Competition & Free Enterprise - Teacher Notes

Directions:
Fill in the blanks.

Competition Within Economic Systems

1. Competition

- Is the business action of **two or more** companies striving to gain customers
- Helps consumers by:
  - providing more choices
  - **lowering prices**
  - offering incentives

2. Types of Competition

- Include:
  - **price competition**
    - exists when marketers compete on the basis of price
      - for example:
        - price wars
  - **non-price competition**
    - focuses on factors such as features, quality, service and promotion
      - for example:
        - store loyalty cards, extended hours of operation, home delivery options, mass marketing

3. Competition

- Arises between companies **offering similar products**
- Thrives in a free enterprise economy
- Encourages companies to:
  - improve products
  - **reduce prices**
  - target different markets

Free Enterprise – freedom of private businesses to operate in a competitive manner for profit, without government controls

4. Competition

- **Does not occur** in communist or socialist countries as all production resources are **government owned**

5. Alternative Economic Systems
- **Include** the following:
  - capitalism
  - **communism**
  - socialism

6. Capitalism
- Allows for the **private ownership** and management of resources
- Provides a marketing system in which flexible prices are a necessity due to competition arising between producers
- Recognizes and encourages the **different levels of income** and wealth which may be acquired
  - seen as an incentive to promote creativity and productivity

7. Resources
- Are the capital, labor and **land assets** used in production operations
  - capital includes buildings and equipment
  - labor includes management and production workers
  - land includes renewable and **non-renewable natural resources**

8. Communism
- Prohibits the **private ownership** or management of resources
  - government regulates production resources
- Emphasizes income and **wealth equality**

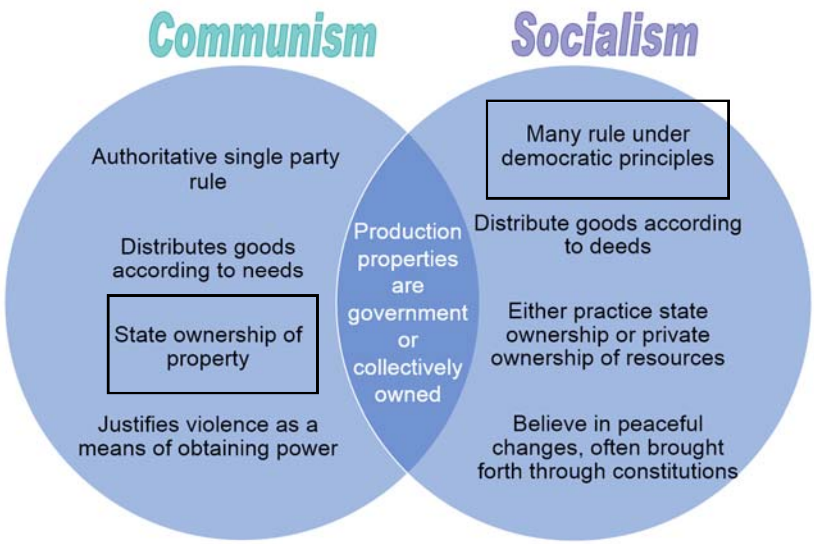
Private Ownership – ability of individual citizens to own and operate resources at their own discretion

9. Communism
- Utilizes **central planning**, meaning the government **sets prices** and levels of output
  - for example:
    - a car company in a communist country may be told they can only produce 5,000 cars a month and must sell each at $12,000

10. Socialism

- Lies **between** capitalism and communism
- Resembles communism because most resources are **government owned**
  - for example:
    - a car company in a socialist country will produce cars in a building using machinery and parts which the government, not the company, owns
- Provides many services back to its people, such as health care

11. Communism vs. Socialism



Alternative Market Structures Segment

1. Alternative Market Structures

- Account for eight general forms of **market competition**
  - four for buyers
  - four for sellers
- Include the following:
  - pure competition
  - monopolistic competition
  - **oligopoly**
  - pure monopoly

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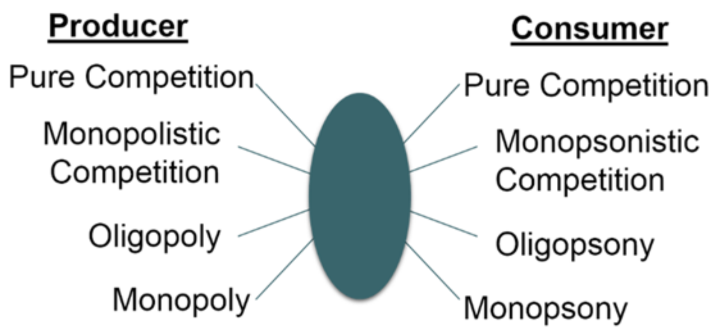
2. Alternative Market Structures

- Allow for **16** different relationships between the **producer and consumer**



3. Pure Competition

- Is also known as **perfect competition**
- Is the opposite of a monopoly
- Allows for easy access and freedom of buyers and sellers to get **in or out** of the market

4. Pure Competition

- Creates markets with **large numbers** of buyers and sellers exchanging a **homogenous product**
  - for example:
    - wheat, coffee, corn or other commodities

Homogenous – of or exhibiting similar features; two or more objects which are the same

5. Pure Competition

- Is based upon the following assumptions:
  - all firms **maximize profits**
  - there is free entry and exit to the market
  - all firms sell completely identical goods
  - there are no **consumer preferences**

6. Pure Competition

- Stipulates the individual seller **does not determine** the price of the product
  - prices reflect the **supply and demand** of the product
- Includes providing perfect information concerning the product
  - all buyers and sellers know the prices of all other buyers and sellers

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7. Pure Competition

- Is a benchmark in which **real-world markets** can be compared
  - real-world experiences differentiation in production, **marketing and selling**

8. Monopolistic Competition

- Refers to a market structure where many firms **compete against each other** when selling similar, but **slightly differentiated** products
  - for example:
    - restaurants and clothing stores

Firm – organization which employs resources in order to produce a good or service for a profit

9. Monopolistic Competition

- Allows firms to make production decisions and set prices **based on their individual costs**
- Can have **one or a few firms** obtain a large share of the market even though consumers have many choices to choose from

10. Monopolistic Competition

- Is based on the following assumptions:
  - all firms maximize profits
  - there is **free entry and exit** to the market
  - firms sell differentiated products
  - consumers may **have a preference** for one product over another
- Does not result in a socially optimal level of output because firms have more power and can influence price to a certain point

11. Oligopoly

- Literally means "**few sellers**"
- Is most distinguished by the firms interdependence on pricing and marketing
- Creates established markets which are **extremely difficult** to enter
  - for example:
    - most agricultural equipment brands are owned by three multinational companies – John Deere®, CNH Global® or AGCO®

Interdependence – mutual dependence

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12. Oligopoly

- Is based on the following assumptions:
  - all firms maximize profits
  - oligopolies **can set prices**
  - there are barriers to enter and exit the market
  - products may be **homogeneous or differentiated**
  - there are only a few firms which dominate the entire market

13. Oligopolistic Interdependence

- Accounts for the firms consciousness of their competition's **prices and actions**
- Describes the tendency of products in these markets to be **similarly priced**

14. Oligopolistic Interdependence

- Is crucial in maintaining an operation **in this form of market** as a decrease in price of one company could directly result **in loss for another**
  - for example:
    - if John Deere® notices an AGCO® company has lowered its price on tractors, usually they will drop their prices as well so they do not lose customers to their competitor

15. A Monopoly

- Is an industry with **only one firm** producing the product, thus **controlling the market**
  - for example:
    - at one time, Apple® was accused of being a digital media player and online music retailer monopoly as their iPods® did not support files not purchased from iTunes® and purchases from iTunes® could not be played on other digital music players

16. A Monopoly

- Produces a **unique product** which has no close substitutes
- Must possess economic, legal or **technical barriers** to prevent other firms from entering the market

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17. A Monopoly
- Is based on the following assumptions:
  - the monopolist (company who has the monopoly) **maximizes profit**
  - sets the price
  - high barriers to **enter and exit** the market
  - there is only one firm dominating the entire market
- Is not desirable because it results in lower outputs and higher prices compared to more competitive markets

18. A Monopoly
- Can occur due to barriers to entering the market which are generally classified into the following groups:
  - **specific resources**
    - a company or individual owns all of the resource
  - **government regulations**
    - laws can be put in place so only one firm can make a product
      - patent or copyright law

19. A Monopoly
- Can occur due to barriers to entering the market which are generally classified into the following groups:
  - **natural monopolies**
    - if it is more efficient for one producer to supply the entire market than for two or more suppliers
  - **deliberate actions**
    - a firm intentionally takes steps to place barriers to entry into a market

20. Natural Monopoly
- Is a type of monopoly which exists as a result of the **high fixed costs** or startup costs of operating a business in a specific industry
  - an industry where **multiform production** is more costly than production by a monopoly

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21. Natural Monopoly

- Can arise in industries which require **unique raw materials**, technology or **similar factors** to operate
  - for example:
    - utility companies (gas network, electricity grid, water pipe networks) and railway infrastructure

22. Government Regulation of Monopolies

- Typically falls into the following categories:
  - **competition law**
    - government controls mergers and acquisitions to make sure competition exists and to prevent collusion
  - **price regulation**
    - government specifies the price a monopolist is able to charge for their product

23. Government Regulation of Monopolies

- Typically falls into the following categories:
  - **nationalization**
    - government directly controls the firm's behavior (very rare in free enterprise economies)
  - **inactivity**
    - nothing is done due to possible negative effects of government intervention

Free Enterprise in the United States

1. Anti-Trust Laws

- May also collectively be known as **competition laws**
- Allow fair access to markets for entrepreneurs
- Protect the **consumer** from issues such as price gouging or discrimination

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2. Anti-Trust Laws

- Address the following three main concerns:
  - practices or agreements which **restrict free trade** and/or competition between other companies
  - abusive behavior or anti-competitive tendencies of companies **dominating a market**; includes price gouging, predatory pricing or the refusal to deal with certain entities
  - mergers or acquisitions between large corporations which may result in a threat to the competitive process

3. The Microsoft® Anti-Trust Trial

- Began in **1998**
- Stated Microsoft® was abusing its monopoly over PC operating systems
  - bundled the Microsoft® operating system Windows® with the **Internet Explorer® program**, limiting or even preventing competition from other Internet browsers

4. Revenue vs. Profit

- Is defined as the following
  - revenue accounts for the **entire income** before any deductions are made
  - profit is the **monetary gain** of a producer after subtracting operating costs such as:
    - wages
    - rent
    - utilities

5. Alternative Buyer Structures

- Include the following:
  - pure competition:
    - many buyers and sellers for a homogeneous product
  - **monopsonistic competition:**
    - modest amount of buyers and many sellers for a differentiated product
  - **oligopsony:**
    - just a few buyers
  - monopsony:
    - single buyer

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6. Free Enterprise Markets

- Encourage **competition**
- Cannot exist in countries where the government owns all production enterprises
- Support the doctrine of **laissez-faire** to a certain degree

7. Free Enterprise Markets

- Are able to sell products on an **international level**
  - must adhere to trade regulations set forth by countries
- Fluctuate depending on the **state of the economy**

8. Laissez-Faire

- Is a **French term** which literally translates to "let do"
- States there should be no government interference in the economy
- Does not fully exist in the United States as the government imposes in the following ways:
  - institutes **minimum wage**
  - establishes welfare programs
  - supports anti-trust regulation

9. Free Enterprise Markets

- Are often criticized because of the following:
  - promotes **inequality** between the classes
  - puts power into the hands of the **wealthy**
  - essential needs (health care, insurance, heating, etc.) are not provided to those who cannot afford them

10. The United States

- Practices capitalism using a **free enterprise market**
- Utilizes many combinations of the market-buyer structures
- Encourages **competition** between producers in order to promote the free enterprise economy

11. Free Enterprise

- Promotes free will and **individual choice** for small business owners
- Allows entrepreneurs to start new businesses without fear of excessive government regulation
- Gives individuals and **small businesses** the ability to compete for their own personal financial gain

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12. Free Enterprise

- Requires small business owners to have a **strong work ethic**, to be business savvy and to have a **niche** for their small business