

Monopolistic competition and pure competition essay

[Business](#), [Decision Making](#)



In this paper, we will discuss the four market structures of Monopoly, Oligopoly, Monopolistic Competition and Pure Competition.

We have identified four companies that operate in each of these market structures: Salt River Project, The Coca Cola Company, Russ's Market, and Columbia House. In each market structure we will describe the pricing and non-pricing strategies of the companies operating in that market. We will also examine Quasar, a notebook computer company. They entered the market with a new product and we will explain the progress from one market segment to the next as the lifecycle of the product changes and the number of suppliers and consumers also that changed along with it.

Monopoly Market Structure The concept of monopoly arises when one firm is the sole producer and marketer of a product or service. According to McConnell and Brue (2004) monopolies come in being when a single firm is the sole producer of a product that has no close substitutes. Monopolies are characterized by a single seller, no close substitutes, price maker, blocked entry and non price competition.

The market structure that Salt River Project called SRP operates in is monopoly. SRP is the sole generator of electricity in the Phoenix metropolitan area. The SRP website (2007) state that the company established in 1937 generates hydro, thermal and gas operated electricity. The Phoenix area is specifically assigned to SRB by the government and no other company competes with it. The company uses different pricing strategies to deal with its customers. The strategies are penetration pricing which is designed to initially capture a customer by charging low prices,

(Koh, 2005). They also use price matching which matches the price charged by other monopolies like APS, geographical pricing which results in charging different prices in different geographical areas and differentiated pricing in which they charge higher prices in summer because of excessive demand due to the high temperature and lower prices in the winter due to low demand, (Strategic Pricing, 2007). The company also uses the following non-price strategies to stimulate demand.

According to Contact (2007) a monthly newsletter of SRP, the company states that customers can pay the same amount every month irrespective of the period and this is calculated by the average monthly payment of the previous year. The company also has energy saving devices like wind power, landfill gas energy, geothermal generation that uses water which is converted into steam and land fill gas energy. SRP is also environmental friendly and embarks on tree planting, archeology sponsorship, bird protection, air quality promotion and incentives to become a member of the company by having an account in SRP Credit Union which entitles customers to vote for directors and policies that have effect on the operations of the company. The company provides efficient services to its customers but since it is a monopoly in the Phoenix area, its effectiveness cannot be adequately assessed in terms of price since there are no competitors. Oligopoly Market Structure Oligopoly is a market structure characterized by a small number of large firms that dominate the market, selling either identical or differentiated products and having significant barriers to entry such as patents, resource ownership, franchises, start-up cost, brand name recognition and decreasing

average cost. Oligopolistic industries are “ price makers” but like the monopolist can set its price and output levels to maximize its profits (McConnell and Brue, 2004, p. 467). Since there are few firms in the market for an oligopolistic industry, there is mutual interdependence when means that “ each firm’s profit depends not entirely on its own price and sales strategies but also on those of the other (oligopolistic) firms” (McConnell and Brue, 2004, p.

467). Prices are kept relatively constant in the marketplace for oligopolies because competitors are likely to match price decreases but not price increases. Therefore, the oligopolistic firm has little to gain from utilizing pricing strategies that results in rigid or inflexible prices. Oligopolistic firms rely on non-pricing strategies of competition such as advertising, product differentiation, and barriers to entry. The goal for oligopolies is to increase market share while keeping price constant. The Coca-Cola Company is the global leader for carbonated soft drinks (Carbonated Soft Drinks Industry Profile: United States, 2005). In 2004, Coca-Cola had a 44% volume of the U. S.

market, PepsiCo, Inc. had a 31. 1% share, Cadbury Schweppes p/c had 15. 2% (Carbonated Soft Drinks Industry Profile: United States, 2005). The Coca-Cola Company, PepsiCo, Inc. nd Cadbury Schweppes p/c hold 90. 3% market share of carbonated soft drink (CSD) sales in the U.

S. while private label brands have only 0. 4% share of the market (Carbonated Soft Drinks Industry Profile: United States, 2005). The Coca-Cola

Company, Inc. exhibits oligopolistic characteristics whereby it is the largest of three oligopolistic CSD companies in the U. S. market, offers differentiated carbonated soft drink products, controls price with mutual interdependence, limits barriers to entry by significant brand recognition and trademarks and has a high concentration ratio of 44%.

Pricing strategies for Coca-Cola and the other CSD oligopoly firms, as stated above, reflect a kinked-demand curve assuming non-collusion and exhibit price inflexibility. For noncollusive oligopolistic industries prices are generally stable due to demand and cost reasons (McConnell and Brue, 2004, p. 472). The kinked-demand curve reflects that increases in price will result in customers buying other substitute products and other oligopolistic firms will match decreases in price.

Therefore, a price decrease in the inelastic region decreases total revenue with production of higher output resulting in increased total costs. The broken marginal-revenue curve suggests that even if the oligopolist's costs change significantly, the oligopoly may have no reason to change its price (McConnell and Brue, 2004, p. 472). Non-pricing strategies such as advertising also demonstrate the mutual interdependence of oligopolies because each oligopolistic firm will consider how rivals will react.

In response to decreased sales of Diet Coke by 2. %, in 2006 Coca-Cola launched a national advertising campaign to encourage morning consumption of Diet Coke by featuring a can of Diet Coke wrapped in coffee house sleeve with the message " Good Morning" (Zegler, 2007, p. 10). To

illustrate how oligopolistic firms are innovative leaders, Coca-Cola introduced the Coca-Cola Bilak, a soft drink/coffee fusion beverage in April, 2007 (Zegler, 2007, p. 10).

Coca-Cola has announced that it will be funding nutritional studies as well as awareness campaigns on diet and exercise in an effort to “ get the target off our backs” due to the obesity epidemic (Zegler, 2007, p. 0). Coca-Cola attempted to re-position Coke products in the market by using the terminology of “ sparkling beverages” for carbonated soft drinks hoping to dispel the negative connotations associated with the wording of “ carbonated soft drinks” in today’s health conscious society (Zegler, 2007, p. 10). Product development and advertising campaigns are not as easily duplicated as price decreases; and most oligopolists have sufficient financial resources to undertake new product development and unique advertising methods (McConnell and Brue, 2004, p.

472). However, advertising as a non-pricing strategy may affect prices, competition and efficiency both negatively and positively, depending on each oligopolist’s situation (McConnell and Brue, 2004, p. 473). Advertising is a vehicle by which new product development may be introduced allowing technological processes to increase outputs which reduces long-run average total costs to achieve economies of scale (McConnell and Brue, 2004, p. 473). Advertising also permits achievement of monopoly power by establishing “ substantial brand-name loyalty creating barriers to entry” (McConnell and Brue, 2004, p. 73).

Advertising costs may be “ self-canceling” in that increased advertising campaigns by rivals will result in market share staying the same and prices will be higher (McConnell and Brue, 2004, p. 473). Coca-Cola’s brand is the world’s leading brand valued at \$67, 525 million in 2005 by BusinessWeek-Interbrand (The Coca-Cola Company, 2006). Coca-Cola has made significant investment in brand promotion resulting in stable revenues and a distinctive competitive edge over rivals. Therefore, pricing decisions for firms like Coca-Cola Company are strategic decisions because the reactions of their competitors PepsiCo, Inc. and Cadbury Schweppes p/c must be considered.

Monopolistic Competition Market Structure The four key characteristics of monopolistic competition are large number of small firms, similar but not identical products sold by the firms, i. e. differentiated products, relative freedom of entry and exit out of the industry and extensive knowledge of prices and technology (McConnell and Brue, 2004, p. 461). An example of a monopolistic competitive industry is the private label carbonated soda drink (CSD) industry.

Since monopolistic competition is made up of a large number of small firms, a variety of private label CSD companies will be used as examples. Private label CSDs comprise 0. 40% of the total market share for carbonated soft drinks in the United States (Carbonated Soft Drinks Industry Profile: United States, 2005). Private label carbonated soft drinks are a “ gateway product” used to entice customers to buy into a retailer’s offering of private label products (Cosgrove, 2004, p. 14). Soda is the fifth-biggest private-label stockkeeping unit, excluding eggs, milk and butter” (Charter, 2005, p. 49).

Many retailers do not grow market share by engaging in price cutting strategies.

(In 2004, overall sales of CSDs declined due to consumers' change in taste and preference to healthier beverages such as bottled water and energy drinks.) Declining sales were seen as a marketing issue and Russ's Market, an eight-store chain in Lincoln, Nebraska, left their prices as is because the market wanted to maintain the same margin on the store's private label products (Charter, 2005, p. 9). West Point Market, an independent retailer in Akron, Ohio, did not discount their private label CSDs because "once you discount your private label, you discount your brand, and people won't buy it again until it's on special" (Charter, 2005, p. 49). Individual retailers combine pricing strategies with non-pricing strategies to grow their store brand soda sales. Product tiers help to capture different market segments. Wild Oats Natural Marketplace in Boulder, Colorado, offers two levels of private label CSDs under the Wild Oats Natural brand with six varieties of natural sodas in a can including a specialty soda, Italian soda which comes in multiple flavors (Charter, 2005, p.

49). K-VA-T Food Stores in Abingdon, Virginia also used the same two-tier approach because it appeals to differing constituencies by offering the Valu Time, and economy tier, and Food Club, a national brand-comparison label with plans to add a third tier called Food City Premium, priced at a higher price point but still cheaper than the national brands (Charter, 2005, p. 9).

Non-pricing strategies to differentiate private label sodas include aggressive merchandising and advertising. 7-Eleven convenience stores were successful

in 1984 by marketing the “ Super Big Gulp” (a private label CSD) with its “ 7-Eleven Stays Open” advertising campaign (Prince, 2007, p.

46). Giant Food Stores, Carlisle, Pennsylvania, features at least two of its private label CSDs in the corporate-brand section of the chain’s circular and on the Giant Wall of Values as “ best product values” (Charter, 2005, p. 49). Russ’s Market Best Choice sodas are merchandised on endcaps between Coke and Pepsi in the beverage aisles because the store found that private label sales improve when sodas are grouped by brand and placed near the comparable national brand (Charter, 2005, p. 49). In the “ Taking the Next Step” study, Perception Research Services International found that once a consumer has browsed the leading national brand he will move his eye to the right and downward suggesting that private label products be displayed with national brands at or below the average person’s eye level (Charter, 2005, p. 0). Giant Food Stores private label CSDs are integrated with national brands and placed to the right of them because the majority of customers are right-handed, so their hand is near the private label CSDs when they reach out for the national brand (Charter, 2005, p.

50). Retailers such as Russ’s Market and Wild Oats have found that tastings paired with complementary foods like pizza or Italian foods in the case of Italian soda for Wild Oats are a good way to sell their own brand CSDs (Charter, 2005, p. 50). Another non-pricing strategy is packaging. Wild Oats sought a packaging design that would reflect the retailer’s image (Charter, 2005, p. 50). Packaging should make the private label CSDs more visible but

should not imitate national brands so that they appear to be a “ lower-quality knockoff” (Charter, 2005, p. 50).

The goal of monopolistic competitors is to use product differentiation and advertising, non-pricing competition, to make price less important and product differentiation attributes more relevant in consumers’ purchasing decisions (McConnell and Brue, 2004, p. 462). Pure Competition Market Structure Pure Competition exists when there is a large presence of independent firms selling identical or homogeneous products (McConnell and Brue, 2004). These firms are typically run on a small scale, and they have no control over the selling price of their product because no one seller is large enough to set the price of the product. Instead, the market determines the price of the product. There are multiple competitors in a pure competition industry, and it is easy to leave and enter the industry.

If the price of a product is high, consumers will demand less of the product while the suppliers will want to supply more. If the price of a product is low, the consumers will demand more of the product, but the suppliers will not be willing to sell much at such a low price. Therefore, pure competition adheres to the law of supply and demand. The equilibrium lies where the supply and the demand meet and determine the market price. A competitor in the industry of selling multiple homogenous products is Columbia House. They are a direct seller of compact discs, DVDs and videos.

If the going market price for a compact disc is \$15. 95 and Columbia House tries to set the price for compact discs at \$21. 5 a piece, consumers will not

purchase it because they can purchase it for \$15.95 from a different supplier. On the other hand, if Columbia House prices their compact disc for \$14.

95 a piece consumers will buy, but the store has lost money because the compact disc is only worth \$15.95 a piece. To remain competitive Columbia House has to be a price taker. Columbia House cannot change market price; it can only adjust to it. Record clubs typically pay labels a licensing fee for recording masters and prints to manufacture CDs, cassettes, and packaging.

The clubs pay a lower wholesale price than retailers pay, which allows them to give away up to 50% of their product in promotional offers to attract and keep customers (Jeffrey, 2006). Market Structure Simulation According to the University of Phoenix simulation (2007) Quasar computers pioneered the world's first optical notebook computer in 2003. The notebook computer came about as a result of technological expertise and its memory and access speed is five times faster than existing micro chip computers. Its other features includes using energy saving devices and a rechargeable battery that can last three days. The company was given a three year patent for the product.

The patent enabled Quasar to operate as a monopoly, which comes into existence when a single firm is the producer of a product for which there are no close substitutes (McConnell and Brue, 2004). Monopolies are characterized by: a single seller, no close substitutes, price maker, and blocked entry. Quasar computers used the premium pricing strategy in which

producers charge higher prices for their products due mainly to its uniqueness (Koh, 2005).

The price at the intersection of MR and MC is \$550 and the quantity produced was 11 units, the total cost (TC) was \$18.22 billion, total revenue (TR) \$6.1 billion and the total loss -\$12.17 billion. The effect of maximizing profit will be the selling price of \$2550, TC \$12.18 billion, TR \$13.

5 billion, quantity produced 5.6 units and total profit (TP) of \$1.28 billion.

The firm will most likely sell it at this high price to recoup its research and development cost in addition to generating enough revenue. Yarbrough (2006) states that monopolies are undesirable because they stifle innovation and create lack of options while McConnell and Brue (2004) are of the opinion that monopolies have the advantages of economies of scale, which can even lead to decreased prices even for industries that are natural monopolies whose entrance requires huge capital outlay that few firms can afford. The aggregate number of suppliers for a monopoly is obviously one.

The aggregate number of consumers at this point is approximately one in 20 individuals. These consumers mostly purchase the notebooks for business purposes. As the price lowers this will change. Ultimately, the objective is to provide goods and services that are acceptable to the consumer at an affordable price. The life cycle of most products starts with monopoly and if successful, others will enter the market leading to oligopolies.

In 2006, the patent for the optical notebook computer expired resulting in Orion Technologies entering the market as a rival with a similar product. A tight oligopoly exists because only two firms dominate the optical notebook industry that exhibit mutual dependence and strategic behaviors. This situation is very similar to the tight oligopoly that exists for the carbonated soft drink industry where The Coca-Cola Company, PepsiCo and Canada Dry Schweppes represent 90.3% of the market share in the U. S. (Carbonated Soft Drinks Industry Profile: United States, 2005).

Quasar's pricing decisions are strategic decisions in that the response of Orion to price changes must be considered. Since oligopolies are price makers, the two companies must set price and output levels to maximize profit. Quasar can match price changes or ignore price changes instituted by Orion. Excessive price-cutting will lead to an industry slump while high prices will decrease the overall demand for the optical notebook. Oligopolies such as the optical notebook and CSD industry possess kinked-demand curves, i. e. a relatively more elastic segment for price increases and a relatively less elastic segment for price decreases.

Non-pricing competitive tactics such as advertising may be used to introduce new products, which is exactly the pricing strategy that Quasar implemented to maximize profits. Coca-Cola used this technique in the advertisement of their new product, the Coca-Cola Blak (Zegler, 2007, p. 10). The objective of Quasar and Orion is to reach price stability in order to maintain profitability even though productive and allocative inefficiencies result. In 2010 optical notebook computers are approaching the mid-point of the product life cycle.

Consumers are buying the optical notebook for both personal and business purposes. Quasar's market share has decreased since optical technology is readily available resulting in new firms entering the industry. Therefore a monopolistic competition market structure has evolved.

Quasar has just introduced a new model called the "Ceres". Since there is now a market with easy entry and exit for rivals, differentiated products with development of new models with unique product and service attributes, and limited pricing control due to numerous substitute products, Quasar must determine how to maximize the use of the advertising budget. The goal of non-pricing strategies is to highlight the product and/or service attributes so that price will not be the determinant factor in the consumer decision making process. As demonstrated by the private label CSD industry, the demand curve for monopolistic industries is highly elastic because there are many rivals and substitute products (Charter, 2005, p. 50).

Quasar decides to allocate the advertising dollars to the new product line instead of the existing Neutron brand because new market segments will be targeted. Profit maximization in the short run is where marginal revenue equals marginal cost. In the long run the monopolistic competitor will earn only a normal profit, i. e. breakeven. By the year 2013, the market for optical computer notebooks has matured and Neutron's market share and profit margins have stabilized. The maturity of the market means that all manufacturers offer similar products.

At this point, we have entered a market structure of Pure Competition.

Quasar Computers is a price taker, it can maximize its economic profit only by adjusting its output (McConnell and Brue, 2004, p. 416). To adjust its output, Quasar Computers acquired a major controlling interest in Opticom, which produces Optical Display Screens in order to control the distribution of suppliers needed for production of the Neutron computer. The ease of entry and exits has created a change in the aggregate number of suppliers. The number of suppliers has increased so there are many current players in the marketplace who provide similar optical notebook computers with differing options that exceed the quality expectations of consumers.

The prices have stabilized allowing more consumers to purchase products, thus increasing the aggregate number of consumers. Others will copy any imperfections in the market by way of cost savings. This will lead to a reduction in market price and zero economic profits for all firms.