Oligopoly Market and Features

Meaning

The term oligopoly is derived from two Greek words: ‘oligi’ means few and ‘polein’ means to sell. Oligopoly is a market structure in which there are only a few sellers (but more than two) of the homogeneous or differentiated products. So, oligopoly lies in between monopolistic competition and monopoly.

Types of Oligopoly competition

Pure or Perfect Oligopoly:

If the firms produce homogeneous products, then it is called pure or perfect oligopoly. Though, it is rare to find pure oligopoly situation, yet, cement, steel, aluminum and chemicals producing industries approach pure oligopoly.

Imperfect or Differentiated Oligopoly:

If the firms produce differentiated products, then it is called differentiated or imperfect oligopoly. For example, passenger cars, cigarettes or soft drinks. The goods produced by different firms have their own distinguishing characteristics, yet all of them are close substitutes of each other.

Collusive Oligopoly:

If the firms cooperate with each other in determining price or output or both, it is called collusive oligopoly or cooperative oligopoly.

Non-collusive Oligopoly:

If firms in an oligopoly market compete with each other, it is called a non-collusive or non-cooperative oligopoly.

Characteristics of Oligopoly Competition

1. Few firms:

Under oligopoly, there are few large firms. The exact number of firms is not defined. Each firm produces a significant portion of the total output. There exists severe competition among different firms and each firm try to manipulate both prices and volume of production to outsmart each other. For example, the market for automobiles in India is an oligopolist structure as there are only few producers of automobiles.

The number of the firms is so small that an action by any one firm is likely to affect the rival firms. So, every firm keeps a close watch on the activities of rival firms.

2. Interdependence:

Firms under oligopoly are interdependent. Interdependence means that actions of one firm affect the actions of other firms. A firm considers the action and reaction of the rival firms while determining its price and output levels. A change in output or price by one firm evokes reaction from other firms operating in the market.

For example, market for cars in India is dominated by few firms (Maruti, Tata, Hyundai, Ford, Honda, etc.). A change by any one firm (say, Tata) in any of its vehicle (say, Indica) will induce other firms (say, Maruti, Hyundai, etc.) to make changes in their respective vehicles.

3. Non-Price Competition:

Under oligopoly, firms are in a position to influence the prices. However, they try to avoid price competition for the fear of price war. They follow the policy of price rigidity. Price rigidity refers to a situation in which price tends to stay fixed irrespective of changes in demand and supply conditions. Firms use other methods like advertising, better services to customers, etc. to compete with each other.

If a firm tries to reduce the price, the rivals will also react by reducing their prices. However, if it tries to raise the price, other firms might not do so. It will lead to loss of customers for the firm, which intended to raise the price. So, firms prefer non- price competition instead of price competition.

4. Barriers to Entry of Firms:

The main reason for few firms under oligopoly is the barriers, which prevent entry of new firms into the industry. Patents, requirement of large capital, control over crucial raw materials, etc, are some of the reasons, which prevent new firms from entering into industry. Only those firms enter into the industry which is able to cross these barriers. As a result, firms can earn abnormal profits in the long run.

5. Role of Selling Costs:

Due to severe competition ‘and interdependence of the firms, various sales promotion techniques are used to promote sales of the product. Advertisement is in full swing under oligopoly, and many a times advertisement can become a matter of life-and-death. A firm under oligopoly relies more on non-price competition.

Selling costs are more important under oligopoly than under monopolistic competition.

6. Group Behaviour:

Under oligopoly, there is complete interdependence among different firms. So, price and output decisions of a particular firm directly influence the competing firms. Instead of independent price and output strategy, oligopoly firms prefer group decisions that will protect the interest of all the firms. Group Behaviour means that firms tend to behave as if they were a single firm even though individually they retain their independence.

7. Nature of the Product:

The firms under oligopoly may produce homogeneous or differentiated product.

i. If the firms produce a homogeneous product, like cement or steel, the industry is called a pure or perfect oligopoly.

ii. If the firms produce a differentiated product, like automobiles, the industry is called differentiated or imperfect oligopoly.

8. Indeterminate Demand Curve:

Under oligopoly, the exact behaviour pattern of a producer cannot be determined with certainty. So, demand curve faced by an oligopolist is indeterminate (uncertain). As firms are inter-dependent, a firm cannot ignore the reaction of the rival firms. Any change in price by one firm may lead to change in prices by the competing firms. So, demand curve keeps on shifting and it is not definite, rather it is indeterminate.