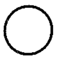
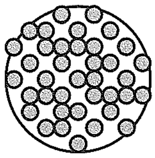
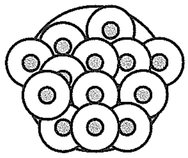
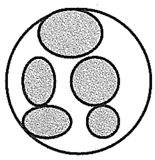
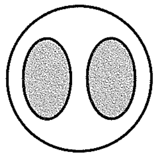
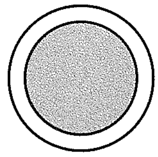
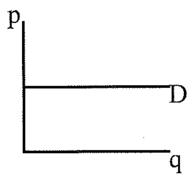
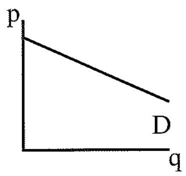
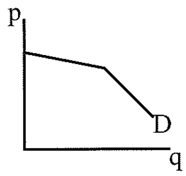
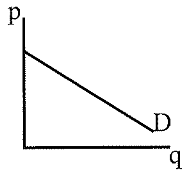
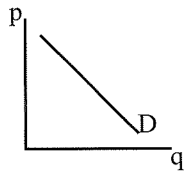
A 11 Market Situations

By the end of this chapter you should be able to investigate the range of market situations. You will be expected to be able to:

- define monopoly, perfect competition, duopoly, oligopoly, monopolistic competition, and monopsony
- identify domestic examples of firms in these market situations
- identify non-price marketing strategies that these firms use
- define product differentiation using domestic examples to explain the importance of this to firms in different market situations.

Market situations

Feature	Perfect Competition	Monopolistic Competition	Oligopoly	Duopoly	Monopoly
 = market  = firm					
Competition	Perfect	Imperfect	Imperfect	Imperfect	Imperfect
Demand curve					
No. of sellers	Many	Many	Few	Two	One
Type of product	Homogeneous	Differentiated	Differentiated	Differentiated	No close substitutes
Barriers to entry	None	Weak	Strong	Strong	Strong

In Chapter 8 we investigated the firm under perfect competition, and in Chapter 10, monopoly. But there is a range of markets that lie between these two extremes. The following are types of imperfect competition:

Monopolistic competition is where there are a large number of firms, selling well-differentiated products. They have a small level of control over price or output, and they face relatively inelastic demand for their produce. The key feature is that they **differentiate** their market through location or type of service provided. Thus the diagram shows that each firm has its own market which it monopolises. Nevertheless, there are few barriers to entry. Examples include shops and other service providers typically seen at a suburban shopping centre.

Oligopoly is where there are only a few large firms that control the market. They produce a differentiated product, and have some control over price. There are strong barriers to entry. *Collusion* exists where existing firms are seen to act together in pricing decisions. It is to their mutual advantage to act together to maintain market share, and to keep further competitors away. Examples include oil companies, chocolate manufacturers, and banks.

Define monopolistic competition.

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Define oligopoly.

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Duopoly is where there are only two sellers in a market. They differentiate their product with heavy advertising and service. There are major barriers to entry, and because these two firms dominate the market, they face inelastic demand. There can be substantial price competition but the firms recognise the danger of price wars developing. Thus non-price marketing strategies are used. Examples include domestic airlines, with Ansett New Zealand and Air New Zealand.

A **monopsony** is the sole buyer in a market, and is the other side to an imperfect market. This can occur in the forestry sector, where in a particular area, a forest product manufacturer may be the sole buyer of logs, or they may be the sole employer in the area.

Marketing strategies
- Price competition
- Non-price competition
  - Product differentiation
  - Product variation

It is only imperfect competitors that use marketing strategies to increase their sales, their market share, and hopefully their profitability.

Any advertising or promotion which involves dropping price to attract custom is called **price competition**, such as under-cutting each other's price with the use of some discounts, sale prices, interest-free offers and "loss leaders". Many firms will be reluctant to get involved in price competition as it may lead to retaliation by competitors and a **price war** developing. There have been price wars in recent times in the following industries; supermarkets, fast foods, domestic airlines and Internet service providers. These can severely upset profits. The firms lose out and the customers gain because of the drop in prices. Thus *many firms favour non-price competition.*

Define duopoly.

Distinguish between monopsony and the other types of market structures already mentioned.

Explain why some firms favour non-price competition over price competition.

Distinguish between price and non-price competition.

Non-price Competition

Non-price competition marketing strategies
- **Product differentiation**
  Getting consumers to buy a good or service by making it appear different and superior to the competition.
  - Location, service, packaging, sponsorship, branding, advertising.
- **Product variation**
  Getting consumers to buy a good or service by giving it real variations to make it different and superior to the competition.
  - Product modification
  - Product variation

Product Differentiation

Location. A firm can compete by choosing a better location than its competitors, increasing its sales and thus market share. A good location could include one that is convenient, classy (snob appeal), close to other shops, and provides good parking. Other businesses choose to locate close to similar types of business, because the area becomes the accepted place to go and buy second-hand cars, takeaways, movie tickets and restaurant meals etc.

Packaging. Firms can compete by making their packaging more attractive than the competition's. Often the consumer benefits because storage and handling are more convenient, but it may mislead the consumer into believing that the product is better than it really is.

Advertising. Producers can use a variety of advertising media eg. TV, radio, print media such as magazines, newspapers, posters etc. Advertising used for non-price competition aims at attracting attention using images that rely on sex appeal, our sense of fair play or fun, or may simply discredit the opposition.

Branding. Branding enables easy recognition of the firm or product in the market place. It includes the use of logos that give a firm its corporate identity. Oil companies encourage brand loyalty with competitions and promotions to get customers to come back, and to keep on buying their brand of petrol.

Service. The firm could offer extra services, such as petrol stations offering to clean windscreens and check oil and water; fast food outlets claiming to provide the fastest service available; or firms that ensure their staff answering the phone are as polite as possible.

Sponsorship. Firms may sponsor a sports team or cultural event in order to be identified with something that appeals to the public, and get media exposure. Major corporate sponsorship has come from BNZ, National Bank, BP, Milo, Steinlager, DB Group etc.

Product Variation

Product modification. Producers attempt to bring in real variations, such as new features to attract customers. Car manufacturers will incorporate the latest features in styling, luxury, economy and safety gear to keep ahead of the competition.

Vertical product variation. To make their product appeal to customers with a wide range of income, producers may introduce a number of different models of the same product. For instance car manufacturers may have: economy, GTI, station wagon, sports model, SGX or whatever, with different engine sizes and go-faster gear and safety features. A new car may be advertised at a range of prices, taking into account the different models and the options selected.

Advantages and Disadvantages of Non-price Competition

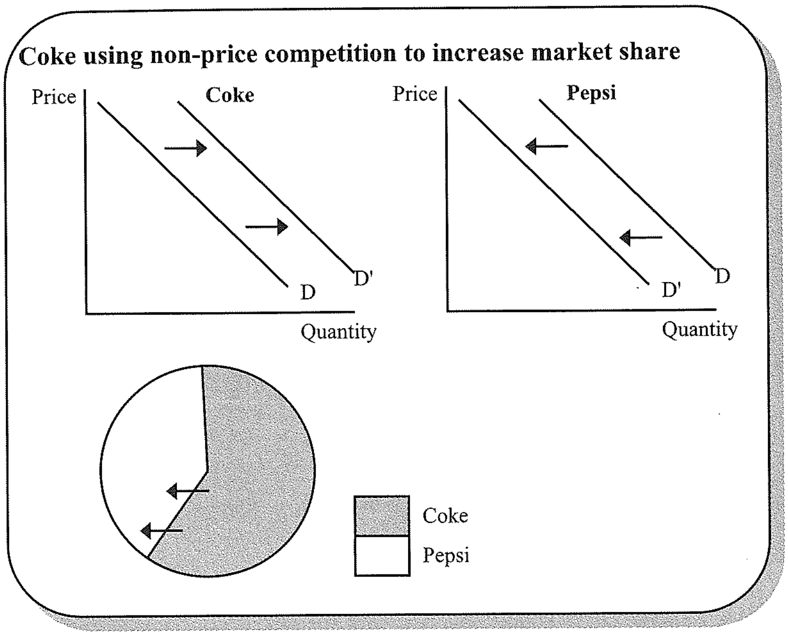
Advantages. Producers will use non-price competition to attempt to shift the demand curve for their product out to the right, and thus increase sales and profits, without the danger of reducing price as in price competition. The firm does not have to cut its margins and profits in order to increase its market share.

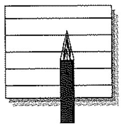
For each of the strategies used in product differentiation list current New Zealand examples.

Distinguish between product differentiation and product variation.

List some current examples of product variation used by car manufacturers.

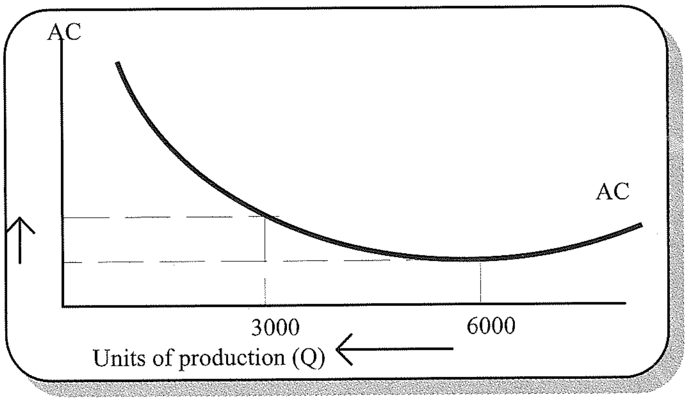
Why do firms use non-price competition?





What is meant by market share?

Disadvantages. Producers will face higher selling costs as a result of advertising etc. This will increase the overall costs of production, and will shift the MC (supply curve) to the left. Also, with an increase in the range of models produced with vertical product variation, fewer of each model are produced. If an ice-cream factory currently capable of producing 6000 litres produces two flavours instead of one, the output of each will be only 3000 litres. There will be an increase in average costs, as shown in the graph below.



What are some disadvantages of non-price competition?

Summary of market structures

Market structures	**Examples**	**Examples of non-price competition**
Monopoly	Tranz Rail	Advertising, branding
Perfect competition	Individual dairy farmer	(Purely price competition)
Duopoly	Air NZ and Qantas	Advertising, branding, sponsorship
Oligopoly	Oil companies	Service, branding, sponsorship
Monopolistic competition	Restaurant	Service