3.1.4.3 Competitive markets

- A **perfectly competitive market** has the following characteristics:
    - Many buyers and sellers
    - Sellers are **price takers**
    - Free entry to and exit from the market
    - Perfect knowledge
    - Homogeneous goods
    - Firms are short run profit maximisers
- In this market, price is determined by the interaction of demand and supply.
- In a competitive market, profits are likely to be lower than a market with only a few large firms.
- This is because each firm in a competitive market has a very small market share. Therefore, their market power is very small.
- If the firms make a profit, new firms will enter the market, due to low barriers to entry, because the market seems profitable.
- The new firms will increase supply in the market, which lowers the average price. This means that the existing firms' profits will be competed away.
- In the short run, firms will be able to make a lot more profit, than in the long run where profits are competed away.