Characteristics of an Oligopoly

Introduction

The defining characteristic of an oligopoly is the recognition that the actions of one firm will produce a response from rivals and that these responses will affect the firm. Each firm is uncertain what its rivals’ responses might be. Oligopolies make both standardized and differentiated products. While reading this section, consider the key takeaways to note in your Learning Journal.

**Oligopoly: Competition Among the Few**

In July, 2005, General Motors Corporation (GMC) offered “employee discount pricing” to virtually all GMC customers, not just employees and their relatives. This new marketing strategy introduced by GMC obviously affected Ford, Chrysler, Toyota, and other automobile and truck manufacturers; Ford matched GMC’s employee-discount plan by offering up to $1,000 to its own employees who convinced friends to purchase its cars and trucks. Ford also offered its customers the same prices paid by its employees. By mid-July, Chrysler indicated that it was looking at many alternatives, but was waiting for GMC to make its next move. Ultimately, Chrysler also offered employee discount pricing.

Toyota had to respond. It quickly developed a new marketing strategy of its own, which included lowering the prices of its cars and offering new financing terms. The responses of Ford, Chrysler, and Toyota to GMC’s pricing strategy obviously affected the outcome of that strategy. Similarly, a decision by Procter & Gamble to lower the price of Crest toothpaste may elicit a response from Colgate-Palmolive, and that response will affect the sales of Crest. In an oligopoly, the market is dominated by a few firms, each of which recognizes that its own actions will produce a response from its rivals and that those responses will, in turn, have an affect.

The firms that dominate an oligopoly recognize that they are interdependent: What one firm does affects each of the others. This interdependence stands in sharp contrast to the models of perfect competition and monopolistic competition, where we assume that each firm is so small that it assumes the rest of the market will, in effect, ignore what it does. A perfectly competitive firm responds to the market, not to the actions of any other firm. A monopolistically competitive firm responds to its own demand, not to the actions of specific rivals. These presumptions greatly simplify the analysis of perfect competition and monopolistic competition. We do not have that luxury in oligopoly, where the interdependence of firms is the defining characteristic of the market.

Some oligopoly industries make standardized products: steel, aluminum, wire, and industrial tools. Others make differentiated products: cigarettes, automobiles, computers, ready-to-eat breakfast cereal, and soft drinks.

Learning Journal

While reading this section, note in your Learning Journal how oligopolies differ from perfectly competitive and monopolistically competitive firms.

Discussion Board

Some examples of oligopolies are cable/Internet/phone providers, automobile manufacturers, soft drink manufacturers, and commercial aircraft manufacturers. What other examples of oligopoly can you think of? Share and explain your reasoning in the Discussion Board.

 Note. Adapted from “Oligopoly: Competition Among the Few,” by Rittenberg, L., 2012, Principles of Microeconomics, Chapter 11, Section 2. Copyright 2012 Flat World Knowledge, Inc.