3.1.4.4 Monopoly and monopoly power

- A **pure monopoly** is the sole seller in a market.
- In the UK, when one firm dominates the market with more than 25% market share, the firm has **monopoly power**. For example, Google dominates the search engine market, with 90% share.
- Monopoly power can be gained when there are multiple suppliers. If two large firms in an oligopoly (several large sellers) have greater than 25% market share, they are said to have monopoly power. For example, Sainsbury's and Asda have more than 25% market share combined, so they are said to have monopoly power.

- There are very few examples of pure monopolies, but several firms have monopoly power.

- Monopoly power is influenced by factors such as:

  - **Barriers to entry:** The higher the barriers to entry, the easier it is for firms to maintain monopoly power. Examples of barriers to entry which can maintain monopoly power are:
    - **Economies of scale:** As firms grow larger, the average cost of production falls because of economies of scale. This means existing large firms have a cost advantage over new entrants to the market, which maintains their monopoly power. It deters new firms from entering the market, because they are not able to compete with existing firms.
    - **Limit pricing:** This involves the existing firm setting the price of their good below the production costs of new entrants, to make sure new firms cannot enter profitably.
    - **Owning a resource:** Early entrants to a market can establish their monopoly power by gaining control of a resource. For example, BT owns the network of cables so new firms would find it very difficult to enter the market.
    - **Sunk costs:** If unrecoverable costs, such as advertising, are high in an industry, then new firms will be deterred from entering the market, because if they are unable to compete, they do not get the value of the costs back.
    - **Brand loyalty:** If consumers are very loyal to a brand, which can be increased with **advertising**, it is difficult for new firms to gain market share.

        - **Set-up costs:** If it is expensive to establish the firm, then new firms will be unlikely to enter the market.
    - **The number of competitors:** The fewer the number of firms, the lower the barriers to entry, and the harder it is to gain a large market share.
    - **Advertising:** Advertising can increase consumer loyalty, making demand price inelastic, and creating a barrier to entry.
    - **The degree of product differentiation:** The more the product can be differentiated, through quality, pricing and branding, the easier it is to gain market share. This is because the more unique the product seems, the fewer competitors the firm faces.

Concentration ratios:

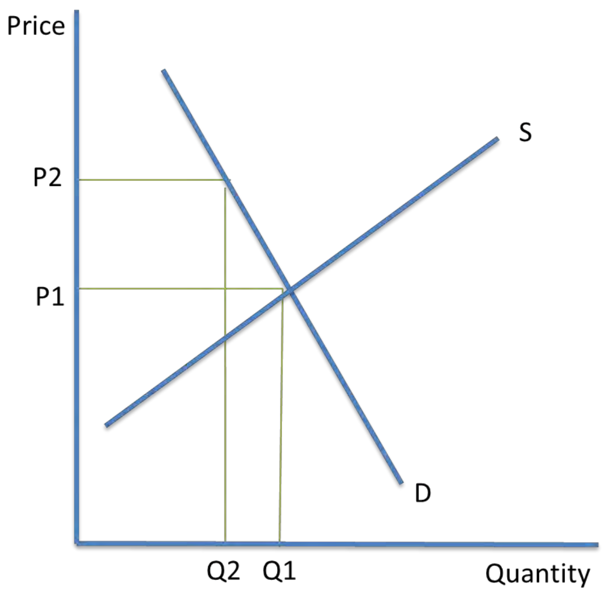
- The concentration ratio of a market is the combined market share of the top few firms in a market.
- For example, the market share for each of the top supermarkets in the UK is shown in the table below:

Supermarket	Market share (12 weeks to 29 March 2015)
Tesco	28.4%
Asda	17.1%
Sainsbury's	16.4%
Morrisons	10.9%
The Co-operative	6.0%
Aldi	5.3%
Waitrose	5.1%
Lidl	3.7%
Iceland	2.1%
	Data adapted from BBC News http://www.bbc.co.uk/news/business-32218170

- If the 4 firm concentration ratio was calculated, the market share of the 4 largest firms would be added together: 28.4% + 17.1% + 16.4% + 10.9% = 72.8%.
- The 2 firm concentration ratio is the market share of the 2 largest firms added together: 28.4% + 17.1% = 45.5%.

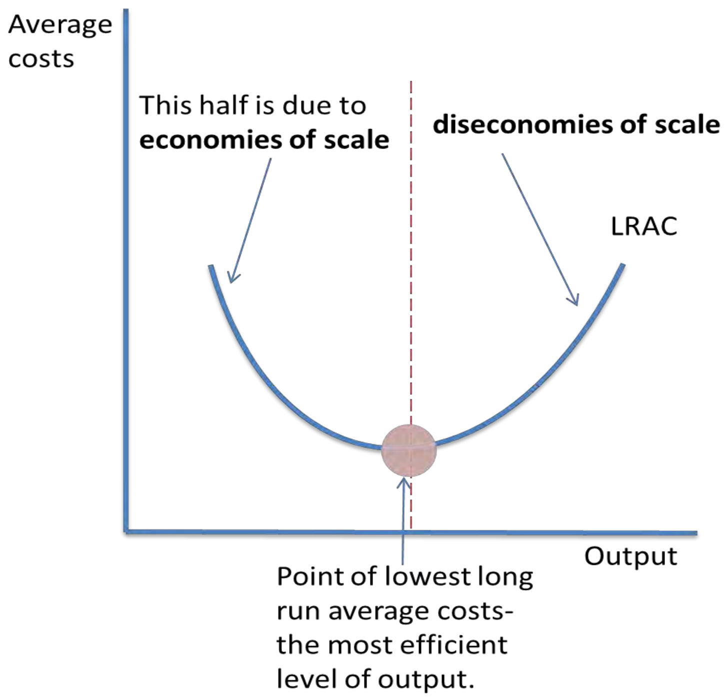
Drawbacks of monopoly power:

- The basic model of monopoly suggests that higher prices and profits and inefficiency may result in a misallocation of resources compared to the outcome in a competitive market.
- Monopolies could exploit the consumer by charging them higher prices.
- This means the good is under-consumed, so consumer needs and wants are not fully met.
- This loss of allocative efficiency is a form of market failure.
- Monopolies have no incentive to become more efficient, because they have few or no competitors, so production costs are high.
- There is a loss of consumer surplus and a gain of producer surplus.
- If a monopolist raises the market price above the competitive equilibrium level, output will fall from Q1 to Q2.
- This leads to gains in producer surplus.



Benefits of a monopoly:

- Since monopolies are large, they can exploit economies of scale, so they have lower average costs of production. The long run average cost curve can be used to show this:



- Monopolies make huge profits, so they may invest more in research and development. This can yield positive externalities, and make the monopoly more dynamically efficient in the long run. There could be more invention and innovation.