**Oligopoly**

Oligopoly is a market structure in which a small number of firms (usually between 2 to 10) hold the large majority of market share.

**Characteristics:**

1. Several large firms: Oligopolies generally consist of a few large firms, and this is what sets them apart from other market structures.
2. High concentration ratio: Oligopoly market structures are composed of a few large firms that dominate the industry. Concentration ratio is the market share of the leading firms.
3. Each firm tends to sell branded or differentiated products
4. Barriers to entry: There are high barriers to entry into an oligopoly.
5. Firms often engage in intensive non-price competition (e.g. advertising, economies of scale) and also may engage in periodic aggressive price wars.

Examples of Oligopoly

An example of an oligopoly is the wireless service industry in Canada, in which three companies – Rogers Communications Inc (RCI), BCE Inc (BCE) subsidiary Bell and Telus Corp (TU) – control approximately 90% of the market. Canadians are conscious of this oligopolistic market structure and often lump the three together as "Robelus," as though they were indistinguishable. In fact, they are often indistinguishable in price: in early 2014 all three companies raised the price for smartphone plans to $80 in most markets, more or less in tandem.

PepsiCo and Coca Cola Co. are the two market leader and sellers of soft drinks around the world. Thus two numbers of firms selling to large number of buyers makes it an Oligopoly market. Furthermore these companies are always making heavy investments on advertisements around the globe. Some of the advertisements may be meant to harm the brand image of other. They also use advertisements to create barriers to entry for other firms.

**Collusion**

Firms in oligopoly market structure all aim to maximize profits (i.e. produce at MR = MC). Since there are only a few firms in the industry, firms often engage in competition with each other to capture their rival’s market share. Firms may engage in price competition (where firms compete to lower prices till the other surrenders and exits the market) or they may engage in non-price competition (such as use aggressive advertising to undermine the other brand). However, engaging in competition is harmful for both firms as it leads to periodic fall in revenue or rise in costs. Instead firms may engage in collusion. This means firms jointly fix prices to achieve profit maximization. Price fixing represents an attempt by suppliers to control supply and fix price at a chosen level. Price fixing is deemed illegal by US, UK and European competition law. Hence, cartels are usually formed in secret.

Organization of Petroleum Exporting Countries (OPEC) including countries like Iran, Iraq, Kuwait, Saudi Arabia and Venezuela is an intergovernmental organization that engaged in open price fixing. However, due to international pressures and Middle East wars, OPEC’s ability to control prices has been greatly reduced.

**Concentration Ratio:**

Concentration ratio is calculated as a sum of the market share percentage held by the largest specified number of firms in an industry. Concentration ratio may be between 0 to 100 percent. Medium concentration occurs when an industry’s ratio is between 50 to 80 percent. High concentration occurs when the concentration ratio ranges from 80 to 100 percent. This means the industry is an oligopoly. If concentration ratio is exactly 100%, that means the industry is a monopoly.

Example:

Assume that ABC Inc., XYZ Corp., GHI Inc. and JKL Corp. are the four largest companies in the biotechnology industry, and an economist aims to calculate the degree of competition.

Their respective market shares for the recent fiscal year are given below:

|  |  |
| --- | --- |
| **Firm** | **Market Share** |
| ABC Inc. | 10 |
| XYZ Corp. | 15 |
| GHI Inc. | 26 |
| JKL Corp. | 33 |
| Other firms | 16 |

1. What is the two-firm concentration ratio, i.e. what is the concentration ratio of the top 2 firms?

Ans: 59 percent

1. What is the four-firm concentration ratio?

Ans: 84 percent

Hence, the market is an oligopoly.