Most firms in the United States find themselves in highly competitive markets. For these firms competition seems never-ending and the possibilities for good profits are few.

**HIGHLY COMPETITIVE INDUSTRIES**

Highly competitive industries have:

- a large number of firms, and
- very low barriers to entry.

The low barriers to entry mean that whenever competition reduces the number of firms by a large amount and, so, competition falls and profits rise, new firms enter the industry trying to grab these rising profits.

**HIGH COMPETITION**

A large number of firms and very low barriers to entry mean that firms in highly competitive industries face relentless competition. So many firms exist in the industry that no mutual interdependence exists between firms. Whatever one firms does will have little impact on the industry as a whole because each firm is so small.

In such a setting, firms reasonably look out only for themselves. They fight tooth and nail to gain advantages over other small competitors.
In other words, firms in highly competitive markets are subjected to relentless and impersonal “market forces.” They have little control over prices but generally must set price close to what “the market” has set.

Consumers in the market have a large number of choices of firms to buy from. Consumers are able to find many firms selling very similar products. These consumers will shift between sellers of the product depending on who has the lowest prices.

Price decision for the firm in the highly competitive industry starts with recognition that the firm can’t have a price that is much higher that that offered by rival firms. For instance, if all other firms have a price between 1.99 and 2.10 from their product, a firm is almost forced to select its price from within this range. If it sets a higher price, consumers will not buy their product and will buy from a lower-priced seller.

From the point of view of each individual firm the “price is given by the market.” Firms have completely lost control over their own prices and face a “market-determined price.”

This characteristic of highly competitive industries makes them very different from monopoly and oligopoly industries.

One example, perhaps extreme, of what can go on within a highly competitive environment is provided by this description:

[Miss Bird] was determined to view of Falls from Goat Island, and now, on this second visit in 1855, she found she could travel by hack across Roebling’s newly opened bridge to the American side without hazarding the rocky ferry crossing. That, however, meant another infernal squabble with a crowd of some twenty ragged hack drivers, all clamoring for a fare. She and two other guests ... were scarcely out the door when the drivers all began shouting various prices.

The first offered to do the rounds for five dollars. A second dropped to four dollars and a half and was immediately attacked as a thief and a blackguard, whereupon “a man in rags” offered to take them to Goat Island for three. When she accepted, the first hackman offered to meet the three-dollar price, insisting that his rival was drunk and his carriage wasn’t fit for a lady.

A fist fight followed, with much shouting and squabbling, until the ragged man succeed in driving up to the door. Only
then did Miss Bird realize, with a sinking heart, that the hack really wasn’t fit for ladies—the stuffing was quite bare of upholstery, the splashboards were held together by pieces of rope, and the driver was at least half drunk.

Off they went, bumping along the Niagara gorge, 250 feet above the green flood, with no protective parapet to offer security.¹

**SUPPLY AND THE SUPPLY CURVE**

All markets have demand curves. Only highly competitive markets, however, have what are called “supply curves.” Supply curves do not exist in monopoly markets or oligopoly markets.

Supply curves show how the level of output in a highly competitive market changes with changes in market prices.

The supply curve represents how the sellers in highly competitive markets respond to changes in the price. In particular, it indicates how the quantity of goods brought to be sold in the market responds to the price. An increase in the price will lead suppliers to bring more to market.

The reason is simple: a higher price will generally give to highly competitive firms a higher profit each time they sell a good or service. They will, therefore, desire to sell even more than before because of a higher price/profit each time they sell their product.

In Figure 1 the upward slope of the curve indicates that a higher price leads to a greater quantity of good brought to market. The market portrayed in this figure is the wheat market. IF the price is $2.80 then 2.7 billion bushels are brought to market. If the price rises to $3.10 then 2.9 billion bushels are brought to market.

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WHAT CAUSES THE SUPPLY CURVE TO SHIFT?

The supply curve can move right or left. Among the most important changes that lead to these shifts are: changes in wages, change in non-labor inputs, changes in productivity, and changes in the number of firms in the industry.

CHANGES IN WAGES

Labor is generally the key input into production. And, the wages and salaries paid to workers often represent the largest single cost of the business. If wages grow, the profits firms earn will be squeezed and firms will desire to reduce their output. This will cause the supply curve to shift left. Such a shift is illustrated in Figure 2.
If wages fall, profitability improves and, as a consequence, the supply curve shifts to the right.

**NON-LABOR INPUT PRICES**

The supply curve for a commodity is affected by the prices of the resources such as the prices of machines, of tools, and of raw materials. Increases in the price of these non-labor inputs make it more expensive to produce output. This will decrease profitability and firm will become less interested in supplying their produce then before: the supply curve will shift left. This is illustrated in Figure 3. On the other hand, decreases in the price of inputs will cause the supply curve to shift right.

**Figure 3**
TECHNOLOGICAL CHANGE AND PRODUCTIVITY CHANGE

Technology can be defined as society’s pool of knowledge concerning the industrial arts. As technology progresses, it becomes possible to produce commodities more cheaply, so firms often are willing to supply a given amount at a lower price than formerly.

In other words, technological improvement leads to an improvement in productivity. An increase in productivity permits firms to produce more with the same level of inputs. Alternatively, it permits firms to produce the same amount as before with fewer inputs. In other case, firms find their production costs per unit fall. This will, everything else remaining equal, lead to higher profits. Firms will, in this case, want to produce more: the supply curve shifts right.

Technological or productivity improvements cause the supply curve to shift to the right. This certainly has occurred in the case of many products. For instance there have in the last century been many important technological improvements in wheat production, ranging from the introduction of tractors to the development of improved varieties of wheat with higher yields and greater disease resistance. Figure 4 shows a shift to the right in the supply curve for wheat as technological progress/productivity improvement occurs.

Figure 4
INCREASES IN THE NUMBER OF FIRMS

As firms move into and out of an industry, the supply curve shifts. More firm in an industry means, simply, more sellers at any given price. The supply curve shifts right as more firms enter the industry. This is illustrated in Figure 5.

Figure 5
As firms exit the industry, fewer sellers exist at any price: the supply curve shifts left.

<table>
<thead>
<tr>
<th>Changes that cause the supply curve to shift</th>
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<tbody>
<tr>
<td>Prices of goods used in production, $P_i$</td>
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<tr>
<td>$P_i$ up → profitability down → supply curve shifts left</td>
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<tr>
<td>$P_i$ down → profitability up → supply curve shifts right</td>
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<td>Wages of labor, $W$</td>
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<tr>
<td>$W$ up → profitability down → supply curve shifts left</td>
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<td>$W$ down → profitability up → supply curve shifts right</td>
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<td>Productivity changes</td>
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<td>Productivity up → profitability up → supply curve shifts right</td>
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<tr>
<td>Productivity down → profitability down → supply curve shifts left</td>
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<tr>
<td>Number of firms in the market</td>
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<tr>
<td>More firms → more suppliers → supply curve shifts right</td>
</tr>
<tr>
<td>Fewer firms → fewer suppliers → supply curve shifts left</td>
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