The level of competition in pricing and output decisions under an oligopolistic m...

The level of competition in pricing and output decisions under an oligopolistic market structure The need to evaluate the empirically Structure-Conduct-Performance between concentration and profitability has been a process requirement in establishing factual data to overcome the endogenous problem of market structure and expand on the traditional business analysis in several ways. Evidently, national concentration does increase profitability, but only in geographically dispersed industries, suggesting that regional markets are an important source of market power for oligopolistic industries. It proves that the effects of market structure are persistent in the long run. There was much experimentation with forms of business structures until the pattern of oligopoly finally evolved. In the United States, during the last quarter of the 19th century, businesses avoided competition by forming trusts. Under this structure, the leading firm in one industry would hold voting stock in its former competitors. Output could be limited and prices kept high. In many parts of Europe, cartels were legal. Firms in the same line of business would enter into a formal and enforceable agreement to limit production, and maintain high prices. But both agreements; trusts and cartels brought business stability and profits at the cost of high consumer prices, limited new investment (in order to limit production of products) and a diminution of the type of competition that drives firms to develop new products and new production processes.

However, many modern markets are oligopolistic. The growth of oligopoly poses problems both for economic theory and policy because only a handful of large firms produce most of the output in these industries. An oligopoly market exhibits many sellers but is concentrated on only a few sellers.

Market shares matter because these few firms control majority of the entire

market with some assistance from new technologies. Institutionalists claim that the structure of oligopoly leads to a form of administered pricing. Prices will be set at a level, which achieves a target range of operating profits.

The retail petrol industry is a predominant big business structure. Each firm has a large share of the market but they are independent. With only four or five large firms responsible for most of the output, avoidance of price competition became almost automatic. If one firm were to lower its prices, it is likely that its competitors will do the same and all will suffer lower profits. On the other hand, it is dangerous for any single firm to increase its prices since the others might hold their prices in order to gain market share. The safest thing is not to lower prices and only raise prices when there is sufficient evidence that the other firms will also raise prices. The largest or lowest cost or most aggressive firm will often emerge as the price leader. When business conditions permit, the price leader will raise prices with the expectation that the others will follow. The practice of price leadership prevails in many industries such as automobiles, breakfast cereals, beer, cigarettes, steel and bank loans are among the many goods and services that usually follow this pricing trend.

On the surface, it looks as though the effect of oligopolistic price leadership is the same as the effect of the fixing of prices by a cartel or a trust. But there is a fundamental difference. The trust or cartel assigns production quotas to its members in order to keep production down and there is no competition in any form. Oligopolies that follow a price leader do not engage in price competition but they still compete for market share with a variety of forms of non-price competition. Pepsi and Coke each spend billions on TV advertisements designed to entice soft drink consumers to switch cola

brands, but those expensive advertisements never mention price.

Oligopoly, then, is a compromise and a social adaptation to powerful technological trends. While the rules of perfect competition should both assure that prices reflect the real costs of production and that firms continue to improve their products and production processes. Operating under these rules leads to the types of competition that continually threatens the value of vast holdings of expensive and specialized production facilities. So we have accepted a set of economic rules that limit price competition but still remain competing over product and production process development. Technology forced firms to become bigger, and once the target size is obtained, they deal with the new risk of continue aiming high and become bigger in order to control prices.

Analytically, from the trusts of the 1980s to the oligopolies of today, there have been a number of strategies and tactics used by these firms to either limit competition or expand their markets. Oligopolies enjoy periods of stability in which price competition is limited or absent even while these firms struggle over market share through various forms of non-price competition. But there are also periods of instability like when a new firm is invading an established market wherein the leading firms might use price as a competitive weapon. Oligopolies can become unstable when new firms attempt to gain entry, thus businesses in the industry have developed a number of practices that serve to limit entry of investors into the industry to avoid price competition and manipulate demand.

It also proves costly to enter an industry dominated by a small number of known trade names that small firms contend with. The large firms will often offer purchase of the up-and-coming small firm, or the large firms simply rely

on its established relationships with customers or suppliers to limit the activities of smaller firms. Market dominance by two or three mega firms may make it more difficult for smaller firms to introduce innovative products or production processes.

Oligarchy becomes a full competition scenario leading to implausibly high market shares, resulting in oligopolistic market structure. However, the changing customer demands and government regulations may hamper economic success of oligopoly in the varying market need of individual countries.

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