**Market structure summary**

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**Summary on Market Structures**

Market structure is best defined as the organisational and other characteristics of a market. We focus on those characteristics which affect the nature of competition and pricing – but it is important not to place too much emphasis simply on the [market share](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/market+share/) of the existing firms in an industry.

Traditionally, the most important features of market structure are:

**The number of firms** (including the scale and extent of foreign competition)

**The market share of the largest firms** (measured by the concentration ratio – see below)

**The nature of costs** (including the potential for firms to exploit [economies of scale](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/economies+of+scale/) and also the presence of sunk costs which affects market [contestability](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/contestability/) in the long term)

**The degree to which the industry is vertically integrated** - [vertical integration](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/vertical+integration/) explains the process by which different stages in production and distribution of a product are under the ownership and control of a single enterprise. A good example of vertical integration is the oil industry, where the major oil companies own the rights to extract from oilfields, they run a fleet of tankers, operate refineries and have control of sales at their own filling stations.

**The extent of product differentiation** (which affects cross-price elasticity of demand)

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| **Characteristic** | **Perfect Competition** | [**Oligopoly**](http://www.tutor2u.net/blog/index.php/economics/C187/) | [**Monopoly**](http://www.tutor2u.net/blog/index.php/economics/C180/) | Contestable Market |
| Number of firms | Many | Few dominant firms | One with pure monopoly Effective duopoly in many cases | Many |
| Type of product | Homogenous | Differentiated | Limited | Differentiated |
| [Barriers to entry](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/barriers+to+entry/) | None | High | High | Low entry and exit costs |
| Supernormal short run profit | ü | ü | ü | Any profit possible |
| Supernormal long run profit | û | ü | ü | Supernormal invites hit and run entry |
| Pricing power | Price taker (passive) | Price maker but interdependent behaviour | Price maker – constrained by demand curve and possible regulation | Price maker – but actual and potential competition limits pricing power |
| Non price competition | û | ü (important) | ü | ü (important) |
| Economic [efficiency](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/efficiency/) | High | Low allocative but scale economies and innovation | Low allocative but economies of scale and reinvested profits Risk of X-inefficiency due to lack of competition | High – depending on strength of contestability |
| Innovative behaviour | Weak | Very Strong | Potentially strong | Strong |

**The structure of buyers in the industry** (including the possibility of [monopsony](http://www.tutor2u.net/blog/index.php/economics/tagged/tag/monopsony/) power)

**The turnover of customers** (sometimes known as “market churn”) – i.e. how many customers are prepared to switch their supplier over a given time period when market conditions change. The rate of customer churn is affected by the degree of consumer or brand loyalty and the influence of persuasive advertising and marketing

**Market structure and innovation**

Which market conditions are optimal for effective and sustained innovation to occur? This is a question that has vexed economists and business academics for many years.

High levels of research and development spending are frequently observed in **oligopolistic markets**, although this does not always translate itself into a fast pace of innovation.

The recent work of **William Baumol** (2002) provides support for oligopoly as market structure best suited for innovative behaviour. Innovation is perceived as being “mandatory” for businesses that need to establish a **cost-advantage** or a significant **lead in product quality** over their rivals.

“As soon as quality competition and sales effort are admitted into the sacred precincts of theory, the price variable is ousted from its dominant position…But in capitalist reality as distinguished from its textbook picture, it is not that kind of competition which counts but the competition which commands a decisive cost or quality advantage and which strikes not at the margins of profits and the outputs of the existing firms but at their foundations and their very lives. This kind of competition is as much more effective than the other as a bombardment is in comparison with forcing a door”

**Supernormal profits** persist in the long run in an oligopoly and these can be used to finance research and development.