The Kinked Demand Model of Oligopoly

My competitors will not increase their price and I will lose a lot of sales

A

S

S

u

m

e

t

h

a

t

e

a

C

h

f

i

r

m

i

n

t

h

e

O

—

i

g

O

p

O

I

y

u

S

e

S

t

h

e

f

O

O

W

i

n

g

r

e

a

S

O

n

i

n

g

a

b

O

u

t

i

S

C

O

p

e

t

t

i

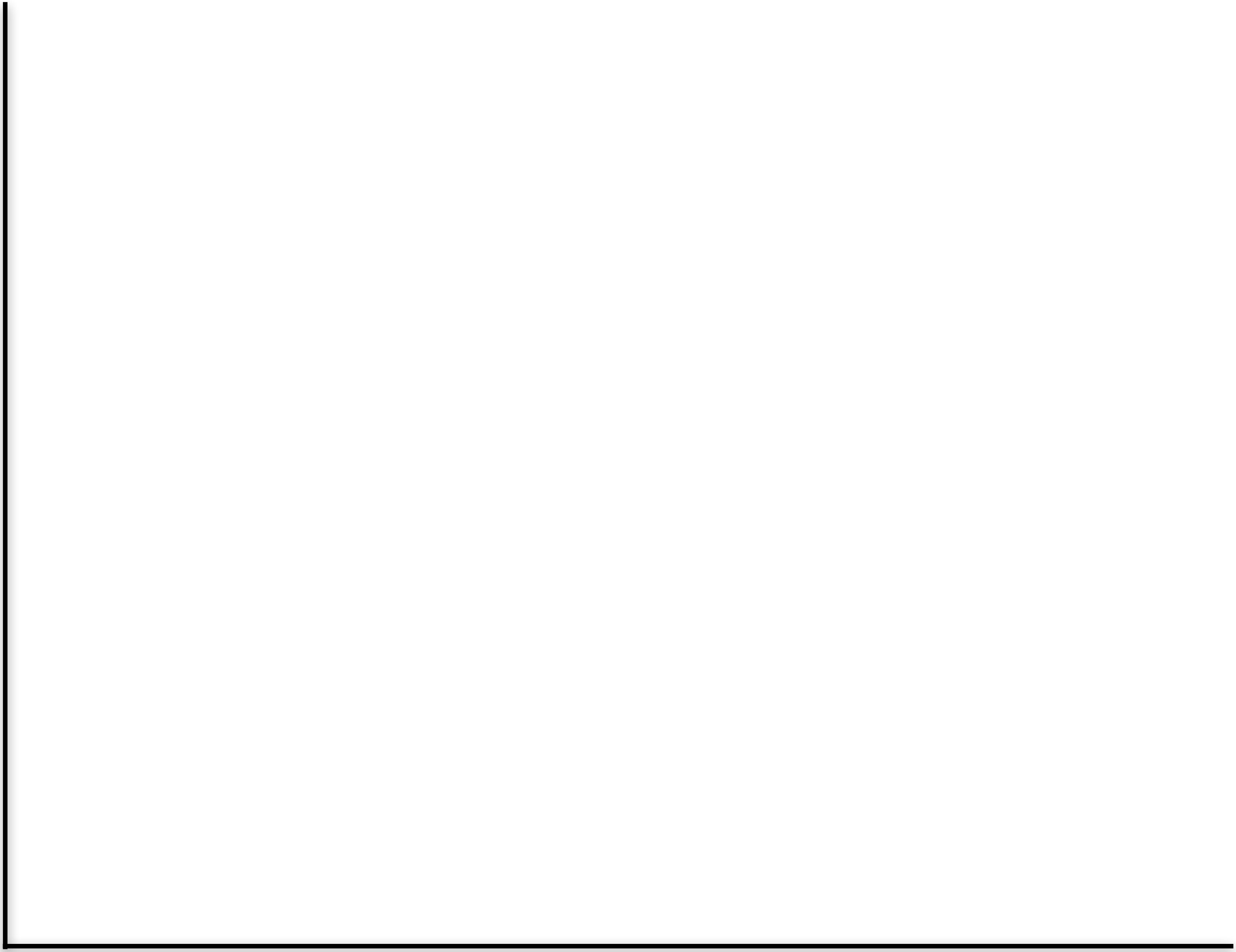
n

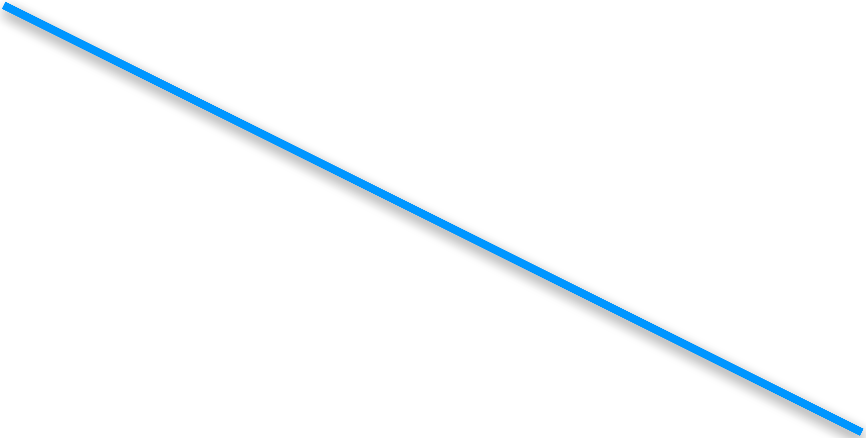
:

If I increase my price

My competitors will also decrease their price and I will gain very little in extra sales

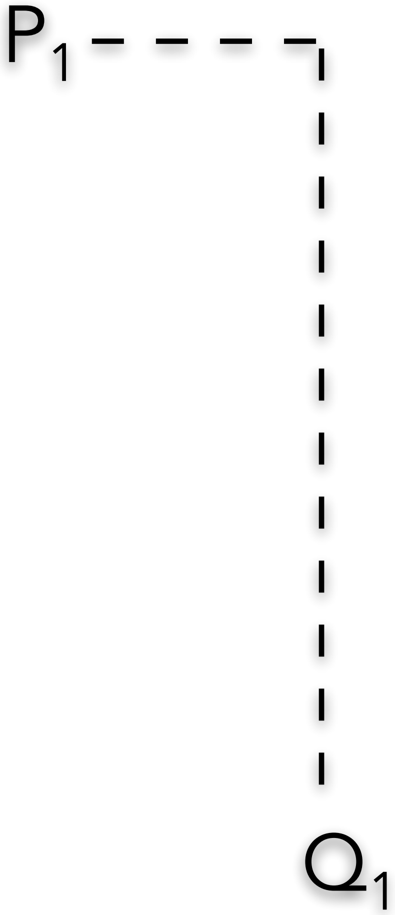
If I decrease my price





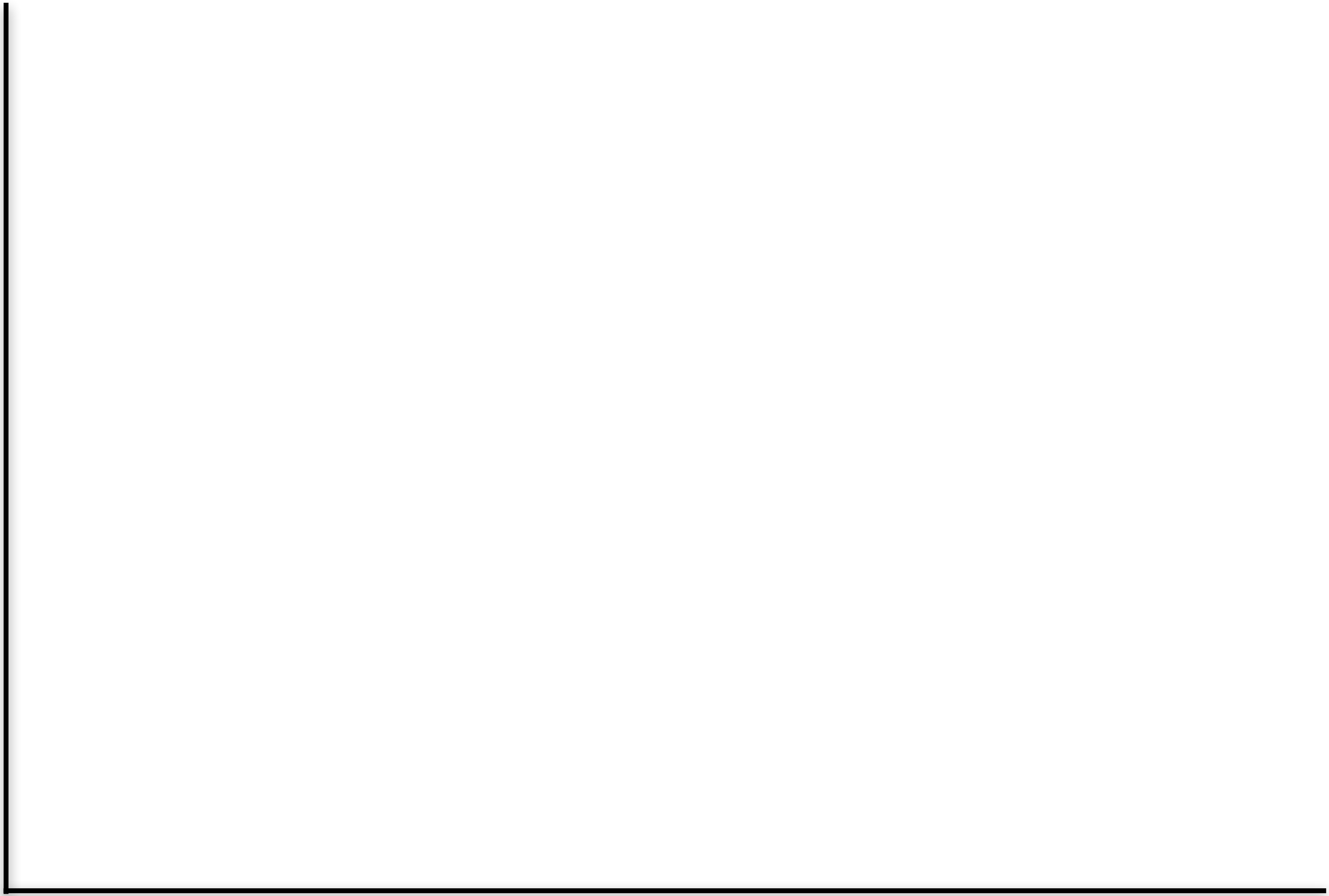
D_0

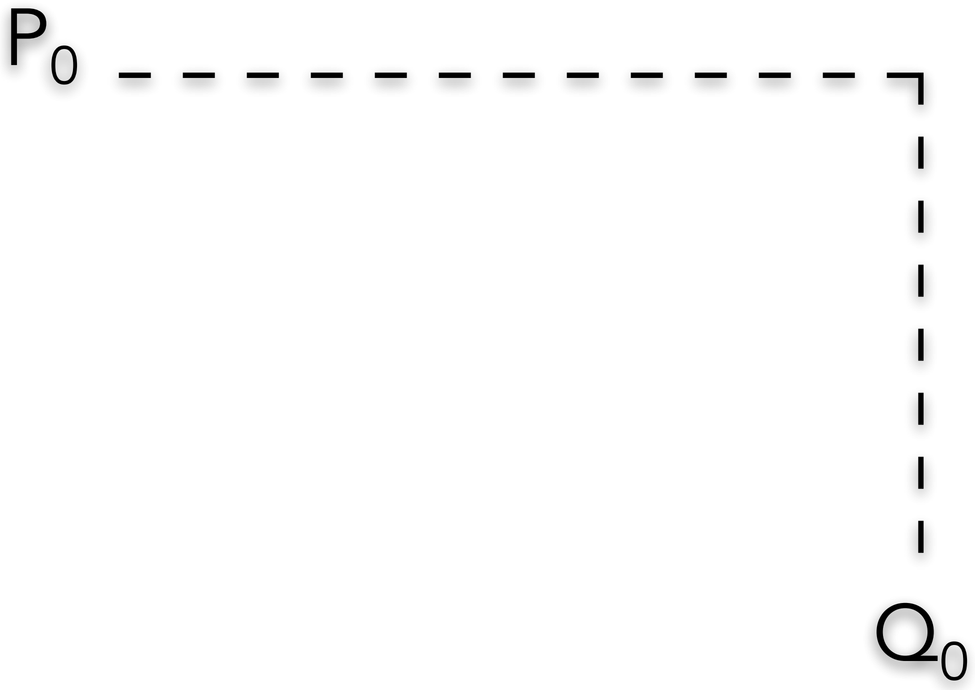

P_0
Q_0


P_1
Q_1

Quantity
demanded
drops by 20%

I increase price by 10%

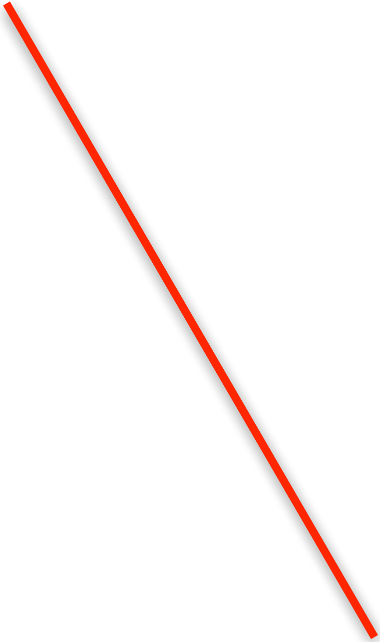



P_0
Q_0

I decrease price by 10%

Quantity demanded
increase by 5%

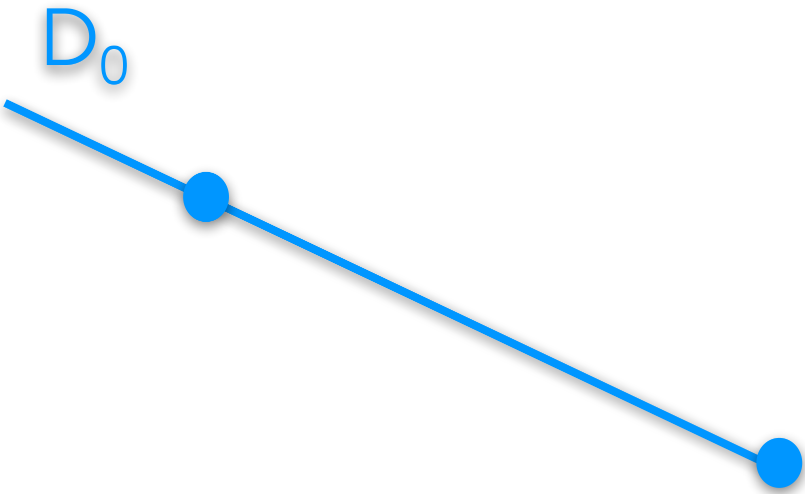

P_2
Q_1



D_1

Quantity demanded drops by 20%

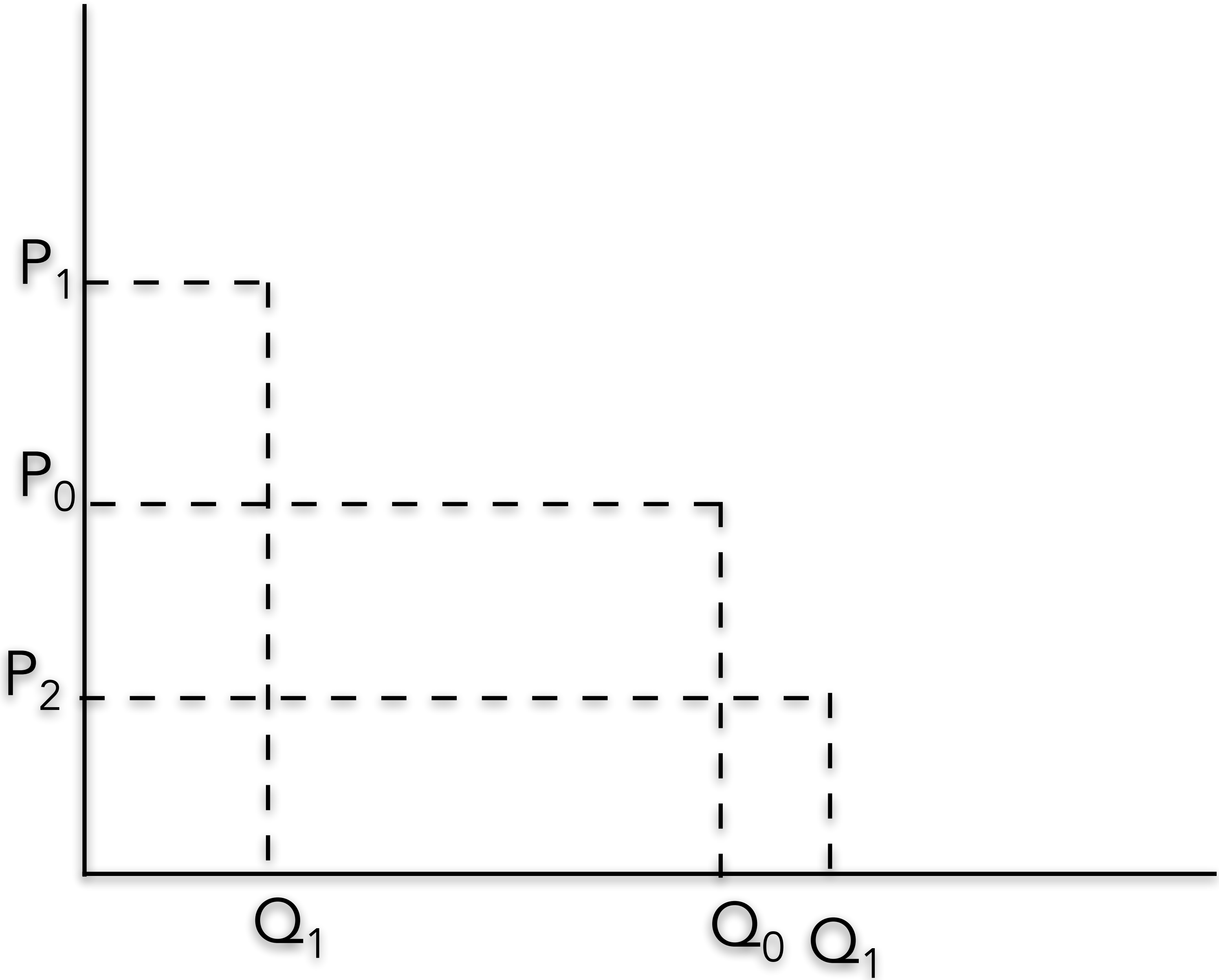
I increase price by 10%

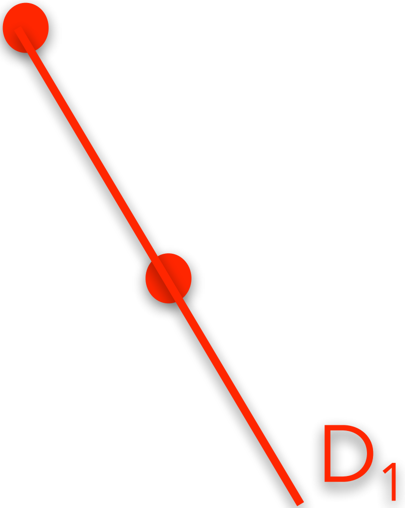

D_0

I decrease
price by
10%

Quantity demanded

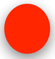
increase by 5%


P_1
P_0
P_2
Q_1
Q_0
Q_1


D_1

Above the current price, demand is **more** elastic

Below the current price, demand is **less** elastic



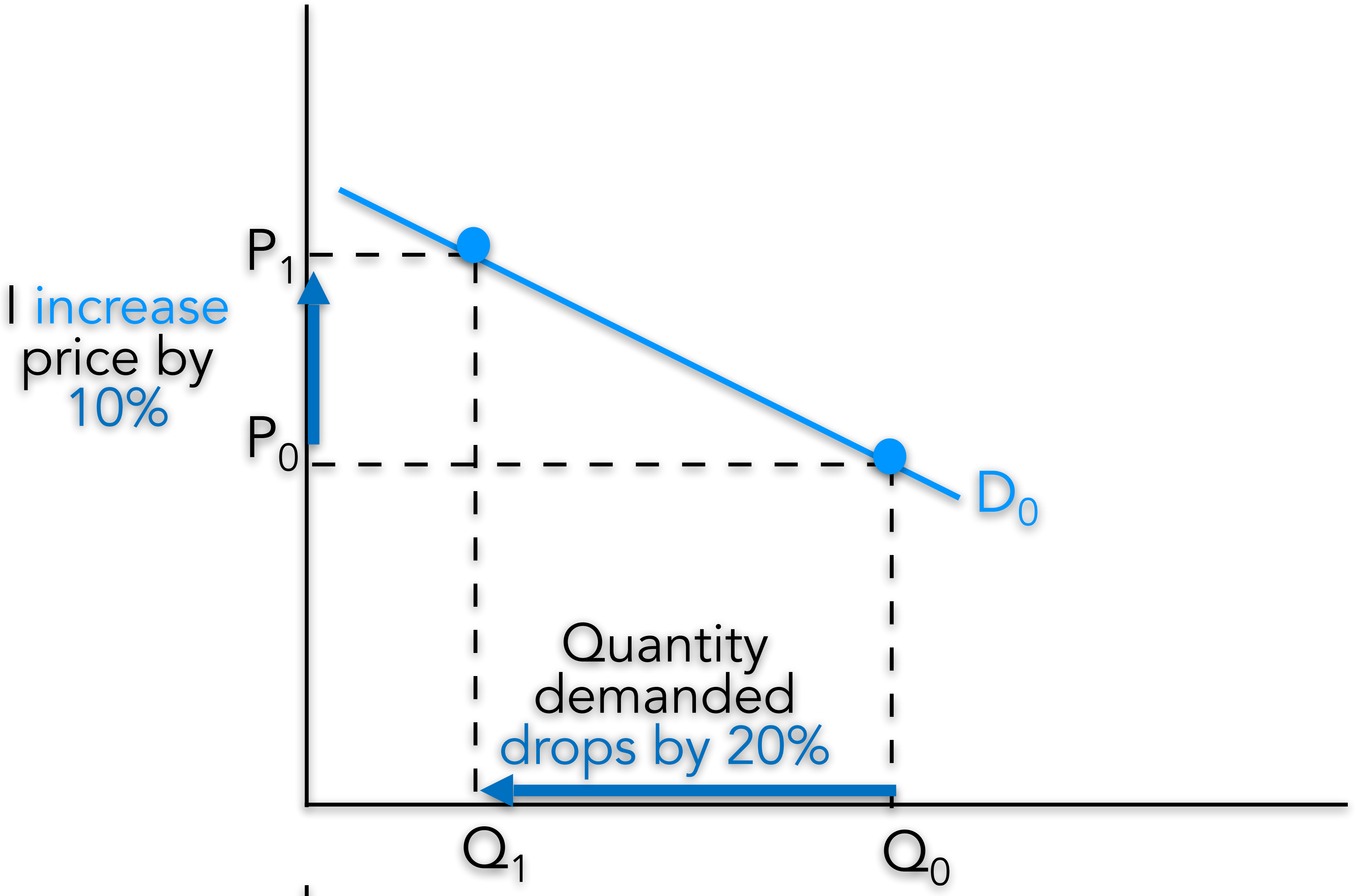
The result is a Demand line with a “kink” at the current price

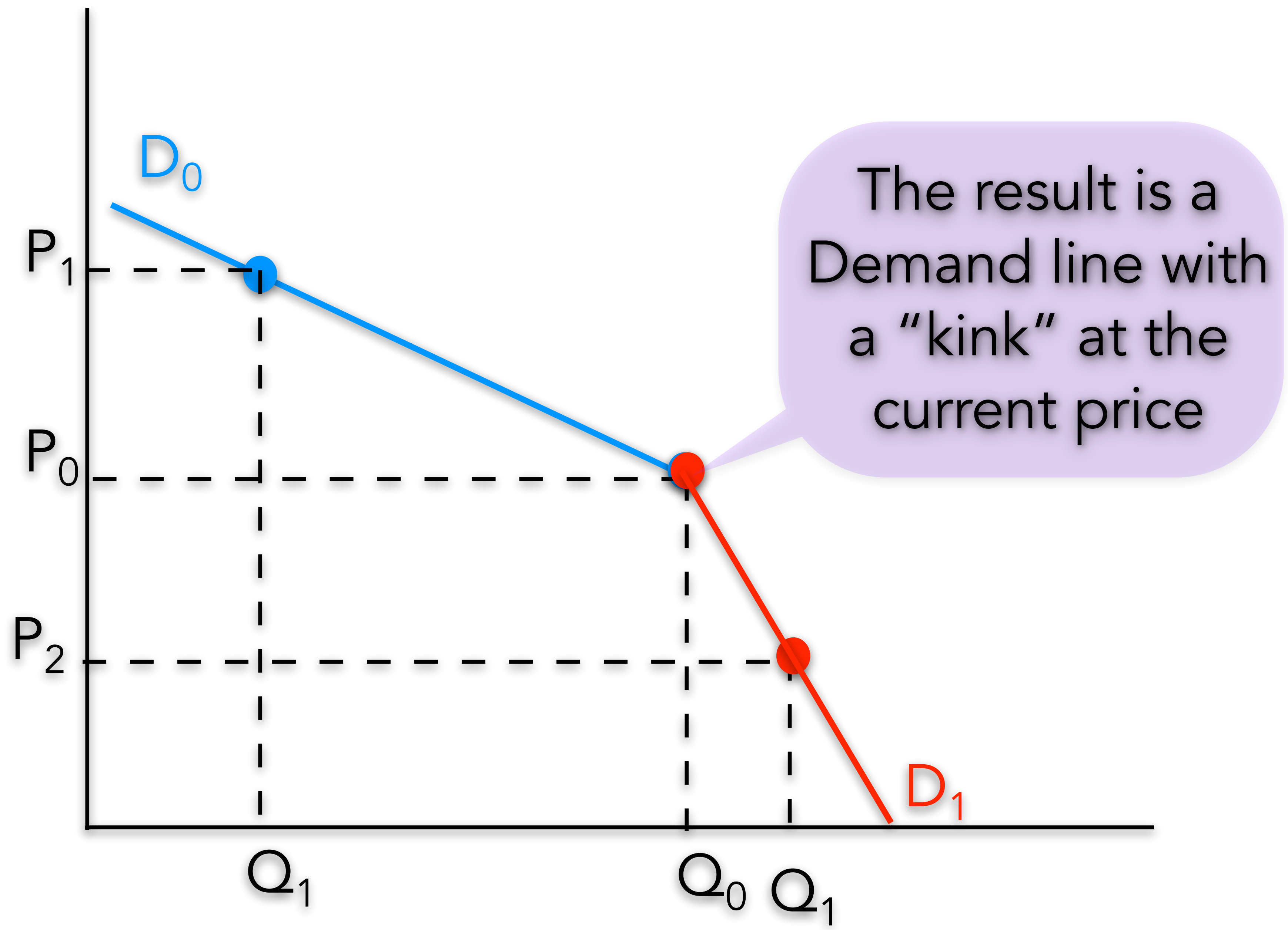
Assume that each firm in the Oligopoly uses the following reasoning about its competition:

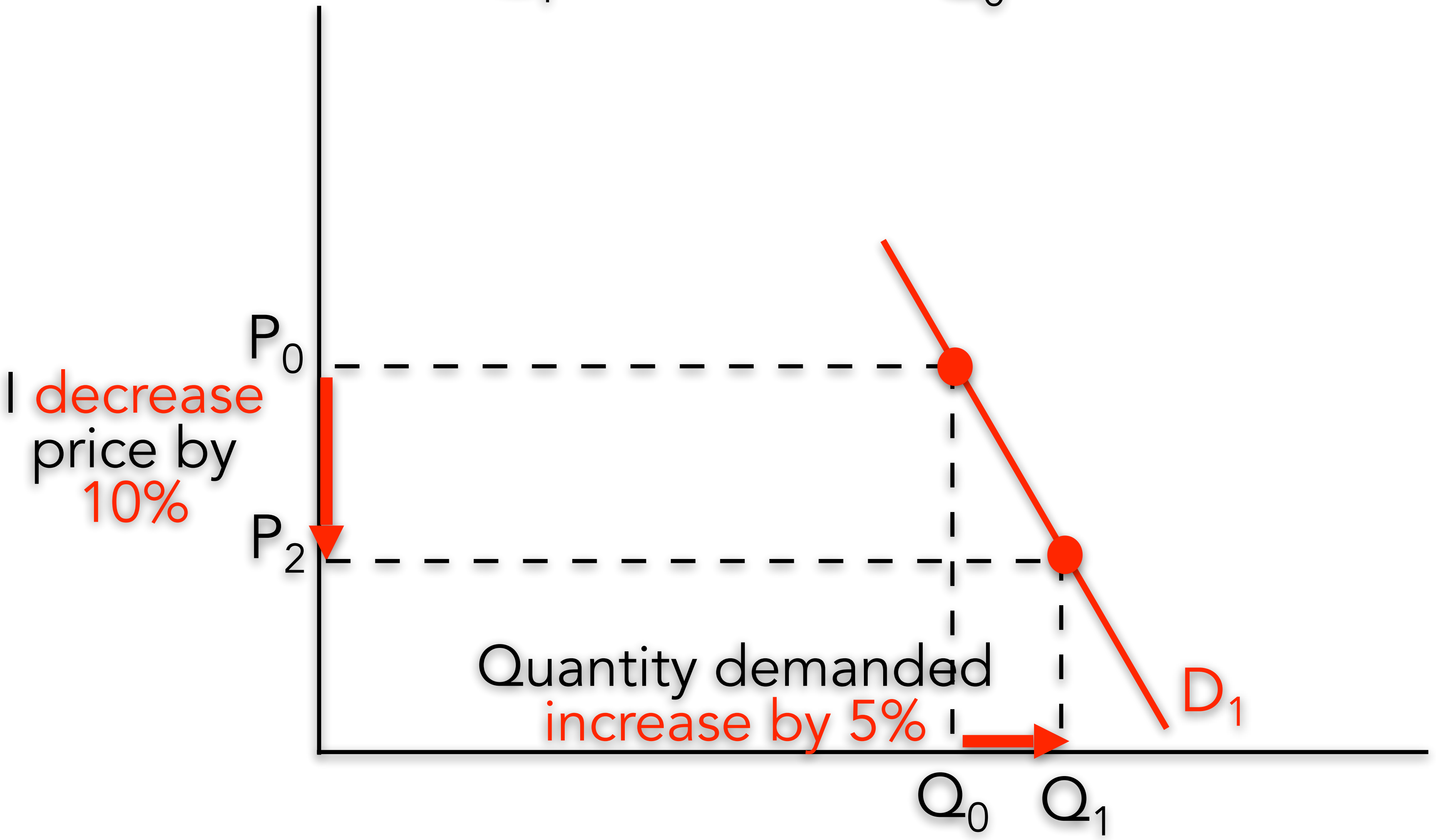
The Kinked Demand Model of Oligopoly

Assume that each firm in the Oligopoly uses the following reasoning about its competition:

If I increase my price → My competitors will not increase their price and I will lose a lot of sales







If I decrease my price → My competitors will also decrease their price and I will gain very little in extra sales

Price and Output Determination in the Kinked Demand Model of Oligopoly