Oligopoly and how it deals with competitive forces it faces

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Oligopoly refers to a market structure where few firms are dominating the market, while there could be several other firms operating in the same market, which are also sharing the same market with the few large firms. When such large firms are dominating the market, they tend to control either the price of the product, or the quantity of the product to be availed to the market, so that their profit margin can remain at the desired level. This way, the few markets dominating a market must collaborate to ensure that they act in unison, and thus sets the pace of the market in the manner that is highly favorable to them. There are several strategies that the oligopolies apply to deal with the forces of competition.

The first strategy applied by an Oligopoly and to deal with competitive forces it faces, is Price fixing. Price fixing refers to a situation where the main large firms that are operating in the market agrees to set the price of the products they offer at a certain level, through collusion, which in turn serves to dismantle the whole market by stifling any operations of the free market concept (Baye, 2010). The oligopoly achieves this through controlling the demand and supply of the products they offer, since the other market operators are small and therefore cannot meet the market needs of the product or service. This strategy shifts the prices from the existing price level, to a price level that destabilizes the market and disorients the other small market operators (Baye, 2010). This effectively eliminates the competition emanating from the small firms.

Limit pricing is yet another strategy that is applied by oligopoly to deal with

competitive forces that faces it. This entails a situation where the oligopoly fixes the prices at the lowest possible level, which makes the market very unattractive for other market players, such that they opt out of the market, since their attempt to operate at that market will not earn them any profit, and may even lead to losses (Baye, 2010). Through applying this strategy, the oligopoly manages to move the competitors out of the market, taking the advantage of the economies of scale of production, because it is a large firm. This way, the oligopoly is left operating singly in the market, and can therefore increase the prices to the highest level possible; to make-up for the duration it was fighting competition, and thus did not earn profits (Baye, 2010).

Tying is another strategy that is applied by the oligopoly to overcome the competing forces that it faces, through combining two related products and selling them to the customers jointly (Baye, 2010). This way, the oligopoly is able to discharge two items in a single sale, by forcing the customer to purchase the other related product, considering that the oligopoly dominates the market, and thus the customer has no choice but to purchase from the firm. This way, the oligopoly earns substantial profits while the other competing market operators lag behind, which eventually sees them thrown out of the market.

References

Baye, M. R. (2010). Basic Oligopoly Models in Managerial Economics and Business Strategy. (7th ed.). New York, NY: McGraw-Hill Irwin.