Perfect competition

In this market structure, although there would be a large number of competing firms, the individual firm has little scope for competitive behaviour. This is because the products are all of the same quality, the firm has no power to alter the price it could charge and there are no barriers to entry. The firm is a **price taker** and its revenue depends on the output it chooses. The only way that firms will end up with different profits is if some of them have lower production costs than others. If any firms do make abnormal profit, it will only be temporary because in the long run new firms will be attracted into the industry and the abnormal profit will be competed away. From this description it is unlikely that there will be any markets that match this description. The nearest economic activity might be parts of the agricultural industry where large numbers of small producers supply a homogeneous product, such as milk or grain.

Monopolistic competition

The main feature which distinguishes this market structure from a perfect market is product differentiation. Each of the suppliers also has a degree of control over the price that is charged. Firms can therefore indulge in both price and **non-price competition**. The large number of substitute products makes this a very competitive market structure. Firms will only be successful in making abnormal profit in the short run because there are no or few barriers to entry. However a successful advertising policy to promote the brand, combined with product innovation, could shift the firm's demand curve to the right and at the same time reduce its price elasticity of demand if consumers no longer see rivals' products as close substitutes. The market power of firms is constrained by the ease of entry and the behaviour of rival firms. This is a very relevant type of market structure and includes hairdressers' shops, video rental outlets and driving schools.

Oligopoly

When an industry is dominated by a handful of big firms, action taken by one will have a big impact on the others. It becomes risky for a firm to alter its price because the reaction of the others is uncertain. Firms in this market structure may prefer to use non-price competition, such as product innovation, advertising and brand proliferation. The risks associated with competitive behaviour may become so great that firms are tempted to collude or settle for a quiet life; hence the relevance of the satisficing objective. There may be takeover and merger activity, which can take the market towards duopoly or monopoly. The difficulty of getting extra sales may lead to firms diversifying in order to grow in a different direction. In the real world, firms' behaviour in oligopoly is difficult to predict. Some oligopolies are highly competitive even though there are not many rivals. The example often quoted is the intense rivalry between Pepsi and Coca Cola. On the other hand, the giant petrol companies and breweries have in the past been accused of **collusion** and following the price leadership of a main player.

Monopoly

There are few situations where one firm has nearly all of the industry sales. The definition of monopoly used by the Competition Commission is where the dominant firm has more than 25 per cent of the market. This figure is deliberately set low to allow any potential monopoly situation to be investigated in the public interest. Sales concentration ratios show that a large number of firms operate in industries close to a monopoly structure. The reason for this is mainly to be found in barriers to entry. Monopolists have the power to raise prices and make abnormal profits at the expense of the consumer in both the short run and the long run, but monopoly does have some positive benefits. Some monopolies such as passenger train operating companies are a consequence of government action; others are not. Other monopolies have been created through a patent, for example cats' eyes and the Dyson vacuum cleaner.

Finally, table 3.1 summarises the characteristics of competitive markets in terms of their relevant economic characteristics.