Managing Financial Resources

Business economics

Oligopoly (18)

Patrick Galig / HB41 / Henley Business School

Oligopoly

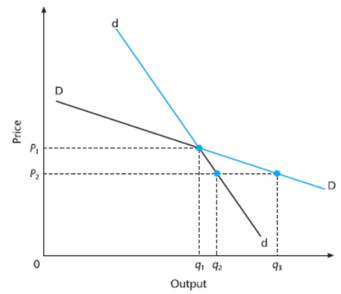
- Small number of suppliers and entry or exit of the market is restricted
  - Few suppliers and many buyers
  - Homogeneous or diffentiated products
  - Barriers for market entry
  - Mutual interdependance between firms in the industry
  - Enough power to be not a price taker, but market rule companies out with too high prices
- strategy based on "reaction of rivals"
  - Oligopolist considers firms own costs and demand as well as competitive reactions
- Product differentiation
  - 
    Physical differences
  - 
    Differences in consumer perception
- Entry limit pricing
  - set price as low as possible so that possible entrant can't enter the market due to too high costs --> cost(entrant) > cost(existing company)
  - Entry deterrent strategy
- Price leadership
  - Dominant firm price leadership
    - where one company has a competitive advantage (cost, product etc)
  - Barometric price leadership
    - company which measures demand etc. and sets price and others follow (not necessary a dominant firm)
  - Collusive price leaderhsip
    - collusion of price between companies
      - Explicit collusion
        - cartel or restrictive practice
      - Tacit collusion
        - take actions that minimise competitive response (avoid price attack etc.)
  - Strategies
    - Tit-for-tat (Wie du mir so ich dir)
      - cooperating/cheating if other company cooperated/cheated in previous period
    - Trigger strategy
      - if cooperation breaks down and cheating occurs --> company adopts its NASH equilibrium strategy permanently
      - Cheat

Firm A \ Firm B	Cheat	Co-operate
Cheat	(1) A = 0 B = 0	(2) A = 6.0 B = –2.0
Co-operate	(3) A = –2.0 B = 6.0	(4) A = 3.0 B = 3.0

      - Co-operate

Firm A \ Firm B	Cheat	Co-operate
Cheat	(1) A = –1.0 B = –1.0	(2) A = 3.0 B = 0
Co-operate	(3) A = 0 B = 3.0	(4) A = 4.0 B = 4.0

- The kinked demand curve



  - Optimistic scenario
    - movement up dd lead to price increase, and down demand curve DD when price is reduced
  - Pessimistic scenario
    - Movement up DD leads to price rise, down dd when price is reduced
  - **Price elasticity of DD is bigger than dd --> if company a changes price and company b too --> than dd up = small quantity change, if company a increase price and company b not --> than DD up = large quantity change (less demand)**
- Game theory
  - A game occurs when there are two or more interacting decision takers (players) and each decision or combination of decisions involves a particular outcome (pay-off)

Dick

Harry \ Dick	Deny	Confess
Deny	(1) Dick: 3 years Harry: 3 years	(2) Dick: 2 years Harry: 8 years
Confess	(3) Dick: 8 years Harry: 2 years	(4) Dick: 4 years Harry: 4 years

  - Strategies
    - choose strategy with the least bad outcome
      - Maximin strategy
    - Choose the best possible outcome
      - Maximax
    - minimizing the possible loss while maximizing the potential gain.
      - Minimax
  - Equilibriums
    - 2 firms are not talking to each other
      - A non-cooperation equilibrium
    - Nash Equilibrium
      - solution concept of a game involving two or more players, in which **each player is assumed to know the equilibrium strategies of the other** players, and no player has anything to gain by changing only his or her own strategy unilaterally --> e.g. both produce the same quantity and therefore achieve the best price
      - Dominant strategy equilibrium