Industrial Organizations Group Assignment- Áron, Ádám, Adél

1, What is Market power?

Market Power is the ability of an entity to raise and maintain price above a perfectly competitive level, which means that they have the ability to profitably raise their price (the market price of a good or a service) over the marginal cost. Thus, firms with Market Power will be enabled to earn higher supernormal profits due to higher prices. Moreover, market structures to a large extent are determined by the level of market power in an economy or in one specific field. In a *perfect competition* market power does not exist, in a *monopolistic competition* there is a little market power, in an *oligopoly* there is a lot or some market power and lastly in a *monopoly* there is a lot of market power.

How does this compare to "power"?

Market Power and power in general are undoubtedly strongly connected because as we know, power in general means that the ability to affect something or someone to acquire your desired outcome. In an economical sense Power is the ability to acquire goods below their market price.

2, Measuring the Market Power

-The Lerner index-

The Lerner index is a measure of market power. The index measures the price cost margin. In other words, the difference between price and marginal cost divided by the output price, that is [p-mc]/p. The primary indicator of a market power is the margin because the larger the margin is, the larger the difference between the firm's price and the other competitor's price.

-Concentration ratios-

Concentration ratios are also a measure of a market power. This ratio indicates the size of a firm compared to the industry as a whole, where their firm is located. Low concentration ratio indicates higher competition, on the other hand a high concentration ratio indicates a market structure with low competition, even a monopoly.

- Herfindahl-Hirschman Index (HHI)-

More specifically, The Herfindahl-Hirschman Index (HHI) is a common way of measuring the market power because this index mainly indicates the market concentration which reflects the competitiveness of an industry.

3, Examples of Market Power

-Apple-

A perfect example is Apple in the tech, more specifically in the smartphone industry because they have the ability to control the smartphone price market due to the big credibility and big presence in the industry. Moreover, they have the ability to charge a premium price due to the brand loyalty that they have.

These companies below also have

-Tesla-

Although the market for electric cars in the world is very small with only a 1% of the total sales, Tesla still manages to dominate their industry. The company sold almost half a million cars in this year alone, leaving other competitors behind.

-Durex-

Durex can be undoubtedly named as the leader of their market with more than 20% in market shares in their sector.

-Amazon in the e-book industry-

Amazon sells 74% percent of all e-books sold online in the US.

-LVMH Group in the champagne industry-

The LVMH Group headed by the billionaire Bernard Arnault captures 60% of the American champagne industry/market.

4. Why might market power be a good thing? Why might it be a bad thing?

In the following overview one may read the potential advantages and disadvantages of high market power and monopolies:

Advantages:

- High profit
- This profit can be used for research and development
- Lower average cost due to increased scale
- The reward of getting much market power or monopoly power can encourage investment
- Through monopolies governments can regulate both economies of scale and fair prices

Disadvantages:

- Higher prices for consumers, decline in consumer surplus
- Less incentive to innovate

- Less motivation to cut costs
- Less variety and smaller range of choices for the consumers
- Potential diseconomies of scale

5. What is the difference between antitrust and regulation?

Antitrust laws are regulations that encourage competition by limiting the market power of any particular firm. Thereby they hinder the creation of monopolies as well as break up existing monopolies.

Although in a sense antitrust is also a type of regulation, in general, regulation in industrial organization is understood as a government regulation of an entire industry. (such as in airline, railroad, trucking, banking, and television broadcasting) The objective of industry regulation is to keep a close eye on products and prices to ensure that no one starts a monopoly or takes advantage of the consumers.

Generally, I believe the main difference could be that while antitrust laws regulate a firm, a regulation is usually in place for an entire industry.

6. What is the Deadweight loss triangle?

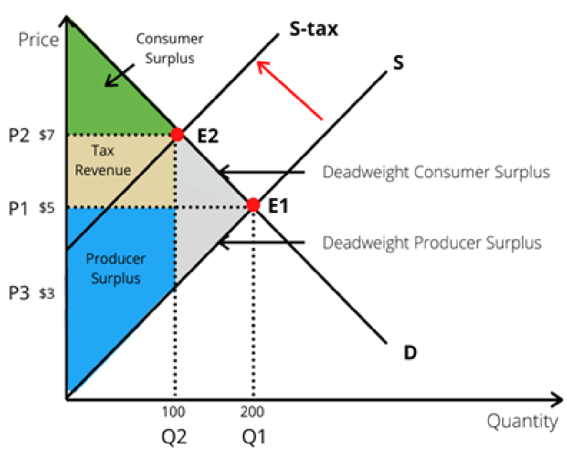
· cost to society created by market inefficiency

· when supply and demand are out of equilibrium

· goods and services are either being under or oversupplied

· reduction in the producer or consumer surplus

· usually a result of a government intervention



7. Video:

1. Which example Friedman gives is most convincing and why?
Milton Friedman points out that monopolies are only able to sustain their market power and existence with the help of the government. In nearly all the cases monopolies will naturally fall apart without government intervention. Passing a new law is not the solution, in fact we need less government intervention if we want to solve the monopoly problem. I think it is convincing since, we can barely name monopolies from the past that were able to operate without the assistance of the government.

2. What is Friedman's solution to the monopoly problem? Can you think of pros and cons to his solution?

Friedman's solution to the monopoly problem is simply free trade. He argues that we should eliminate all tariffs and all restrictions on foreign trade, consequently foreign competition will prevent domestic monopoly situations.

I am convinced that foreign competition benefits the consumers, since the competition will lower prices of certain products. Competition also incentivises research and development which has a positive outcome for the consumers, because the quality of the products available on the market will be generally better.

However, certain governments are willing to sacrifice the greater well-being of the consumers in exchange for the protection of domestic market and firms. In that way the country will be less dependent on foreign supply and the profit made will be invested inside the country, meaning more workplaces and overall infrastructural and economical advance.

3. Can you think of some examples where the monopoly problem is especially prevalent?

The monopoly problem is certainly prevalent in the US. Three companies control about 80% of mobile telecoms. Three have 95% of credit cards. Four have 70% of airline flights within the U.S. Google handles 60% of search. The list goes on.

In agriculture, four companies control 66% of U.S. hogs slaughtered in 2015, 85% of the steer, and half the chickens, according to the Department of Agriculture.

Similarly, just four companies control 85% of U.S. corn seed sales, up from 60% in 2000, and 75% of soybean seed.

The problem is that they have no incentive to deliver better products or to get more efficient. They simply take in cash from people who have no choice but to hand it over.