Comparison of Market Structures

	Monopoly	Oligopoly	Monopolistic Competition	Perfect Competition
No. of firms	One	Few	Many	Almost infinite
Barriers to entry	Significant	Significant	Few	None
Pricing decisions	MC = MR	Strategic pricing	MC = MR	MC = MR = P
Output decisions	Most output restriction	Output restricted	Output restricted, product differentiation	No output restriction
Interdependence	No competitors	Interdependent decisions	Each firm independent	Each firm independent
LR profit	Possible	Possible	None	None
P and MC	P > MC	P > MC	P > MC	P = MC

Classifying Industries and Markets in Practice

- An industry seldom fits neatly into one category or another
- One way to classify markets in practice is by its cross price elasticity
- **Cross-price elasticity** measures the responsiveness of the change in demand for a good to a change in the price of a related good
  - Goods with a cross-price elasticity of 3 or more are in the same industry

The North American Industry Classification System

- **North American Industry Classification System (NAICS)** is an industry classification system that categorizes industries by the type of economic activity and groups firms with like production processes

Two Digit Sectors		Three to Six Digit Sectors
23	Construction	
42	Wholesale Trade	
51	Information	517 –Telecommunications 5172 – Wireless telecommunications carriers 517211 – Paging
61	Education Services	

Empirical Measures of Industry Structure

- The **concentration ratio** is the value of sales by the top firms of an industry stated as a percentage of total industry sales
- The **Herfindahl index** is the sum of the squared value of the individual market shares of all firms in the industry
- Because it squares market shares, the Herfindahl index gives more weight to firms with large market shares than does the concentration ratio measure

Concentration Ratios and the Herfindahl Index

Industry	Four Firm Concentration Ratio	Herfindahl Index
Poultry	46	773
Soft drinks	52	896
Breakfast cereal	78	2,999
Soap and detergent	38	664
Men's footwear	44	734
Women's footwear	64	1,556
Pharmaceuticals	34	506
Computer equipment	49	1,183
Burial caskets	73	2,965

Conglomerate Firms and Bigness

- Neither the four-firm concentration ratio nor the Herfindahl index gives a complete picture of corporations' bigness because many firms are conglomerates
- **Conglomerates** are huge corporations whose activities span various unrelated industries

Oligopoly Models and Empirical Estimates of Market Structure

- The cartel model fits best with empirical measurements because it assumes that the structure of the market is directly related to the price a firm charges
  - It predicts that oligopolies charge higher prices than monopolistic or perfect competitors
- The contestable market model gives less weight to the empirical estimates of market structure
  - Markets that look oligopolistic could be highly competitive

Chapter Summary

- Monopolistic competition is characterized by:
  - Many sellers
  - Differentiated products
  - Multiple dimensions of competition
  - Ease of entry of new firms
- The central characteristic of oligopoly is that there are a small number of interdependent firms
- Monopolistic competitors differ from perfect competitors in that the former face a downward sloping demand curve

Chapter Summary

- Monopolistic competitors differ from monopolists in that monopolistic competitors make zero long-run profit
- In monopolistic competition firms act independently; in an oligopoly they take account of each other’s actions
- An oligopolist’s price will be somewhere between the competitive price and the monopolistic price
- A contestable market theory of oligopoly judges an industry’s competitiveness more by performance and barriers to entry than by structure

Chapter Summary

- Cartel models of oligopoly concentrate on market structure
- Industries are classified by economic activity in the North American Industry Classification System (NAICS)
- Industry structures are measured by concentration ratios and Herfindahl indexes
- A concentration ratio is the sum of market shares of the largest firms in an industry
- A Herfindahl index is the sum of the squares of the market shares of all firms in an industry