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Define non collusive oligopoly

Let us learn about Non-Collusive and Collusive Oligopoly. Non-Collusive Oligopoly: Sweezy's Kinked Demand Curve Model: One of the important features of oligopoly market is price rigidity. And to explain the price rigidity in this market, conventional demand curve is not used. The idea of using a non-conventional demand curve to represent non-collusive oligopoly (i.e., where sellers compete with their rivals) was best explained by Paul Sweezy in 1939. Sweezy uses kinked demand curve to describe price rigidity in oligopoly market structure. The kink in the demand curve stems from the asymmetric behavioural pattern of sellers. If a seller increases the price of his product, the rival sellers will not follow him so that the first seller loses a considerable amount of sales. In other words, every price increase will go unnoticed by rivals. On the other hand, if one firm reduces the price of its product other firms will follow the first firm so that they must not lose customers. In other words, every price will be matched by an equivalent price cut. As a result, the benefit of price cut by the first firm will be inconsiderable. As a result of this behavioural pattern, the demand curve will be kinked at the ruling market price. Suppose, the prevailing price of an oligopoly product in the market is QE or OP of Fig. 5.19. If one seller increases the price above OP, rival sellers will keep the prices of their products at OP. As a result of high price charged by the firm, buyers will shift to products of other sellers who have kept their prices at the old level. Consequently, sales of the first seller will drop considerably. That is why demand curve in this zone (dE) is relatively elastic. On the other hand, if a seller reduces the price of his product below QE, others will follow him so that demand for their products does not decline. Thus, demand curve in this region (i.e., ED) is relatively inelastic. This behavioural pattern thus explains why prices are inflexible in the oligopoly market — even if demand and costs change. The kink in the demand curve at point E results in a discontinuous MR curve. The MR curve has two segments : At output less than OQ the MR curve (i.e., dA) will correspond to DE portion of AR curve, and, for output larger than OQ, the MR curve (i.e., BMR) will correspond to the demand curve ED. Thus, discontinuity in MR curve occurs between points A and B. In other words, between these two points, MR curve is vertical. Equilibrium is achieved when MC curve passes through the discontinuous portion of the MR curve. Thus the equilibrium output is OQ, to be sold at a price OP. Suppose, costs rise. As a result, MC curve will shift up from MC1 to MC2. The resulting price and output remain unchanged at OP and OQ, respectively. This fact explains stickiness of prices. In other words, in oligopolistic industries price is more stable than costs. At first sight, the model seems to be attractive since it explains the behaviour of firms realistically. But the model has certain limitations. Firstly, it does not explain how the ruling price is determined. It explains that the demand curve has a kink at the ruling price. In this sense, it is not a theory of pricing. Secondly, price rigidity conclusion is not always tenable. Empirical evidence suggests that higher costs force a further price rise above the kink. Despite these limitations, the model is popular among textbook authors. Collusive Oligopoly Model: Price Leadership Model: Non-collusive oligopoly model (Sweezy's model) presented in the earlier section is based on the assumption that oligopoly firms act independently even though firms are interdependent in the market. A vigorous price competition may result in uncertainty. The question that arises now is: how do oligopoly firms remove uncertainty? In fact, firms enter into pricing agreements with each other instead of adopting competition or price war with each other. Such agreement—both explicitly (or formal) and implicit (or informal)—may be called collusion. Always, every firm has the inclination to achieve more strength and power over the rival firms. As a result, in the oligopolist industry, one finds the emergence of a few powerful competitors who cannot be eliminated easily by other powerful firms. Under the circumstance, some of these firms act together or collude with each other to reap maximum advantage. In fact, in oligopolist industry, there is a natural tendency for collusion. The most important forms of collusion are: price leadership cartel and merger and acquisition. When a formal collusive agreement becomes difficult to launch, oligopolists sometimes operate on informal tacit collusive agreements. One of the most common form of informal collusion is price leadership. Price leadership arises when one firm—may be a large as well as dominant firm—initiates price changes while other firms follow. An example of dominant firm price leadership is shown in Fig. 5.20 where DT is the industry demand curve. Since small firms follow the leader—the dominant firm—they behave as "price-takers". MCs is the horizontal summation of the MC curves of all small firms. Suppose, the dominant firm sets the price at OP1 (where DT and MCs intersect each other at point C). The small firms meet the entire demand P1C at the price OP1. Thus, the dominant firm has nothing to sell in the market. At a price of OP3, the small firm will supply nothing. It is obvious that price will be set in between OP1 and OP3 by the leader. The demand curve faced by the leader firm of the oligopoly industry is determined for any price—it is the horizontal distance between industry demand curve, DT, and the marginal cost curves of all small firms, MCS. In Fig. 5.20, DL is the leader's demand curve and the corresponding MR curve is MRL. Being a leader in the industry, the dominant firm's supply curve is represented by the MCL curve. Since it enjoys a cost advantage, its MC curve lies below the MCS curve. A dominant firm maximizes profit at point E where its MCL and MRL intersect each other. The corresponding output of the price leader is OQL. Price thus determined is OP2. Small firms accept this price OP2 and sell QLQT (=AB) amount – industry demand the OQT output. In actual practice, the analysis of price leadership is complicated, particularly when new firms enter the industry and try to become the leader or dominant. Collusive Oligopoly—Merger and Acquisition: Another method to remove price war among oligopoly firms is merger. Merger may be defined as the consolidation of two or more independent firms under single ownership. When a firm purchases assets of another firm, acquisition takes place. Merger and acquisition take place because the management comes to a conclusion that a consolidated firm is powerful than the sum of individual firms. Since basically the difference between cartel and merger is a legal one, we won't consider mergers and acquisitions. The marginalistic principle applied in the case of profit maximizing cartel is also applicable in the case of merger. Conclusion: Can we make some definite conclusions from the oligopolistic market structure? Though one can make unambiguous predictions about perfect competition as well as monopoly, no such predictive element of an oligopolistic competition exists. It is, thus, a perplexing market structure. One important characteristic of an oligopoly market is interdependence among sellers. Each seller's price-output decision is influenced by the perceptions of countermoves of rival sellers. Given the large number of possible reactions, we come up with different models based on different assumptions about the behaviour of the rival sellers, the extent and form of exit and entry, the likelihood of collusion between firms. 'Unfortunately, economic theory does not suggest which assumptions to use. In any event, each of these theories must ultimately stand or fall on its predictive powers'. The literal meaning of the word 'oligopoly' is 'competition among few'. Collusive Oligopoly is when the oligopolists come in formal or informal agreement with one another to avoid competition among themselves. On the other hand, in a non-collusive oligopoly, the firms tend to compete with each other, by setting their own price and output policy, which is independent of the other firms. Oligopoly is a type of market characterised by a few firms offering either homogeneous product or differentiated product for sale in the market. For example Telecom service providers. When the firms sell homogeneous products, they are called pure oligopolies, such as cement, steel, aluminium, etc., whereas if the firms are selling differentiated products, it is called impure or differentiated oligopoly, such as cold drinks, automobiles, etc. This post is all about the difference between collusive and non-collusive oligopoly. Content: Collusive Oligopoly Vs Non-Collusive Oligopoly Comparison Chart Basis for ComparisonCollusive OligopolyNon-Collusive Oligopoly MeaningA Collusive Oligopoly is one in which the firms cooperate and not compete, with one another with respect to price and output.A Non-Collusive Oligopoly is one wherein each firm in the industry pursues a price and output policy that is independent of competitors. ProfitCollective profitIndividual profit ObjectiveTo reduce competition and to create and maintain entry barriers.To maintain competition and to work independently as a normal business. Price and Output decisionMutual or InterdependentIndependent Formation of monopolyYesNo Price benefitConsumers receive fewer price benefits, due to monopoly.Consumers receive price benefits due to competition between sellers. Brand LoyaltyNo need to incur expenses to create brand loyalty.Powerful advertisement creates brand loyalty. Definition of Collusive Oligopoly Collusive Oligopoly refers to a form of oligopoly in which the competing firms collude so as to minimize competition and maximize joint profit by reducing the uncertainties arising due to rivalry and selling the goods and service at a monopoly price. In this, the oligopolists enter into a contract to establish the levels of price and output, in the market. It can be found in the industries where the products sold by the firms are homogeneous. In this type of oligopoly firms know that if they increase or decrease their prices, there will be a shift in the demand curve, as the products offered by all the firm are homogeneous. And so, the customers can make purchase indifferently from any firm. Hence, it may lead to a huge loss of profit to a price war. Hence, by deciding not to compete with each one another, they can set up a monopoly price to be charged and an agreement to be reached on the output produced by each firm. By doing this, oligopolists can achieve the maximization of joint profit, i.e. by working as a single firm. Collusion can be of two types: Cartels: Producer firms enter into a formal agreement that states the price and output, of each firm that are members of the cartel. So, in a cartel firms jointly fix the price and output policy by way of agreements. For Example OPEC Price Leadership: There is an implicit understanding between the oligopolists to coordinate prices, wherein the dominant firm initiates the price changes and all the other firms follow, or match the change in price. It can be used to prevent uncertainty causing due to interdependence, prevent price wars, avoid competition, increase prices and also increase profit margins. It can be an open agreement or a tacit (Secret) one. In most nations, an open agreement concerning the formation of a monopoly is considered illegal, and that is why the firms often go for tacit agreement. Also Read: Difference Between Monopoly and Oligopoly Definition of Non-Collusive Oligopoly Non-collusive Oligopoly is the oldest theory of competition. It refers to the oligopoly in which firms are in competition with each other. In a non-collusive or non-cooperative oligopoly, the firms survive in a strategic environment, as they begin with a particular strategy without colluding with competitors. So, in a non-collusive oligopoly: Firms are independent of each other. There are a large number of firms. Barriers to entry are very less. It has strict government regulations. Each firm develops an expectation as to what the rivals firms are about to do. Therefore, the firms have to consider the possible actions of competitors and how to react. So, a non-collusive oligopoly is characterised by price inflexibility. Each firm in a non-collusive oligopoly attempts to increase its market share by way of competition. Hence, the firms prefer competition over collusion, as a way of profit maximization. Also Read: Difference Between Perfect Competition and Monopolistic Competition As we have understood the meaning and concept, let us now take a look at the difference between collusive and non-collusive oligopoly: Collusive Oligopoly can be defined as the form of oligopoly wherein the sellers eliminate competition by way of a formal or informal agreement. As against, a non-collusive oligopoly is one in which each firm sets its own price and level of output and compete in the market. In a collusive oligopoly, firms act as a single monopoly and intend to increase their collective profit, instead of individual profit. As against, in a non-collusive oligopoly, the firms intend to increase their own profit and determine the volume of output to be produced, in an assumption that competing firms would not change the quantity supplied by them. Firms operating under oligopolistic competition often enter into a collusive agreement to avoid uncertainty causing due to interdependence, to avoid price wars and cut-throat competition. On the other hand, the aim of a non-collusive oligopoly is to maintain competition and to work independently as a normal business. The price an output decision under collusive oligopoly is mutual and interdependent, whereas, in the case of non-collusive oligopoly, the price and output decision is independent of other firms. In a collusive oligopoly, firms agree to set prices and output jointly, so they act as a single firm, which leads to the formation of a monopoly. But, in a non-collusive oligopoly, as no firms collude with one another and a sense of competition exists among them, monopoly does not form. As collusive oligopoly leads to the creation of a monopoly, consumers receive less benefit, as the products are offered for sale to the consumers at the same price by all the sellers. Unlike, in a non-collusive oligopoly, monopoly does not exist, which results in competition among the seller firms and so, the consumers get price benefits. In a collusive oligopoly, no need to incur expenses to create brand loyalty. On the other hand, in a non-collusive oligopoly aggressive advertisement creates brand loyalty. Oligopolistic Models Collusive Models Cartels: Initially, the word 'cartel' is used for those agreements wherein a common sales agency exists which carries out the selling activities of all the member firms. However, at present, all the formal, informal and tacit agreements that took place between oligopolists are termed cartels. As they tend to reduce competition, these are considered illegal in many countries. Price Leadership: In a price leadership model, one dominant firm fixes the price of the goods while the rest of the rivals follow it. Low-Cost Price Leader: To maximize the profit, a low-cost firm sets a price lower than the profit-maximizing price of the high-cost firm so that high-cost firm will be forced to lower down their price. Market Dominant Price Leader: As per this model, there is one of the few firms in the industry, producing a substantially large volume of the total output of industry and so they dominate the market. The firm forecast its demand and sets the price accordingly which increases its profit. Barometric Price Leader: In this model, the oldest, largest, most experienced and respected firm acts as custodian to other firms, which safeguards the interests of all the firms. The firm analyses the market condition, as to various factors like demand, cost of production, competition, etc., and decides a price, which is the best possible price, from the point of view of all the firms in the industry. Exploitative or Aggressive Price Leadership: Under this, one dominant firm marks its leadership by pursuing aggressive pricing policies and thus forces other firms existing in the industry to follow the same price regime. Non-Collusive Models Cournot Model: This model describes a structure in the industry wherein competitors offer the homogenous product. They compete on the amount of output produced, independently and concurrently. Bertrand Model: It is an economic model, wherein few firms produce homogeneous goods and sell them to many customers. Identical products are produced at a constant marginal cost. Each firm in the industry considers the price of competitors as fixed, at the time of determining the price to be charged. So the prices are set up independently. Edgeworth Model: In this model, the firms sell homogeneous product and they have the same cost function with zero marginal cost. It is assumed that no duopolist can produce the output, which is as large in size as the competitive market. Stackelberg Model: In this model, one firm is a market leader while others are followers. the firms offer homogeneous products and they compete on the basis of output. Further, the output is chosen by the firms sequentially. The leader firm establishes quantity prior to any other firm. It is suitable when a large firm dominates the entire industry. Sweezy Model: Also known as the kinked demand model. As per this model, there are only a few firms in the market that sells differentiated products to consumers. There are barriers to the entry of new firms. It is believed that the firms will follow price reduction, but won't follow price hike. Conclusion In a non-collusive oligopoly, the firms operating in the industry are rivals, due to their interdependence. In contrast, in a collusive oligopoly, the competing firms come together to remove the uncertainly causing out of inherent rivalry among the firms.

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