Types of Competition

Perfect Competition

Perfect Competition is characterized by many producers and a uniform product. Suppliers of agricultural goods, for example, operate within such a market. A perfectly competitive market is distinguished by five main characteristics:

1. There are many buyers and sellers in the market. There are so many sellers that individual firms have no control over total market supply.
2. All the firms sell a standardized product. Imagine a very long country road along which every second farmer has a stand selling the same produce: corn, peaches, and apples.
3. Producers must accept the market equilibrium price for their product. They can sell as much or a little as they choose at that price without changing it. They are price takers – they must take the market price – because individually they have no impact on total supply.
4. It is relatively easy to enter and exit the market. That is, the start – up costs or the costs of leaving are not so great as to prevent firms from doing either one.
5. Because all firms sell the same product and each firm can sell as much or as little as it wants at the market price, there is little non-price competition among them.

The success of a firm in a perfectly competitive market depends entirely on how well it manages its costs. Decision making focuses entirely on reducing the costs per unit produced. Because the firm has no influence on price or total quantity sold, profitability depends entirely on making efficient use of the economy's scarce resources. Those firms that are the most efficient (that is, can maintain low costs) will be rewarded with profit. Achieving very low costs can work against a firm, however, because large profits will attract more producers who, collectively, will increase supply and drive market prices and profits down. Such competitive pressure guarantees the lowest price to consumers with just enough profit for producers to keep them producing.

In reality, the perfectly competitive market does not exist, primarily because there are always some start-up costs and some use on non-price competition. The classic example of a group of producers that comes closest to being perfect competitors are wheat farmers. They produce an identical product, have no influence over the market price, and do not participate in non-price competition. Nonetheless, wheat farmers need huge amounts of capital to start up a new business, so there is a barrier to entering the market.

Monopolistic Competition

In most markets, there are some sellers who compete with one another in different ways and with varying degrees of intensity. When the product can be differentiated and there are a substantial number of firms operating in the market, the market is called monopolistic competition, as opposed to perfect competition.

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The major characteristics of the market structure of monopolistic competition are as follows:

1. A substantial number of firms compete in the market.
2. Firms sell a similar but not identical product.
3. Individual firms are large enough to influence total supply, and so they have some influence over price.
4. It is relatively easy for a new firm to start up.
5. Non-price competition is significant.

Monopolistically competitive markets are most prevalent in the service and retail sectors of the Canadian economy. As consumers we shop in them frequently. Think of your favourite pizza parlour. It competes with several other pizza parlours. The competition might come in the form of a price war if each store attempts to increase its market share by offering lower prices and special deals. Competition might also include non-price factors. For example, each pizza store might try to differentiate itself from the rest by offering different services, such as guaranteed 15-minute delivery, gourmet toppings, thin-crust or deep-dish pizzas, and 24-hour service. It might expand its product line or advertise its goods in various media. The problem with any of these initiatives is that they all have to be factored into the firm's cost of production.

Monopolistically competitive markets are also relatively easy to enter and exit. Generally, the firms are fairly small. The economics of scale and capital requirements are limited. Firms must still distinguish their products from those of their competitors, and this creates some financial barriers.

In monopolistically competitive markets (and in oligopolistic markets, about which you'll read more in the next section), firms seek to distinguish their product or service from those of their competitors in some desirable way. They use a number of techniques to accomplish this product differentiation like: product quality, services, location and accessibility, and promotion and packaging.

When product differentiation is successful, it leads to something marketers call brand loyalty, a situation in which consumers become attached to a product and will pay more to satisfy that preference. Because of brand loyalty, successful firms in a monopolistically competitive market do have some control over price.

Oligopoly

If you made a list of the ten best-known brand-name companies in Canada, you might mention Air Canada, Indigo-Chapters, CIBC, Irving Oil, PetroCan, and Loblaws. All of these are oligopolists. They operate as huge firms in each of their respective markets. CIBC, for example, shares the market for financial services with just a few other major firms. The main characteristics of the market structure known as an oligopoly are as follows:

1. It is dominated by a few, very large firms.
2. Competing firms may produce products as similar as steel or as different as automobiles.

3. The firm's freedom to set price varies from slight to substantial.
4. Significant financial and other barriers to entry exit.
5. Non-price competition can be intense.

Many consumers become frustrated as they watch competition play out between firms in an oligopoly. Their frustration comes from a sense of helplessness because oligopolies seem to raise and lower prices at will. Prices do move up or down, but competitors' prices all seem to move in exactly the same way at exactly the same time. Gasoline prices are an excellent example: they all go up about the same time. At times, observers suspect that a price conspiracy exists, and they demand that the firms be investigated for illegal activity.

Further suspicion arises because prices for products in an oligopoly tend to stay within a particular range. The service charges on your bank account, for example, will be pretty similar no matter which bank you decide to trust with your savings. Similarly, all banks charge about the same rate of interest on funds borrowed on a credit card. Again, is there a conspiracy going on?

Not necessarily. By shopping around for the lowest price, consumers push firms to compete on the basis of price. In a free-market economy, firms have the right to set prices at any level they see fit. A station that sticks with a slightly higher price will lose a lot of business.

Nonetheless, a common pricing strategy among oligopolists may occur. Competitors may talk with each other and perhaps even make a deal. If so, they have participated in a form of collusion, which is a secret agreement among firms to set prices, limit output, or reduce or eliminate competition. It is illegal in Canada and the United States for firms to collude. A recent example has occurred in the music and recording industry. In 2000, 28 states launched suits against several recording companies for inflating their production costs for CDs and enforcing minimum prices at which they could be sold in retail stores. The outcome of this case is yet to be decided.

Monopoly

The word *monopoly* comes from the Greek words *monos polien*, which mean "alone to sell." In a monopoly, one firm or organization enjoys complete control of the market. The major characteristics of a monopolistic market area as follows:

1. It is a market completely dominated by a single firm. This firm has complete control over total supply.
2. The firm produces a unique product for which there are no close substitutes.
3. The firm is a price maker; that is, by changing supply it can set whatever price will maximize its profits.
4. Major barriers to entry prevent other firms from entering the market.
5. Because it has no direct competitors, a monopoly need not engage in non-price competition.

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A firm may establish a monopoly by gaining legal control of its product and the exclusive right to benefit from its sale. Copyright law gives writers control of the work they produce. Patent law protects inventors and developers of a new product or technology by giving them the sole right to benefit from its sale for a period of time. Many a private firm owes its birth, growth, and profitability to patent protection.

Government may also create at least a local monopoly by awarding the sole right to provide a product or service to a particular firm. The Canadian Radio-television and Telecommunication Commission (CRTC) awards exclusive rights of service to cable providers in specific areas of Canada. Each provider then holds a monopoly in its area. In most cases, the CRTC must approve any price changes.

In a few cases, producers themselves may create a monopoly by selling franchises. Professional sport leagues are an example. Residents in the Hamilton area would probably love to have an NHL team in their city, but NHL team owners in Toronto and Buffalo would oppose such a move.

Are monopolists better at producing goods at lower prices than perfect competitors? In some ways this is true. Monopolists are better able to produce large quantities of output. They have the financial resources to assume the costs and risks of capital-intensive production and can achieve the efficiencies that come from economies of scale.

Some products, particularly those with high fixed costs, are more efficiently produced by a monopoly than by a few or many smaller producers. This type of monopoly is referred to as a natural monopoly. It is found most often in the field of public utilities (such as generation, supply, and delivery of natural gas or electricity; local telephone service; and water and sewer supply) where having more than one supplier would be impractical and wasteful. Many markets that were once considered more efficient as natural monopolies are now being opened up for market competition through a process of deregulation or privatization. Deregulation involves opening a market to more competition. This may be accomplished in a variety of ways. Privatization refers to one method of deregulation that involves, among other things, the sale of public assets to private firms.