Lecture 1.
Theoretical framework, objectives and principles of competition

Competition as a category

1. Between producers (suppliers in specific case)
2. Sphere – market
3. Consumers preferences
4. Main aim: profit

Competition - is an economic contest of producers in market for the consumers preferences with the aim of receiving a maximum profit

Category of competition was observed by representatives of <u>different economic concepts</u>:

-classical

-neoclassical

-conflict

-system

Classical concept

The basis of classic theory of competition were laid by A. Smith, W. Petty and D. Ricardo.

According to main streams of this concept competition is treated as “perfect” and is defined as market measure of balance. Role of government in regulation is absent.

A.Smith: competition is a contest of producers;

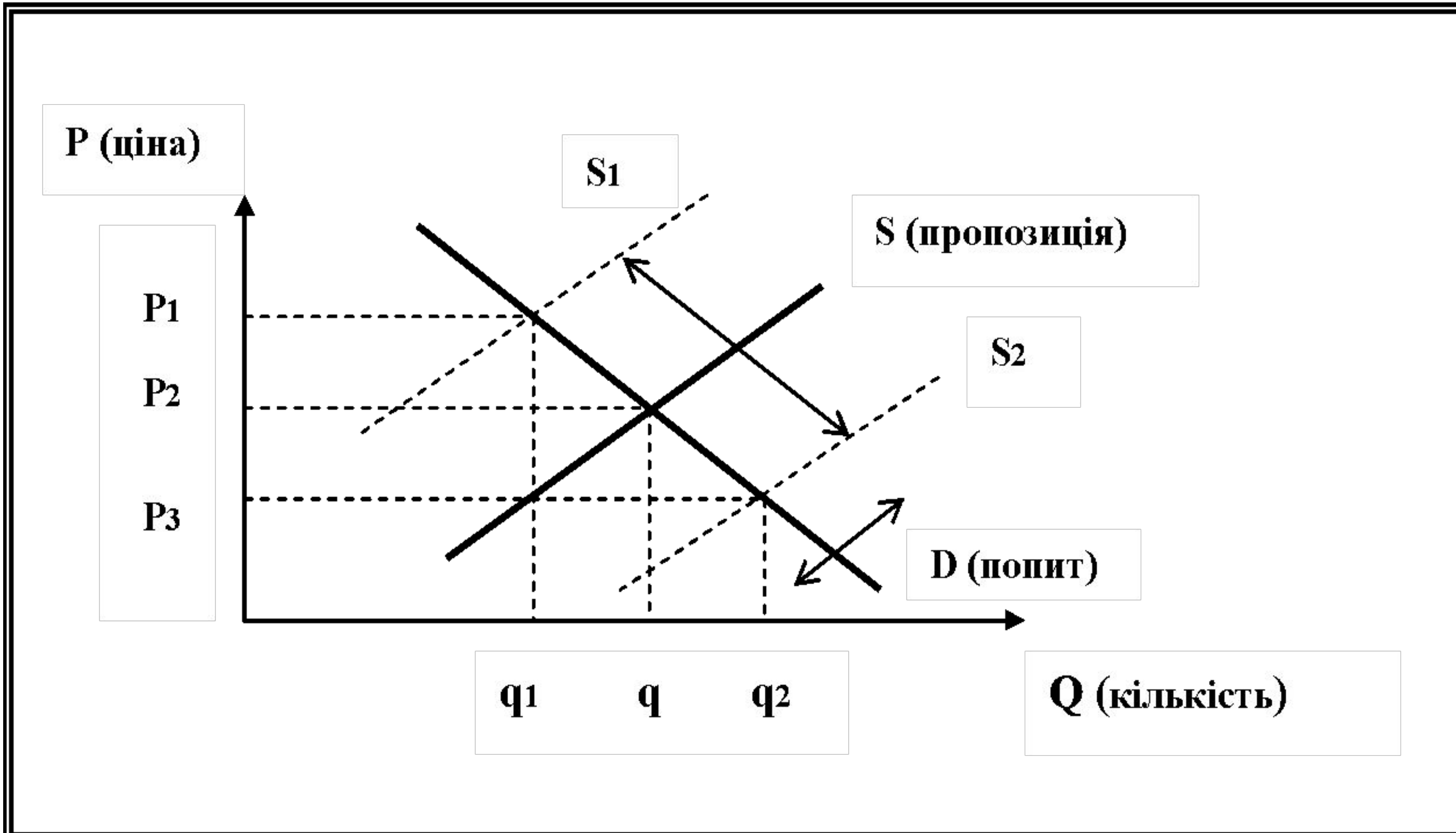
it is an “invisible hand” that regulates market (makes producers to act for the social profit);

it also is a factor that regulates social and private interests (rises the quality of products)

Premises of the development of perfect competition

1. big amount of companies that produces the same products
2. price is determined by market
3. products are homogenous
4. full availability of information
5. absence of transport costs
6. full mobility of all production factors between companies and branches

Mechanism of establishing the balanced price



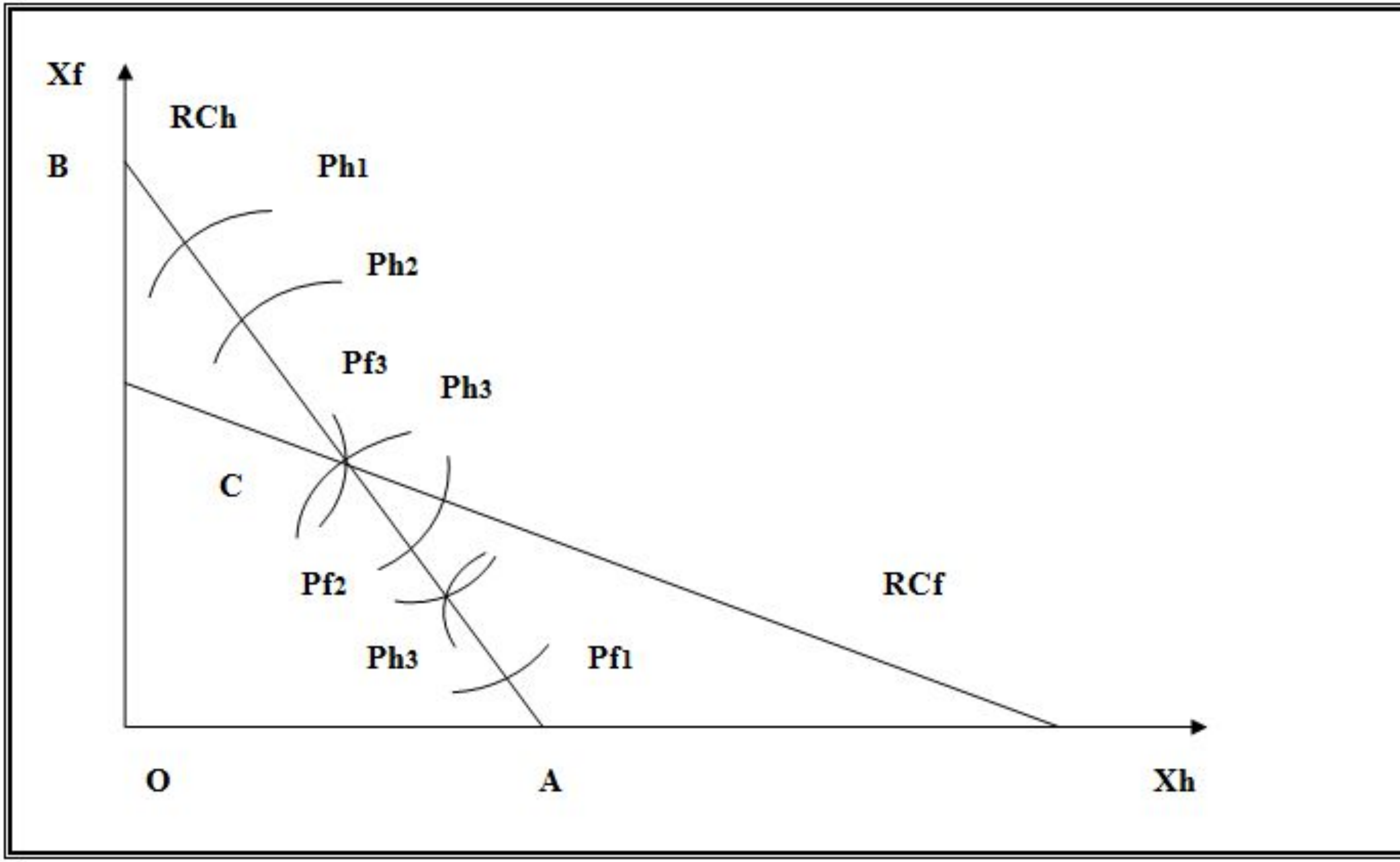
Neoclassical concept

Majority of researches were devoted to problems of static equilibrium and optimal division of recourses in “perfect” competition

A.Kurno: the more there are competing producers on the market the fewer are the prices and bigger amount of goods are sold

L. Valras: market is in balance when demand for good equals good’s supply. If demand reduces the price becomes smaller and it now on determines new conditions of competitive equilibrium

Competition according to the model of Kurno



Conflict theories of economic competition

Representatives deny the necessity of existence of competition. Practically they declare monopoly governed by society (by means of government i.e. national production that doesn’t assume competition).

K. Marks, F. Engels: “new society will destroy competition and will establish association on it’s place”

O. Shik (market socialism): planning orientation, introduction of free prices, market competition with antitrust measures

System concepts of economic development

1920-1930th first system concepts of monopolistic market. Researches of representatives (J.Clark, P.Sraffa, J.Robinson, E.Chemberline) showed that “perfect competition” turned into “imperfect”. (P.Sraffa “The laws of returns under competitive conditions”)

Balancing between perfect competition and monopoly. Existence of free market regulated by the government.

<u>Keynesian and neo keynesian theories (J.Keynes, J. Gelbraith):</u> “dynamic equilibrium”; promotion of demand within the crisis and depression periods and suppression on demand in periods of recovery

- **J. Shumpeter:** innovation process – central link of competition, meaning that competition is a process of creative destruction
- **M. Porter:**

- "Five forces model" (companies)
- "Five generic descriptions of industries" (industries)
- "Diamond model" (nations)

"Five forces of Porter"

concept of expanded contest of competitive companies (five forces influencing competition in an industry):

1. The threat of new entrants
2. The threat of substitute products or services
3. The bargaining power of buyers
4. The bargaining power of suppliers
5. The competitive rivalry among current members of the industry

Porter's Five Forces of Competitive Position

New Market Entrants, eg:

- entry ease/barriers
- geographical factors
- incumbents resistance
- new entrant strategy
- routes to market

Supplier Power, eg:

- brand reputation
- geographical coverage
- product/service level quality
- relationships with customers
- bidding processes/capabilities

Competitive Rivalry, eg:

- number and size of firms
- industry size and trends
- fixed v variable cost bases
- product/service ranges
- differentiation, strategy

Buyer Power, eg:

- buyer choice
- buyers size/number
- change cost/frequency
- product/service importance
- volumes, JIT scheduling

Product and Technology Development, eg:

- alternatives price/quality
- market distribution changes
- fashion and trends
- legislative effects

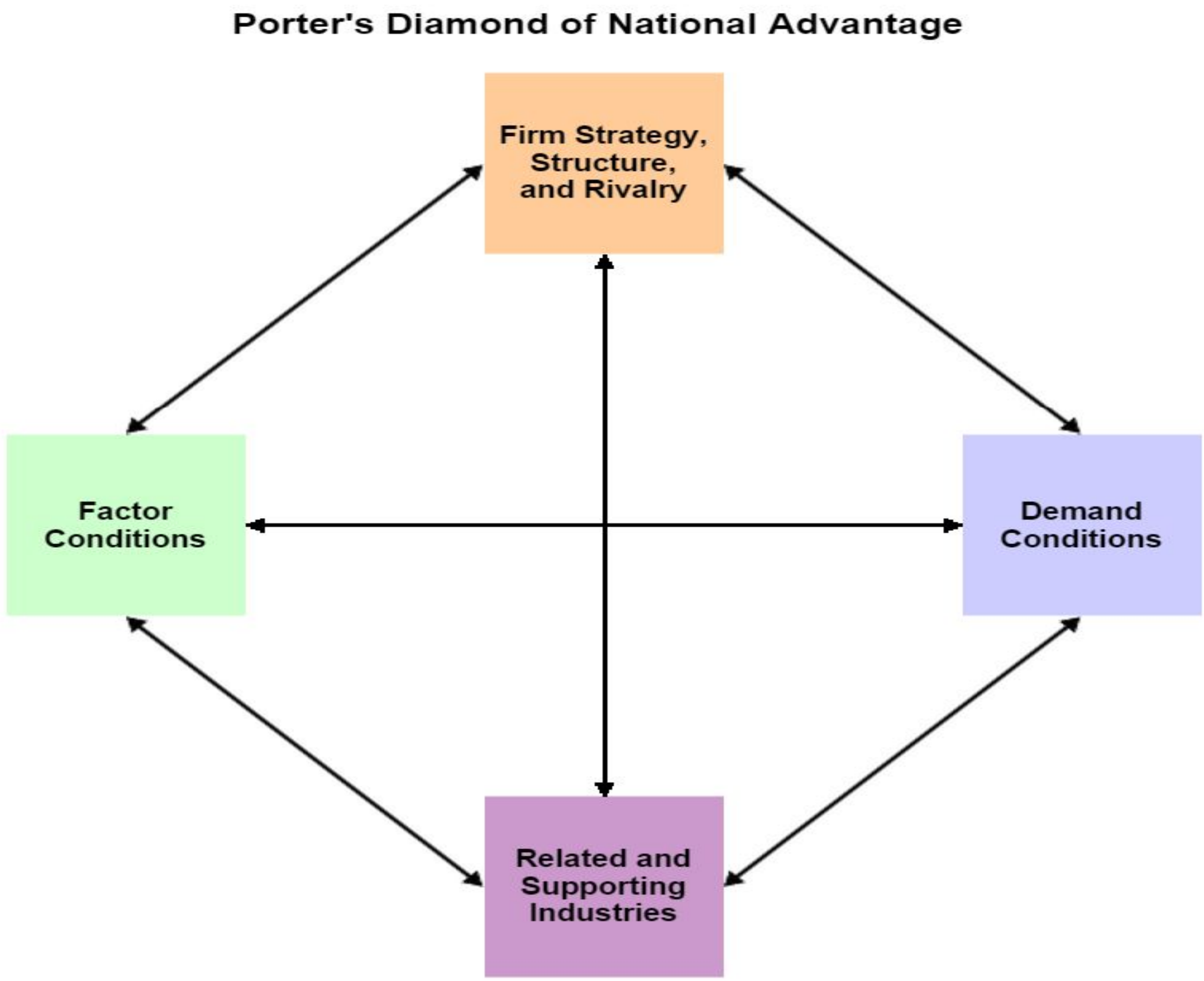
- Porter's Five Forces model can be used as good analytical effect alongside other models such as the SWOT and PEST analysis tools.

- Porter's Five Forces model provides suggested points under each main heading, by which you can develop a broad and sophisticated analysis of competitive position, as might be used when creating strategy, plans, or making investment decisions about a business or organization.

Porter's five generic descriptions of industries

1. **Fragmented** (production of value chains)
2. **Emerging** (space travel)
3. **Mature** (automotive)
4. **Declining** (solid fuels)
5. **Global vs Multidomestic**

Porter's Diamond Model



1. **Factor Conditions:** production factors required for a given industry, eg., skilled labour, logistics and infrastructure.
2. **Demand Conditions:** extent and nature of demand within the nation concerned for the product or service.
3. **Related Industries:** the existence, extent and international competitive strength of other industries in the nation concerned that support or assist the industry in question.
4. **Corporate Strategy, Structure and Rivalry:** the conditions in the home market that affect how corporations are created, managed and grown; the idea being that firms that have to fight hard in their home market are more likely to be able to succeed in international markets.

The Diamond as a System

- The effect of one point depends on the others. For example, factor disadvantages will not lead firms to innovate unless there is sufficient rivalry.
- The diamond also is a self-reinforcing system. For example, a high level of rivalry often leads to the formation of unique specialized factors.

Government's Role

The role of government in the model is to:

- Encourage companies to raise their performance, for example by enforcing strict product standards.
- Stimulate early demand for advanced products.
- Focus on specialized factor creation.
- Stimulate local rivalry by limiting direct cooperation and enforcing antitrust regulations.

Types of category of competition

1. Behavioral- contest for the money of the supplier by means of the best satisfaction of his interests
2. Structural – depends on level on influence of competition on the market prices (perfect/imperfect competition)
3. Functional – contest of old and new (J.Shumpeter)

Classification of economic competition

1. According to the type of market

   - perfect
   - imperfect:

✔ monopolistic competition

✔ oligopoly

✔ monopoly

Parameters of markets	Perfect competition	Monopolistic competition	Oligopoly	Monopoly
Quantity of suppliers	big amount	big amount	2-10	1
Quantity of buyers	big amount	big amount	big amount	big amount
Homogeneity of products	homogenous	differential(sometimes partly)	homogenous or differential	homogenous
Substitution of products	full	considerable	considerable	irreplaceable
Competition force	very strong	moderate	weak	absent
Parts of market of competitors	small	small	big	100%
Market access	free	slightly complicated	complicated	blocked
Companies control of prices	absent	some (market prices)	considerable	full
Example	in real economy is an utopia Competition of company and market	fruits, vegetables, hairdressers, pharmacies, ect.	MTC vs. Kievstar rating services gold/diamonds markets	City subway National raiway

2. According to the **object** : on market of goods and services, capitals, labor

3. According to the **subjects**: between producers, customers

4. According to the **type of economy**: in market economy, in developing economy, in planned economy, in transfer economy

5. According to the **role of government**: controlled, uncontrolled

6. According to the **level of integration to the world economy**: opened, closed

7. According to the **character**: pricing, non-pricing

8. According to the **territory**: local, regional, national, international

9. According to the availability of **barriers**: real, potential

10. According to the **form of relations**: contest, struggle, war