14 OLIGOPOLY

Oligopoly	
Definition	**As per Peter C. Dooley:** "An oligopoly is a market of only a few sellers, offering either homogenous or differentiated products." **As per McConnell:** "Oligopoly is a market situation in which number of firms in an industry is, so small that each must consider the reactions of the rivals in formulating its price policy."
Meaning	**1.** The term 'Oligopoly' is derived from two Greek words - 'Oligoi + Pollen'. 'Oligoi means few and 'Pollen' means to sell. **2.** Oligopoly is a market situation where there are few sellers in the market, producing either identical products or close but not perfect substitute of each other e.g. Airlines, Tyres, Automobiles, Refrigerators etc. **3.** Oligopoly exists where modern techniques of production can be adopted. It is the competition among few sellers. Each oligopolist formulates its policies regarding price and output which considers the reaction of their competitors. Because of their interdependence oligopolist face a situation in which the decision of one firm depends on the decisions of other firm. There may be situation of conflict and co-operation.
Features	**1. Few Sellers and Many Buyers:** Oligopoly is that market structure in which few firms control (dominate) the industry. e.g. In India, four companies Maruti, Hyundai, Cello and Tata, produce 90% of small cars. **2. Identical or differentiated products:** In Oligopolistic market, firms are free to produce either homogeneous or differentiated products e.g. If the firms produce homogeneous products like cement or steel, the industry is called perfect or pure oligopoly. If the firm produces differentiated products like automobiles, the industry is called imperfect oligopoly or differentiated oligopoly. **3. Lack of uniformity:** Important feature of oligopoly is lack of uniformity (similarity) in the size of firms. Some from may be very large and other may be small. e.g.: Share of Maruti Udyog (86%) is much more in comparison to share of Hundayi or Tata, in automobile industry. **4. Elements of Monopoly:** Firms enjoys some powers of monopoly under differential or imperfect oligopoly. Every firm has monopoly of its own brand. No other firm can sell its product under that brand. **5. Mutual interdependence:** Mutual interdependence means that firms are significantly (expensively) affected by each other's decisions (i.e. price and output decision). In oligopolistic structure firm cannot take independent decisions. Since in oligopoly, a small number for firms compete with each other the sales of one firm depend upon that firm's price and the price charged by other firms. **6.** In oligopoly, the cross elasticity of demand is very high between the products of the oligopolists firms because the products are 'close substitutes'. In short the oligopoly firm has to give importance to the action and reactions of his rivals while deciding its price and output policies.

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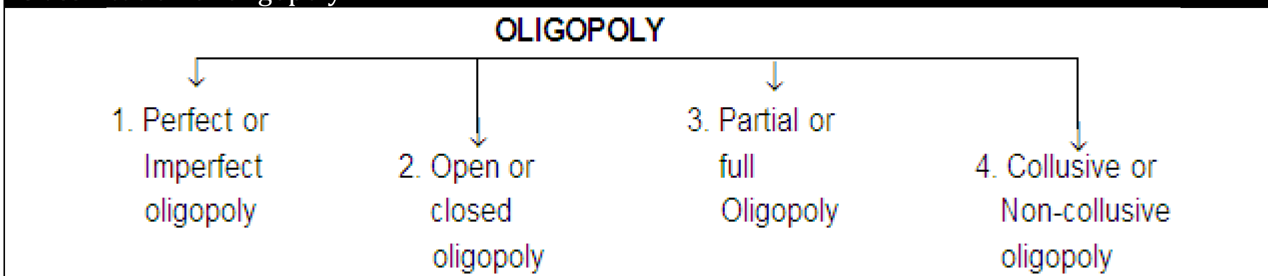
	7. Existence of Price rigidity (strictness): The term price rigidity means that firms would not like to change the prices. Any change in price will not beneficial for the firm. e.g. If a firm reduces the price of their product, then rival firm will also reduce their price, so price reduction will not be beneficial. Likewise, if a firm tries to raise its price, other firm will not do so. So, as a result, the firm will lose its customers. So there is price rigidity in an oligopolistic market. **8. Existence of Non-profit Motive:** Under oligopoly, a firm may not always aim at maximum profit only. it may have other motives like sales maximisation, risk minimisation, output maximisation etc. In the absence of motive of Profit maximisation it becomes difficult to determine equilibrium level of output and price.

Classification of Oligopoly



1. Perfect or Imperfect Oligopoly	Perfect Oligopoly is that situation in which all the firms produces homogeneous (identical) products. e.g. - steel, cement etc. It is also known as pure oligopoly. On the other hand, imperfect oligopoly is that market situation in which all firms produces differentiated but close substitutes e.g. - Automobile, Airlines etc.
2. Open or Closed Oligopoly	Open oligopoly is that market situation in which there is no barrier on the entry of the firm in the industry. They can freely enter in the industry. On the contrary, under closed oligopoly, there is barrier on the entry of the firm in the industry. e.g. : Technological, legal barrier etc
3. Partial or full Oligopoly	Partial oligopoly is that situation in which there is a controller (dominant) firm in the industry. This controller firm is called the price leader. The controller (dominant) firm or the price leader fixes the price and other firms follow that price. Full oligopoly, on the other hand, is that situation in which there is no controller firm or price leader.
4. Collusive or Non-collusive oligopoly	Collusive oligopoly is that oligopoly in which the firms cooperate with each other in determining price and output policies. They follow common policies and do not compete with each other. Non-collusive oligopoly is that oligopoly in which the firms act independently. They compete with each other and determine independently the price of their products.
5. Syndicated and Organized Oligopoly	Syndicated oligopoly refers to that situation where the firms sell their products through a centralized syndicate. Organized oligopoly refers to the situation where the firms organize themselves into a selves into a central association for fixing prices, output, quotas etc.

Why does oligopoly Exists in the market or What are the Causes of the emergence of oligopoly	
1. New Inventions	Oligopoly is often found in industries started by major invention or innovation. The innovating firms may have established such a well-known name and reputation that it became very expensive for other firms to develop a comparable name.
2. Control of an essential resource	An oligopoly may create because a few firms have control of an essential resources e.g. Oil industry, the Organisation of Petroleum Exporting Countries (OPEC) controls most of the world's supply of oil.
3. Legal restriction s and Patents	It is another source of emergence of oligopoly. Patents can make it difficult for new firms to enter. Patents provide exclusive control over a particular resource e.g.:- Japanese firms have been able to dominate the consumer electronics industry because they have successfully obtained patents on each innovation to the original product.
4. Economies of Scale	In some industries low costs cannot be achieved unless a firm is producing an output equal to a substantial percentage of the total available market. The number of firms will tend to be rather small. In addition, there may be economies of scale in sales promotion as well as in production. This too may promote oligopoly.
5. Mergers	Many oligopolies were created by combining two or more previously independent firm. The combination of two or more firms into one firm is called a merger. The reasons of mergers include increasing market power, economies of scale, market extension and economies of wide scope
6. Large fixed capital	The oligopoly may result from the large fixed costs required to establish a new enterprise. If huge capital investment is necessary to operate a business, new firms will be discouraged to enter the industry.

Oligopoly Market

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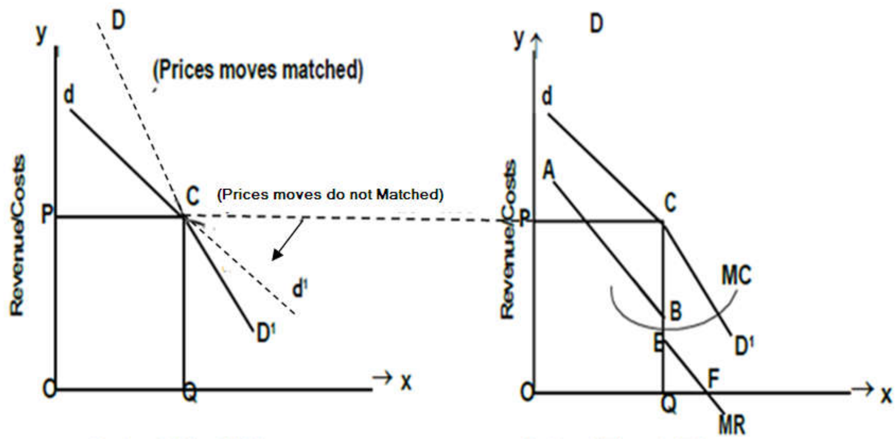
Collusive Oligopoly
- Perfect Collusive Oligopoly
- Imperfect Collusive Oligopoly or Partial & Leadership Oigopoly

Non Collusive Oligopoly
1. Paul Sweezy's Oligopoly
or
2. Price Rigidity Theory
or
3. Kinked Demand Theory

1.3 Demand Function	
Sweezy's Kinky demand curve	Despite many analytical difficulties, two interrelated characteristics of Oligopolistic pricing stand out. Oligopolistic prices tend to be inflexible or sticky. Price change less frequently in Oligopoly than they do under pure competition, monopoly and monopolistic competition. Price tends to be rigid when oligopolist takes independent action (Non-collusive oligopoly). The theory of price rigidity may be explained as follows: – Price Rigidity - Sweezy's Kinky demand curve: A well-known theory formulated to explain the rigidity of prices in oligopolistic market was advanced by Paul Sweezy in 1939

Assumptions	1. If one firm reduces its price, other firms will also reduce their prices. 2. If one firm increases its price, other firms will not follow price increase. 3. There is an established prevailing price. 4. The marginal cost curve will pass through the dotted portion of the marginal revenue curve
Explanation	In Fig.4(A) dd is the demand curve that firm 'A' faces if other firms do not change their prices. It is relatively elastic. DD' is the demand curve that firm 'A' faces when other firms change their prices. It is relatively inelastic.  Output Fig.4 (A) Output Fig. 4 (B) Let point C represents the prevailing price quantity combination. The effect of increase and decrease in the price may be summarised as follows: – • **Price reduction:** If the firm 'A' reduces its price below the market price, its rivals will also reduce their prices. For downward price movements from point 'C' the relevant portion of the firm 'A's demand curve will be CD', of the demand curve DD'. • **Price increase:** If the firm 'A' increases its price, its competitors will not increase their price. For price rise the relevant part of the demand curve will be elastic portion dc. The demand curve for the oligopolisitc firm will be dCD' as shown in figure 4(B). It will be characterised by a kink (sharp corner) at point C. Where the slope of the demand curve changes strongly. The kinked demand curve dCD' is highly elastic above the prevaility price but less elastic below the current price. ABEF is the Marginal revenue curve corresponding to the kinked demand curve dD1. It also has two parts. AB part of the marginal revenue curve, corresponding to dC portion of demand curve. EF portion is related to CD' portion. Because of the difference in elasticity of demand above and below the prevailing price.
Criticism	1. **Wrong assumptions:** The theory of kinked - demand curve is based on the assumption that other firms will follow price decrease but not price increase. This assumption of kinked - demand curve theory could not be proved empirically (experimentally) 2. **Non-price competition is avoided:** The price rigidity theory avoids non-price competition. In fact, the sweezy model ignores, credit facility, concessions and other promotional facilities given to the customers. 3. **No explanation regarding price determination:** The kinked demand curve theory is not designed to deal with oligopolistic price and output determination.

	Rather, it seeks to explain stickiness of price. In short, the kinked demand curve explains price rigidity but not price itself. 4. **Ignores Competitive Reaction:** The kinked demand curve analysis ignores competitive reaction patterns. The kinky demand curve does not show how the oligopolistic firm's view of competitive reaction patterns can affect the changeability of whatever price it happens to be charging.
Price Leadership	Cartels are often formed in industries where there are a few firms, all of which are similar in size. A group of firms that explicitly agree (collude) to coordinate their activities is called a cartel. Most cartels have only a subset of producers. If the participating producers stick to the cartel's agreements, the cartel will have high market power and earn monopoly profits especially when the demand for the product is inelastic. But it is possible that there is a dominant or a large firm surrounded by a large number of small firms. If these firms are numerous or too unreliable, the large firm has to decide how to set its price, taking into account the behaviour of these fringe firms. One strategy is to adopt a 'live and let live philosophy'. Specifically, the dominant firm accepts the presence of fringe firms and sets the price to maximize its profit, taking into account the fringe firms' behaviour. This is called price-leadership by dominant firm. Another type of price leadership is by a low cost firm. Here, the price leader sets the price in such a manner that it allows some profits to the followers also. Then there could be barometric price leadership under which an old, experienced, largest or most respected firm acts as a leader and assesses the market conditions with regard to the demand, cost, competition etc. and makes changes in price which are best from the view point of all the firms in the industry. Whatever price is charged by the price leader is generally accepted by the follower firms. Thus, we find that fixing of price under oligopoly is very tricky affair and involves a number of assumptions regarding the behaviour of the oligopolistic group.

Other Important Market Forms	
1. Duopoly	a subset of oligopoly, is a market situation in which there are only two firms in the market .
2. Bilateral monopoly	is a market structure in which there is only a single buyer and a single seller i.e. it is a combination of monopoly market and a monopsony market.
3. Monopsony	A market in which goods or services are offered by several sellers but there is only one buyer
4. Duopsony	A market in which goods or services are offered by several sellers but there is only two buyer
5. Oligoposny	An Oligoposony is a market form in which the number of buyers are small or few while the numbers of seller could be large

	One	**Two**	**Few or Small**
Sellers	Monopoly	Duopoly	Oligopoly
Buyers	Monopsony	Duopsony	Oligosposony

MULTIPLE CHOICE QUESTIONS

Q.1. In oligopoly, when the industry is dominated by one large firm which is considered as leader or the group, Then it is called: [SM-81]

(a) full oligopoly (b) collusive oligopoly
(c) partial oligopoly (d) syndicated oligopoly

Q.2. When the products are sold through a centralized body, oligopoly is known as [SM-82]

(a) organized oligopoly (b) partial oligopoly
(c) competitive oligopoly (d) syndicated oligopoly

Q.3. The structure of the cold drink industry India is best described as : [SM-44]

(a) Perfectly competitive (b) Monopolistic
(c) Oligopolistic (d) Monopolistically competitive.

Q.4. How many sellers usually exist in a oligopoly market?

(a) A large number of sellers exist
(b) Few sellers exist
(c) Only one seller exists
(d) The number of seller is so large that they cannot be counted.

Q.5. Market which have two firms are known as:(N,07)

(a) Oligopoly (b) Duopoly (c) Monopsony (d) Oligopsony

Q.6. The market structure in which the number of sellers is small and there is inter dependence in decision making by the firms is known as:(J,08)

(a) Perfect competition (b) Oligopoly
(c) Monopoly (d) Monopolistic competition

Q.7. OPEC is example of :(D,08),(D,10)

(a) Monopoly (b) Duopoly (c) Oligopoly (d) Monopolistic competition

Q.8. Oligopoly haring identical products is:(J,09),(J,11)

(a) Pure oligopoly (b) Imperfect oligopoly (c) Price leadership (d) Collusion

Q.9. Which of these is the best example of oligopoly?(J,11)

(a) OPEC (b) SAARC (c) WTO (d) GATT.

Q.10. .... is a situation is which a firm bases its bases its market policy on part of the expected behaviour of few close rivals - (D,15)

(a) Monopoly (b) Oligopoly
(c) Perfect Competition (d) Monopolish

Q.11. **The market fror hand tools (such as hammers and screwdrivers) is dominated by Draper, Stanley, and Craftsman. This market is best described as [SM-54]**
(a) Monopolistic competition (b) a monopoly (c) an oligopoly (d) perfectly competitive

Q.12. **Which of the following assumption is correct in connection with oligopoly.(J,11), (D,13)**
(i) If an oligopolist increase his price his rivals will follow
(ii) If an oligopolist increases his price his rivals will not follow
(iii) If an oligopolist increases his price his rivals will lower their price
(iv) If oligopolist decreases his price his rivals will not react.
(a) (i) Only (b) (ii) Only (c) (iii) Only (d) (iv) Only.

Q.13. **The market in which the numbers of seller, is small and there is interdependence in decision making by the firms is known as**
(a) Perfect competition (b) Oligopoly
(c) Monopoly (d) Monopolistic competition.

Q.14. **Interdependency is a prominent feature of which market form?**
(a) Perfect competition (b) Monopoly
(c) Monopolistic competition (d) Oligopoly.

Q.15. **Which of the following is not a characteristic of Oligopolistic market form?**
(a) Interdependence (b) Indeterminateness of demand curve
(c) Importance of advertising and selling costs (d) Large number of firms.

Q.16. **Kinked demand curve hypothesis is given by :(N,07)**
(a) Alfred marshal (b) A.C Pigou (c) Sweezy (d) Hicks & allen

Q.17. **The kinked demand curve is observed in:(F,08)**
(a) Duopoly market (b) Monopoly (c) Oligopoly d. Competitive market

Q.18. **_______ type of curve is found in oligopoly(D,08)**
(a) Horizontal (b) Vertical (c) Kinked (d) Negativity sloped

Q.19. **Kinked demand hypothesis is designed to explain ______ in context of oligopoly.(D,09) [SM-33]**
(a) Price and output determination (b) price Rigidity
(c) Non-collusion between firm (d) All of the above

Q.20. **In oligopoly, the kink on the demand curve is more due to _____(J,10),(D,11)**
(a) Discontinuity in MR.
(b) Discontinuity in AR.
(c) Fulfillment of the assumption that a price cut is followed by others and a price increase by a firm is not followed by others.
(d) Price war amongst the firms

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Q.21. Price rigidity is a situation found in which of the following market forms?(J,10)
(a) Perfect competition (b) Monopoly
(c) Monopolistic competition (d) Oligopoly

Q.22. Which one of the following statement is incorrect? (D,10)
(a) Competitive firms are price takers and not price makers.
(b) Price discrimination is possible in monopoly only
(c) Duopoly may lead to monopoly
(d) Competitive firm always seeks to discriminate prices.

Q.23. Which of the following is not a feature of oligopoly(D,12)
(a) Interdependence of the firms in decision making
(b) Price rigidity
(c) Group behavior
(d) Existence of large number of firms

Q.24. In the 'kinked-demand' curve model , the upper portion of the demand curve is :(J,13)
(a) Elastic (b) Inelastic (c) Perfectly Elastic (d) Unitary Elastic

Q.25. Kinked DD curve under oligopoly is designed to show_____(J,15)
(a) Price & output (b) Price rigidity (c) Price leadership (d) Collusion among rivals

Q.26. The reason for the kinked demand curve is that:(J,16)
(a) The oligopolists believe that competitors will follow output increases but not output reductions.
(b) The oligopolists believe that competitors will follow price increases but not output reductions.
(c) The oligopolists believe that competitors will follow price cuts but not price rises.
(d) The oligopolists believe that competitors will follow price increases but not output increases.

Q.27. Oligopolistic industries are characterized by: [SM-22]
(a) a few dominat firms and substantial barriers to entry.
(b) a few larg firms and no entry barriers.
(c) a large number of small firms and no entry barriers.
(d) one dominat firm and low entry barriers.

Q.28. Which of the following is the distinguishing characterstic of oligopolies? [SM-27]
(a) A standardized product
(b) The goal of profit maximization
(c) The interdependence among firms
(d) Downward-sloping demand curves faced by firm.

Q.29. Which of the following is incorrect ?(D,16)

(a) Even monopolistic can earn losses
(b) Firms in perfect competitive market is price taker
(c) It is always beneficial for a firm in a a perfectly competitve market to discriminative prices
(d) Kinked Demand curve is related to an oligopolistic market.

Q.30. When an oligopolist individually chooses its level of production to maximize its profits, it charges a price that is [SM-56]

(a) more than the price charged by either monopoly or a competitive market
(b) less than the price charged by either monopoly or a competitive market
(c) more than the price charged by a monopoly and less than the price charged by a competitive
(d) less than the price charged by a monopoly and more than the price charged by a competitive

Q.31. Choose one of the feature of oilgopoly market is.

(a) The pricing policy of a firm is influenced by that of rival firms
(b) The pricing policy of a firm is largely determined by the state
(c) Know consumers' preference play no part in firm' policy decision
(d) Free entry of firms into the industry is always encouraged.

Q.32. The kinked demand curve model of oligopoly assumes that

(a) The response (of consumers) to a price increase in less than the response to a price decrease.
(b) the response (of consumers) to a price increase is more than the response to a price decrease
(c) The elasticity of demand is constant regardless of whether price increases or decreases.
(d) The elasticity of demand is perfectly elastic if price increases and perfectly inelastic if price decreases.

Q.33. Which of the following statements is correct?

(a) Price rigidity is an important feature of monopoly.
(b) Selling costs are possible under perfect competition.
(c) Under perfect competition factors of production do not move freely as there are legal restrictions.
(d) An industry consists of large firms.

Q.34. Identify the correct statement :

(a) Price discrimination is possible only under perfect competition
(b) Price can never change in an oligopoly market
(c) Firms under perfect competition have no control over the price of their products.
(d) None of the above.

Q.35. Sweezy's Model explains the concept of price rigidity relating to following market form: [SM-99]

(a) Oligopoly Market (b) Perfect Competition Market
(c) Monopoly Market (d) Monopolistic Market

Q.36. Combination of Monopoly Market and Monopsony Market is called as: [SM-100]

(a) Duopoly Market (b) Oligopoly Market
(c) Bilateral Monopoly Market (d) Monopolistic Market

Answer

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
c	d	c	b	b	b	c	a	a	b	c	b	b	d	d	c	c	c	d	c
21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36				
d	d	d	a	b	c	a	c	c	d	a	b	d	c	a	C				

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TOTAL MARKS :

No.	Options	No.	Options	No.	Options	No.	Options
1	A B C D	41	A B C D	81	A B C D	116	A B C D
2	A B C D	42	A B C D	82	A B C D	117	A B C D
3	A B C D	43	A B C D	83	A B C D	118	A B C D
4	A B C D	44	A B C D	84	A B C D	119	A B C D
5	A B C D	45	A B C D	85	A B C D	120	A B C D
6	A B C D	46	A B C D	86	A B C D	121	A B C D
7	A B C D	47	A B C D	87	A B C D	122	A B C D
8	A B C D	48	A B C D	88	A B C D	123	A B C D
9	A B C D	49	A B C D	89	A B C D	124	A B C D
10	A B C D	50	A B C D	90	A B C D	125	A B C D
11	A B C D	51	A B C D	91	A B C D	126	A B C D
12	A B C D	52	A B C D	92	A B C D	127	A B C D
13	A B C D	53	A B C D	93	A B C D	128	A B C D
14	A B C D	54	A B C D	94	A B C D	129	A B C D
15	A B C D	55	A B C D	95	A B C D	130	A B C D
16	A B C D	56	A B C D	96	A B C D	131	A B C D
17	A B C D	57	A B C D	97	A B C D	132	A B C D
18	A B C D	58	A B C D	98	A B C D	133	A B C D
19	A B C D	59	A B C D	99	A B C D	134	A B C D
20	A B C D	60	A B C D	100	A B C D	135	A B C D
21	A B C D	61	A B C D	101	A B C D	136	A B C D
22	A B C D	62	A B C D	102	A B C D	137	A B C D
23	A B C D	63	A B C D	103	A B C D	138	A B C D
24	A B C D	64	A B C D	104	A B C D	139	A B C D
25	A B C D	65	A B C D	105	A B C D	140	A B C D
26	A B C D	66	A B C D	106	A B C D	141	A B C D
27	A B C D	67	A B C D	107	A B C D	142	A B C D
28	A B C D	68	A B C D	108	A B C D	143	A B C D
29	A B C D	69	A B C D	109	A B C D	144	A B C D
30	A B C D	70	A B C D	110	A B C D	145	A B C D
31	A B C D	71	A B C D	111	A B C D	146	A B C D
32	A B C D	72	A B C D	112	A B C D	147	A B C D
33	A B C D	73	A B C D	113	A B C D	148	A B C D
34	A B C D	74	A B C D	114	A B C D	149	A B C D
35	A B C D	75	A B C D	115	A B C D	150	A B C D
36	A B C D	76	A B C D				
37	A B C D	77	A B C D				
38	A B C D	78	A B C D				
39	A B C D	79	A B C D				
40	A B C D	80	A B C D				

Max. Marks	Min. Marks	Right Ans.	Wrong Ans.	Blank Que.	Neg. Marks	Obt. Marks	Sub. Wise P/F