

2. Distinguish between oligopolistic competition and monopolistic competition and discuss which of these two market structures best explains the market behaviour of retailers in Singapore. [25]

Suggested Answer:

Comparing key characteristics using examples of various retailers in Singapore

In the monopolistic competitive (MC) market, there is a large number of small firms, each controlling a small market share. In Singapore, such examples include hairdressing, wearing apparels and footwear, food and beverages. The products they offer are differentiated in terms of range of goods and services provided e.g. neighbourhood salons offering basic haircuts at budget prices while hairdressing prices at 'branded' salons such as Kimage and Jean Yip are more expensive (varies with the experience of the hairstylist). It is this characteristic that conferred some market power to each firm. Each firm has some control of the local market, and is a price setter i.e. possesses the ability to set independent price and output (OP3, OQ3) to maximise profit where $MC=MR$. The high number of firms is due to the low barriers to entry which allow entrants. There are low barriers to entry in these retail markets. Start-up cost is likely to be lower for small shops in MC market structure as compared to larger firms in the OC market structure. For smaller shops, rental and labour costs, and cost of goods are also likely to be lower. Eg. The start-up cost of a hair salon is likely to be lower than that of a telecommunications firm which incurs a huge cost of laying cables. On the whole, the MC market structure describes such small retailers to a large extent as many of the characteristics of MC are observed.

In contrast, an oligopolistic (OC) industry has a few dominant firms, each controlling a large market share. Each firm has considerable market power due to its large size and small number of competitors. Mutually interdependence occurs where a firm behavior is affected by that of its rivals. In Singapore, the market behaviour of a number of large retailers such as supermarkets selling general merchandise, petrol service stations and telecommunication apparatus markets are best described by the oligopolistic market structure. For example, in Singapore, the supermarket industry is dominated by three large supermarkets selling general merchandise (i.e. NTUC FairPrice, Dairy Farm [Cold Storage, Shop N Save, Giant] and Sheng Siong; these supermarkets are large in terms of market share, revenue, profits and strength of staff. There are also only three large firms that dominate telecommunication services market in Singapore - StarHub, SingTel and M1. Each of these retailers possesses a significant market share. In terms of product differentiation, a supermarket such as FairPrice sells products under its own house brand as a form of product differentiation. For telecommunication services, they sell different types/bundles of mobile and internet subscription plans. Unlike MC industries, there are **high barriers to entry** (BTE) in these industries limiting the number of retailers in these industries. Economies of scale are a significant BTE in supermarket. E.g. Large supermarkets are able to gain economies of scale through centralized administration and bulk purchase. This allows the supermarket selling a large output to charge low prices which become a formidable BTE to the supermarket industry in SG.

Difficulty of securing a licence, large capital outlay and substantial cost savings enjoyed by large firms (economies of scale) can strongly deter potential firms from entering a particular market. The government offers limited licenses to provide telecommunications services in Singapore. There is also large start-up capital in terms of the costs incurred to lay the cable network. These constraints are formidable BTEs to the telecommunications services industry in SG.

Comparing pricing decisions using examples of various retailers in Singapore

The MC firm has a downward sloping, relatively price elastic demand curve since the product has many good substitutes in the market. Consequently, when the MC firm tries to increase the price of its product, its quantity falls by a greater proportion. Each firm has some, though limited, market power due to its small size and large number of competitors. Hence, while the firm is a price setter, it possesses limited ability to raise prices. It is more able to reduce price. MC firms are not mutually interdependent as each of them has too small a market share and the actions of each of them are unlikely to have much impact

on one another. Unlike most Oligopoly firms, MC firms can compete in terms of lowering prices (i.e. offering discounts) as the PED of their products is high due to the availability of many substitutes.

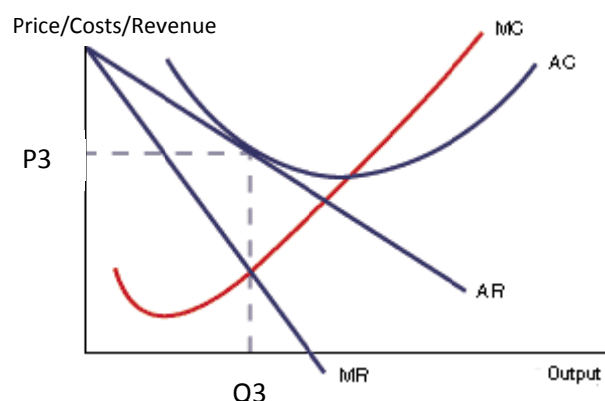


Figure 1: Demand curve of a MC firm

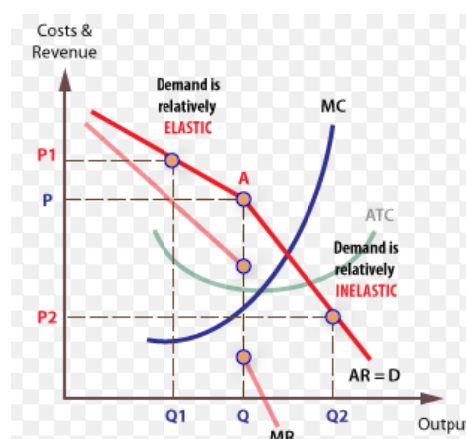


Figure 2 : Kinked demand curve of OC

In contrast, an oligopolistic (OC) industry the few dominant firms are mutually interdependent, where rivals will match each other price reductions but not price increase. This leads to price stability/price rigidity where the demand curve is kinked at the existing market price. as in figure 2. The upper portion of AR (DD) curve is relatively price elastic as rival firms are unlikely to match price increases. An increase in price from OP to OP1 causes a more than proportionate fall in quantity demanded as the oligopolist is likely lose a large number of consumers, Q to Q1 to its rivals. The lower portion of the AR (DD) curve is relatively price elastic - rivals are likely to follow price cuts so as not to lose customers to the firm that has lowered its price from OP to OP2. The cut in price will brings about a less than proportionate increase in quantity demanded from Q to Q2. As a result, **prices tend to stay rigid** at P for the oligopoly, even if costs conditions change (within the disjointed portion of MR).

Supermarkets and telecommunication shops in Singapore have demonstrated that they follow closely their rivals' price cuts and non-price strategies to gain a larger market share. For example, in Singapore supermarkets follow each other in making weekly offers on items, non-price promotions such as "Purchase with purchase" and free gifts. When M1 came up with attractive discounts to bundled mobile subscription plans, M1 and Singtel also included that in their price plans for their mobile phones. Prices of telco plans are also rather similar.

Like a MC firm, a profit-maximising OC firm produces where marginal cost = marginal revenue ($MC=MR$). If the firm produces where $MC < MR$, then producing one more unit of output adds more to revenue than to cost increasing total profit. As long as MR exceeds MC, profits can be increased by increasing production. Likewise, as long as MC exceeds MR, profits can be increased by decreasing production. Thus, profit is maximized when the firm produces an output where $MC = MR$ provided MC cuts MR from below.

Comparing profit levels in long-run equilibrium

The two market structures also differ in terms of the types of profits the firms could earn in the long run.

In an **oligopoly**, there are **substantial barriers to entry** such as higher set-up costs, difficulty of obtaining license etc, unique product knowledge or amount of R&D taken by established firms. → **oligopolists** can continue to **earn supernormal profits** in the **long run**.

However, for MC industry, low BTE → supernormal profits competed away in the LR → firms can only earn normal profits in the LR.

Comparing non-price competition using examples of various retailers in Singapore

The MC firm tends to indulge in non-price competition such as advertising and product promotion to keep its market share.

Like the MC firm, the OC firm also focuses on non-price competition. However, its non-price competition activities such as advertising is of a larger scale and its R&D activities are likely to make real changes to the products resulting in a highly differentiated products

Hence, these several characteristics of oligopolies and MC distinguish the two market structures and examples of these two types of market structures can be found in Singapore, although there are some limitations in identifying the market structure that best explains their market behaviour.

Development 2: A monopoly also describes the market behaviour of some retailers in Singapore: Singapore Power

Also, in retail trade, there exists other market structure such as Singapore Power, a utilities firm that is the sole distributor of electricity in Singapore, a monopoly. The firm enjoys very large market power as electricity is a necessity and there are no other substitutes. The barriers to entry in the distribution of electricity are also very large, with need for a license from the government and also the need to own the power grid of an entire country.

Conclusion: Reasoned conclusion

Address the direction word 'best' by explaining which market structure if either, is more appropriate to retailing in Singapore.

Knowledge, Application, Understanding and Analysis		
L3	For an answer that uses appropriate analysis to explain the differences in retailers & their market structures and which market structure if either, is more appropriate to retailing in Singapore. The answers refers to both monopolistic competition and oligopolistic competition	15-21
L2	For an answer that describes the differences in retailers & their market structures, referring to <u>both</u> monopolistic competition <u>and</u> oligopolistic competition OR for an answer using relevant analysis to explain one market structure and different retailers	9-14
L1	An answer that shows knowledge of market structures, list of key features and different retailers	1-8
Evaluation		
E2	For a discussion justifying the conclusions drawn – this could be one evaluative comment done well	3-4
E1	For an unexplained evaluative statements	1-2