

Different Market Structures

Business owners and managers who take a long term view of their firm's potential must be aware of the type of market that their business operates within. Competitive conditions within a market place are one of the main external influences on how firms behave. Business strategy will to a large extent be determined by the level of competition. Also the level of competition is important to consumers, and affects how they behave in relation to the whole market and firms within the market.

Different Types of Market Structure

When we examine the type of market structure a business operates within we categorise markets according to the degree of competition that exists.

There are four broad categories of types of market, and these are based on the competition that may exist a market. They are:

- Monopoly
- Oligopoly
- Monopolistic Competition
- Perfect Competition

Monopoly.

The strict definition of a monopoly is a firm that is the sole supplier to a market place, i.e. the firm is the market. Another slightly looser definition is any firm that is able to influence market price or quantity supplied to a market. This ability to influence price or quantity supplied is known as monopoly power. The government can regard any firm that has

over 25% of a market as potentially having monopoly power.

Most firms would like to be in a position of a Monopoly, that is one supplier in a market or industry. Monopolies do not have to worry about competition and they can supply the quantity they wish, or alternatively charge the price they wish and let demand follow the price. Monopolies normally try to profit maximise, they do this by supplying a quantity to the market that sells at a price that maximises total profits. In Cardiff during 2007 there were protests that NCP CarParks were using monopoly power to push up car parking prices—those wishing to park in the City centre had little choice but to use the NCP facilities and pay the higher charges.

Monopolies will also work hard to prevent new competition from entering the market. Monopolies will try to establish barriers to entry or use marketing and pricing strategies which will prevent new entrants gaining a foothold in their marketplace. They may even sell their goods or services at prices that do not maximize profits, but instead prevent profitable competition entering the market or discourages the government or competition authorities taking action against the monopoly.

Consumers are regarded as suffering from monopoly power, they pay a higher price than if competition existed, and the lack of competition normally means that quality suffers. Some consumers have fought back against monopolies by going to other markets to purchase goods. For example in the 80's and 90's many individuals avoided inflated UK car prices by

importing right hand drive cars from Ireland and other European countries, and so saving £1,000s.

A natural monopoly occurs when having just one firm in the market creates the most efficient scale of production, and so keeps prices down. In the past there were a number of natural monopolies in the UK, such as Gas, Water etc. Water is now the only one that remains, competition has been created in the other industries and these markets are regulated by official regulatory bodies such as Ofwat, and OFGEM, that control their prices and other activities.

Oligopoly.

Oligopoly is the dominant form of industry in the UK. An oligopoly occurs when a few firms dominate the market place, examples are found in banking, food retailing, petrol retailing, financial services, newspapers, cigarette manufacture etc.

Oligopolies are categorised by degree of concentration. A high degree of concentration means that a few firms completely dominate the market, for example the UK tobacco industry where just 3 companies have over 95% of sales between them. A low degree of concentration means that the market is spread between a number of companies, say 7 companies controlling 60% of the market.

Price wars are rare in oligopolies, and when they do break out they are short lived. Instead in an oligopolistic market, firms will compete on the basis of non-price competition, e.g. special offers, branding etc. The idea of 'added value' is very important, so firms will package their goods and services in

a way that increases desirability to consumers. Firms will also be forced to advertise a great deal, they will watch carefully the action of competitors and often follow their lead. A good example of oligopolies are price comparison websites, like MoneySupermarket, Go Compare etc. Over 80% of these firms expenditure is on marketing!

There may appear to be a great deal of competition between firms, but oligopolistic markets are famous for the amount of collusion (tacit or formal agreements between firms), that can exist. When firms collude, which is illegal, they avoid competing against each other, and may actually agree prices. Collusion has been discovered in industries as diverse as Toy Retailing, Concrete Manufacture and Transatlantic Airlines.

Monopolistic Competition

Monopolistic Competition occurs when in a market several or many sellers each produce similar, but slightly differentiated products—essentially the same but just told apart by different packaging, promotional styles and brand names. Each producer sets its price and quantity without affecting the marketplace as a whole. Typically no one brand dominates, instead there are many competing brands. No firm can market lead by influencing price in the market. Copycat behaviour by firms is typical and firms make not be making large enough profits to innovate. Existing firms in the industry are also open to new competition from new firms entering the market. Examples of this type of market structure are found in hairdressing, computer games, book publishing, snack foods such as biscuits etc.

In this type of market there often arises a

situation where there is excess capacity in the industry. The potential output of all the producers added together is greater than the total demand for the product. This has occurred in the European car industry where capacity is perhaps 30% greater than demand. Local firms in monopolistic competition try to attract customers with services like free delivery of take-away food, coffee with a hair cut, or loyalty cards.

Consumers benefit from the level of competition through increased choice, and competition encourages improvements in quality of products and lower prices. There is a very high expenditure on advertising, monopolistic firms typically spend between 10 and 20% of revenue on advertising, pushing up prices to consumers, but at the same time helping fund newspapers, and internet services. Advertising also provides consumers with valuable information about the brand being marketed.

Notes