and monopoly. A monopoly is a structure in which a single supplier produces and sells a given product. If there is a single seller in a certain market and there are no close substitutes for the product, then the market structure is that of a "pure monopoly". Sometimes, there are many sellers in an industry and/or there exist many close substitutes for the goods being produced, but nevertheless companies retain some market power. This is termed monopolistic competition, whereas in oligopoly the companies interact strategically.

In general, the main results from this theory compare price-fixing methods across market structures, analyze the effect of a certain structure on welfare, and vary technological/demand assumptions in order to assess the consequences for an abstract model of society. Most economic textbooks follow the practice of carefully explaining the *perfect competition* model, mainly because this helps to understand "departures" from it (the so-called *imperfect competition* models).

The boundaries of what constitutes a market and what does not are relevant distinctions to make in economic analysis. In a general equilibrium context, a good is a specific concept including geographical and time-related characteristics ("grapes sold during October 2009 in Moscow" is a different good from "grapes sold during October 2009 in New York"). Most

studies of market structure relax a little their definition of a good, allowing for more flexibility in the identification of substitute goods.

Monopoly versus competitive markets

While monopoly and perfect competition mark the extremes of market structures there is some similarity. The cost functions are the same. Both monopolies and perfectly competitive (PC) companies minimize cost and maximize profit. The shutdown decisions are the same. Both are assumed to have perfectly competitive factors markets. There are distinctions, some of the most important distinctions are as follows:

Marginal revenue and price: In a perfectly competitive market, price equals marginal cost. In a monopolistic market, however, price is set above marginal cost.

Product differentiation: There is zero product differentiation in a perfectly competitive market. Every product is perfectly homogeneous and a perfect substitute for any other. With a monopoly, there is great to absolute product differentiation in the sense that there is no available substitute for a monopolized good. The monopolist is the sole supplier of the good in question.A customer either buys from the monopolizing entity on its terms or does without.

Number of competitors: PC markets are populated by an infinite number of buyers and sellers. Monopoly involves a single seller.

Barriers to Entry: Barriers to entry are factors and circumstances that prevent entry into market by would-be competitors and limit new companies from operating and expanding within the market. PC markets have free entry and exit. There are no barriers to entry, or exit competition. Monopolies have relatively high barriers to entry. The barriers must be strong enough to prevent or discourage any potential competitor from entering the market

Elasticity of Demand: The price elasticity of demand is the percentage change of demand caused by a one percent change of relative price. A successful monopoly would have a relatively inelastic demand curve. A low coefficient of elasticity is indicative of effective barriers to entry. A PC company has a perfectly elastic demand curve. The coefficient of elasticity for a perfectly competitive demand curve is infinite.

Excess Profits: Excess or positive profits are profit more than the normal expected return on investment. A PC company can make excess profits in the short term but excess profits attract competitors, which can enter the market freely and decrease prices, eventually reducing excess profits to zero. A monopoly can preserve excess profits because barriers to entry prevent competitors from entering the market.

Profit Maximization: A PC company maximizes profits by producing such that price equals marginal costs. A monopoly maximises profits by producing where marginal revenue equals marginal costs. The rules are not equivalent. The demand curve for a PC company is perfectly elastic – flat. The demand curve is identical to the average revenue curve and the price line. Since the average revenue curve is constant the marginal revenue curve is also constant and equals the demand curve, Average revenue is the same as price ($AR = TR/Q = P \times Q/Q = P$). Thus the price line is also identical to the demand curve. In sum, $D = AR = MR = P$.

Reasons for Emergence of Monopoly:

A firm enjoys monopoly when it is the sole seller of its product and the product has no close substitutes. The fundamental cause of monopoly is the barrier to entry.

The various reasons for emergence of Monopoly are:

1. Government licensing:

It means that before a firm can enter an industry, it needs to take permission from the government. Licensing is used to ensure minimum standards of competency. By not granting licenses to new firms, government aims to assure that only one firm operates in the market.

2. Patent Rights:
Certain big private companies are engaged in research and development activities. At times, they come up with new products or new technologies. As a reward for their risk and investment in research, government grants them patent right. The period for which patent rights are granted is known as patent life.
3. Cartel:
Under cartel, some firms retain their individual identities but coordinate their output and pricing policies in order to act as a monopoly. The firms agree among themselves to restrict their total output to the level that maximizes their joint profits. The most famous example of Cartel is 'Organisation of Petroleum Exporting Countries (OPEC)' formed in 1960, that led to virtual monopoly in the world market for oil.
4. Control on raw materials:
Monopoly also arises due to sole ownership or control of certain essential raw materials needed in a particular industry. For example, DeBeers Company of South Africa controls about 80 per cent of the world's production of diamonds. Although, the share is not 100 per cent, still it is large enough to exert substantial influence over the market.
Nature of Demand and Revenue under Monopoly:
Under monopoly, it becomes essential to understand the nature of demand curve facing a monopolist. In a monopoly situation, there is no difference between firm and industry. Therefore, under monopoly, firm's demand curve constitutes the industry's demand curve. Since the demand curve of the consumer slopes downward from left to right, the monopolist faces a downward sloping demand curve. It means, if the monopolist reduces the price of the product, demand of that product will increase and vice- versa.

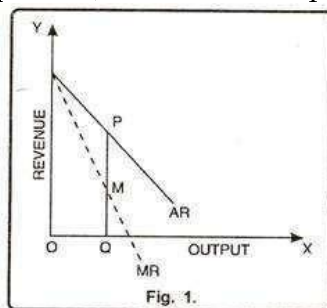

Fig. 1.

In Fig. 1 average revenue curve of the monopolist slopes downward from left to right. Marginal revenue (MR) also falls and slopes downward from left to right. MR curve is below AR curve showing that at OQ output, average revenue (= Price) is PQ where as marginal revenue is MQ. That way AR > MR or PQ > MQ.
Costs under Monopoly:
Under monopoly, shape of cost curves is similar to the one under perfect competition. Fixed costs curve is parallel to OX-axis whereas average fixed cost is rectangular hyperbola. Moreover, average variable cost, marginal cost and average cost curves are of U-shape. Under monopoly, marginal cost curve is not the supply curve. Price is higher than marginal cost. Here, it is of immense use to quote that a monopolist is not obliged to sell a given amount of a commodity at a given price.
Monopoly Equilibrium and Laws of Costs:
The decision regarding the determination of equilibrium price in the long run depends on the elasticity of demand and effect of law of costs on monopoly price determination.
1. Nature of Elasticity of Demand:
If the demand is inelastic, the monopolist will fix high price of his product. Inelastic demand refers to the situation in which consumers must have to buy the commodity what-so-ever may

be the price. On the other hand, if demand is elastic, the monopolist will fix low price per unit.

2. Effects of Laws of Costs:

The monopolist also takes into consideration laws of costs while determining the prices. In the long run, output may be produced under law of diminishing costs, increasing costs and constant costs.

Misconceptions Concerning Monopoly Pricing:

Our analysis explodes some popular fallacies concerning the behavior of monopolies.

1. Monopolist is Interested in Maximum Profits and not in Maximum Price:

Because monopolist can manipulate output and price so it is often alleged that a monopolist "will charge the highest price he can get". It is generally believed that prices under free competition are lower than under monopoly. This is clearly a misguided assertion. Under certain conditions, things may be altogether different. As explained in the previous table and diagram, there are many prices above the one he charges but the monopolist shuns them for the simple reason that they entail a smaller than maximum profits.

2. Maximum Total Profits and not Maximum Profit per Unit:

The monopolist seeks maximum total profits, not maximum per unit profits. The profits per units may be higher at higher price but the total profits will be higher at lower price. It is; therefore, better to sell more at a lower price than to sell less at a higher price.

3. Economies of Scale:

The monopolist may enjoy certain economies like a better and cheaper utilization of by-products, cheaper raw material, better and cheaper methods of production, lower cost of advertisement and so on than under free competition. Evidently, the monopolist may be able to charge prices lower than under free competition.

4. Law of Increasing Returns:

If the commodity is produced under the Law of Increasing Returns, the monopolist may be producing more at lower costs and selling at lower prices. This policy may help him to earn higher total revenue. The consumer may also buy larger output at lower prices.

Sources of Monopoly Power

Monopolies derive their market power from barriers to entry – circumstances that prevent or greatly impede a potential competitor's ability to compete in a market. There are three major types of barriers to entry: economic, legal and deliberate.

Economic barriers: Economic barriers include economies of scale, capital requirements, cost advantages and technological superiority.

Economies of scale: Decreasing unit costs for larger volumes of production. Decreasing costs coupled with large initial costs, If for example the industry is large enough to support one company of minimum efficient scale then other companies entering the industry will operate at a size that is less than MES, and so cannot produce at an average cost that is competitive with the dominant company. Finally, if long-term average cost is constantly decreasing, the least cost method to provide a good or service is by a single company.

Capital requirements: Production processes that require large investments of capital, perhaps in the form of large research and development costs or substantial sunk costs, limit the number of companies in an industry: this is an example of economies of scale.

Technological superiority: A monopoly may be better able to acquire, integrate and use the best possible technology in producing its goods while entrants either do not have the expertise or are unable to meet the large fixed costs (see above) needed for the most efficient technology. Thus one large company can often produce goods cheaper than several small companies.

No substitute goods**:** A monopoly sells a good for which there is no close substitute. The absence of substitutes makes the demand for that good relatively inelastic, enabling monopoly to extract positive profits.

Control of natural resources**:** A prime source of monopoly power is the control of resources (such as raw materials) that are critical to the production of a final good.

Demand Curve under Monopoly:

A monopoly firm is like an industry as the single seller constitutes the entire market for the product, which has no close substitutes. So, a monopolist has full freedom and power to fix price for the product. However, demand of the product is not in the control of monopoly firm. In order to increase the output to be sold, monopolist will have to reduce the price. Therefore, monopoly firm faces a downward sloping demand curve.It is often said that demand curve facing a monopoly firm is a constraint for the monopolist as he can sell more only by reducing the prices.

MR < AR under Monopoly:

A monopoly firm faces a downward sloping demand curve as more output can be sold only by reducing the price. As a result, revenue generated from every additional unit (known as MR) is less than price (AR) of the product. Due to this reason, MR is less than AR.

Advantages and disadvantages of monopoly market in India

A monopoly market exists when there is huge number of buyers but small or very limited number of sellers in the market. Like any other market structure a monopoly market has its advantages and disadvantages to both the buyer and the seller.

Advantages

Stability of prices

In a monopoly market the prices are most of the times stable. This happens because there is only one firm involved in the market that sets the prices if and when it feels like. In other types of market structures prices are not stable and tend to be elastic as a result of the competition that exists but this isn’t the case in a monopoly market as there is little or no competition at all.

It changes the economies of scale.

A business with a monopoly allows for an increased output of goods or services. This means prices can be lowered internally because there are more goods that are being offered or produced. With lower internal costs, the consumer can save money when those changes are reflected in the final retail price of what is being offered.

It allows for a business to compete internationally.

The internet has allowed many businesses to become international businesses, but that doesn’t mean that have the ability to actually compete on a large scale. Monopolies allow a business to create an enormous level of brand recognition on a global basis which does allow them to compete in foreign markets.

Disadvantages

Exploitation of consumers-

A monopoly market is best known for consumer exploitation. There are indeed no competing products and as a result the consumer gets a raw deal in terms of quantity, quality and pricing. The firm may find it easy to produce inferior or substandard goods if it wishes because t the end of the day they know very well that the items will be purchased as there are no competing products for the already available market.

Higher prices-

No competition in the market means absence of such things as price wars that may have benefited the consumer and as a result of this monopoly firms tend to charge higher prices on goods and services hence inconveniencing the buyer.

Price discrimination-

Monopoly firms are also sometimes known for practicing price discrimination where they charge different prices on the same product for different consumers.

Inferior goods and services-

Competition is minimal or totally absent and as such the monopoly firm may willingly produce inferior goods and services because after all they know the goods will not fail to sell.

Main Causes for the Growth of Monopoly

Industrial Policy and the Expansion of the Scope of the Private Sector:

The industrial policy resolutions introduced by the country have also expanded the scope of the participation of the private sector enterprises in various fields of industrial activity. The industrial policy resolutions of 1956, in its list of industries under Schedule A (exclusively reserved for the public sector), allowed the existing private sector enterprises to continue and expand.

Inter-Company Investment:

Inter-company investment is considered another important factor for the growth of large industrial houses and growing concentration of economic power. Through inter-company investment, big industrial houses occupy the directorship of a good number of companies and monopolized the decision-making of these companies.

Government's Licensing Policy:

The licensing policy of the Government has also facilitated the growth of large industrial houses and concentration of economic power. While giving industrial licence, the Government never tried to control the growth of monopoly or concentration of economic power. Rather, the licensing authorities had the tendency to sanction the licenses of new enterprises to experienced person having proven business ability, instead of new entrepreneurs.

Import Duties and Market Protection:

Indian industries are being protected by the Government from foreign competition through the imposition of heavy import duties and also by banning imports of some commodities. This sort of protection has raised the strength of large business houses in the domestic market.

Control over Banking Companies:

Thus the commercial banks played an important role in developing monopolies and industrial empires of large industrial houses. After nationalisation even such tendencies are being persisted as the output of the bankers did not changed much.

Credit Policy of the Public Sector Financial Institutions:

Another important cause behind the growth of monopolies and concentration of economic power in the credit policy pursued by the public sector financial institutions, where they always favoured large industrial houses in advancing loan as compared to that of small entrepreneurs.

Tax Policy:

The Government has also introduced fiscal incentives in the form of tax concessions or tax exemptions so as to provide incentives to some industrial enterprises for its development. Till 1955, the Government granted initial development allowance for such purpose. In 1955, the Government introduced development rebate and in 1976-77, they introduced investment allowance for the private enterprises.

Conclusion

The pros and cons of monopolies show that many of the advantages or disadvantages which can be experienced are based on the internal ethics of the company involved. Some businesses may be keen to invest with the higher profits of a monopoly, while others may

simply hoard profits and refuse to invest. That's why this type of economy can often be fragile and dangerous.

Monopoly refers to a market situation where there is only single seller of a commodity and there are no close substitutes of that commodity. In such a situation, monopolist or the single seller of the commodity has some kind of power or control over the supply of a commodity and hence he is in a position to influence the price.

Since under monopoly, there is only one firm selling a commodity, this firm exercises some control over the supply and price of the commodity. However, this can be possible only when there are no close substitutes of that commodity. Therefore, the two distinct features of monopoly are – a single seller producing and selling the commodity and no close substitutes of that commodity.

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