

The Kinked Demand Model of Oligopoly

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



S

S

U

m







6





2







































Y

U

S



S

















W





9





6

S









9

2

b



U





S











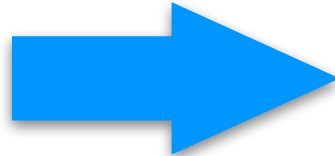






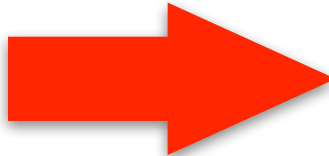


If I increase my price

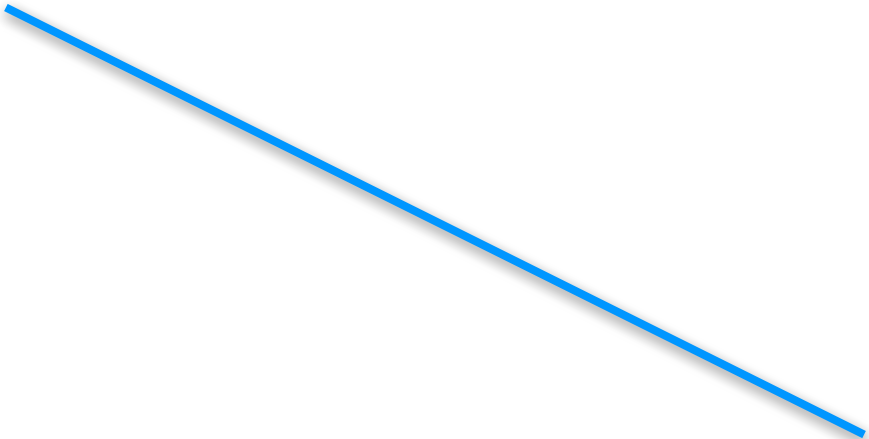


My competitors will also
decrease their price and I will
gain very little in extra sales

If I decrease my price







Do

P_0



Q_0

P_1 - - - -

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|
|
|
|

Q_1

Quantity
demanded
drops by 20%

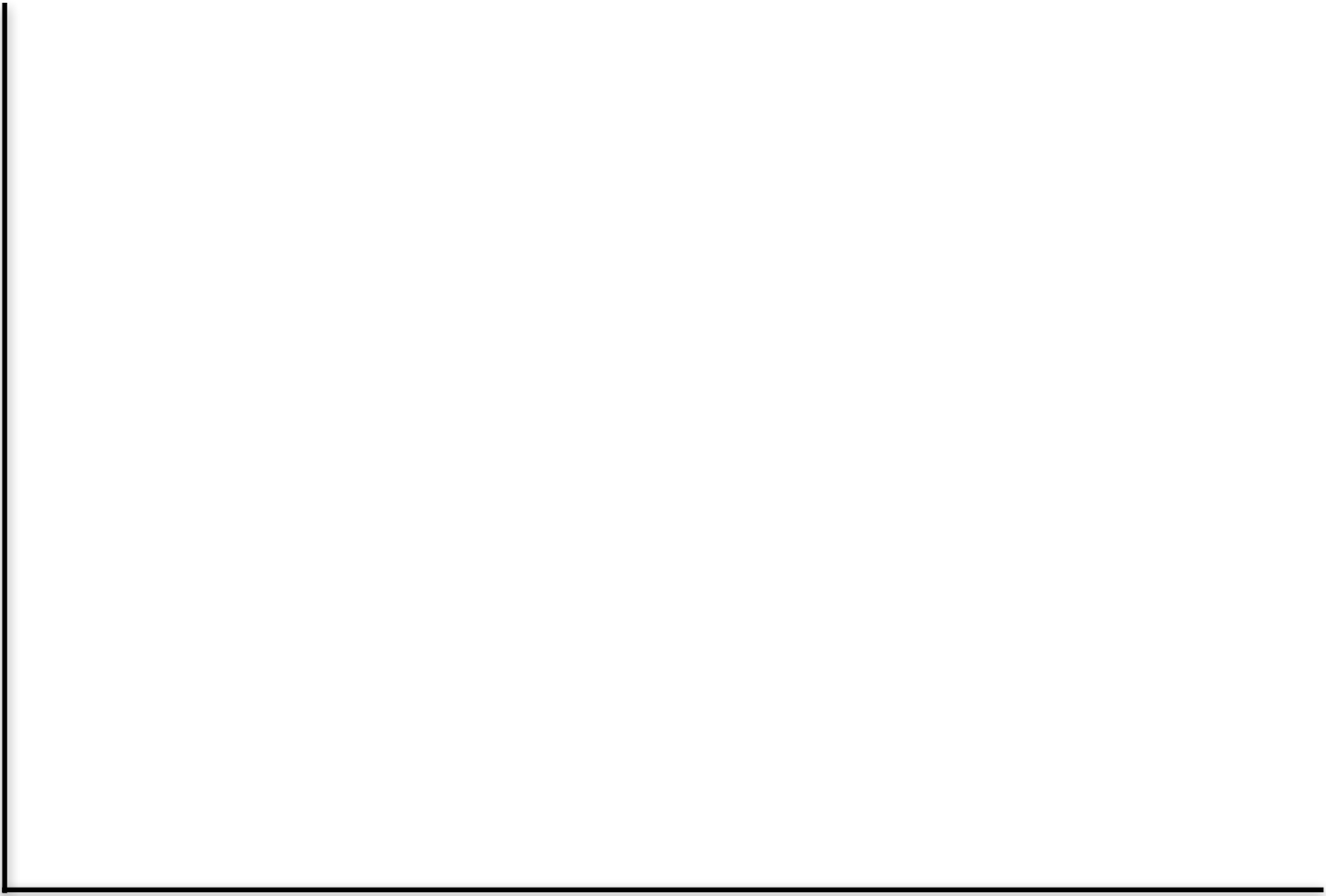


I increase
price by
10%









P_0



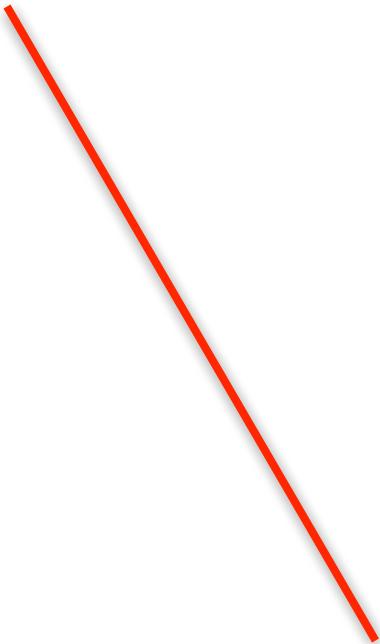
Q_0

I decrease
price by
10%



Quantity demanded
increase by 5% →





D₁

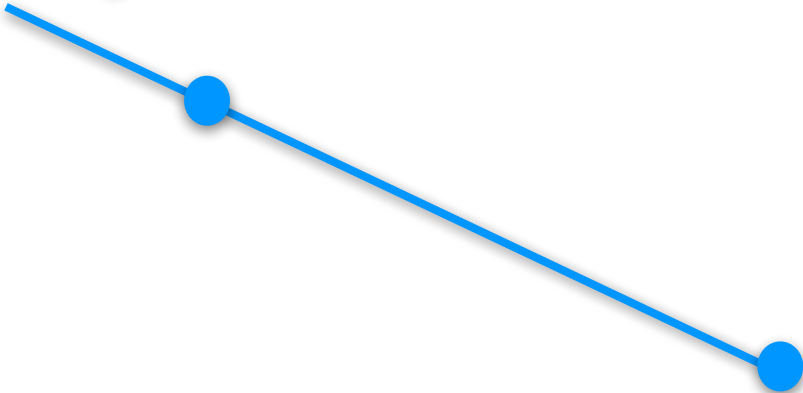
Quantity
demanded
drops by 20%



I increase
price by
10%



D_0

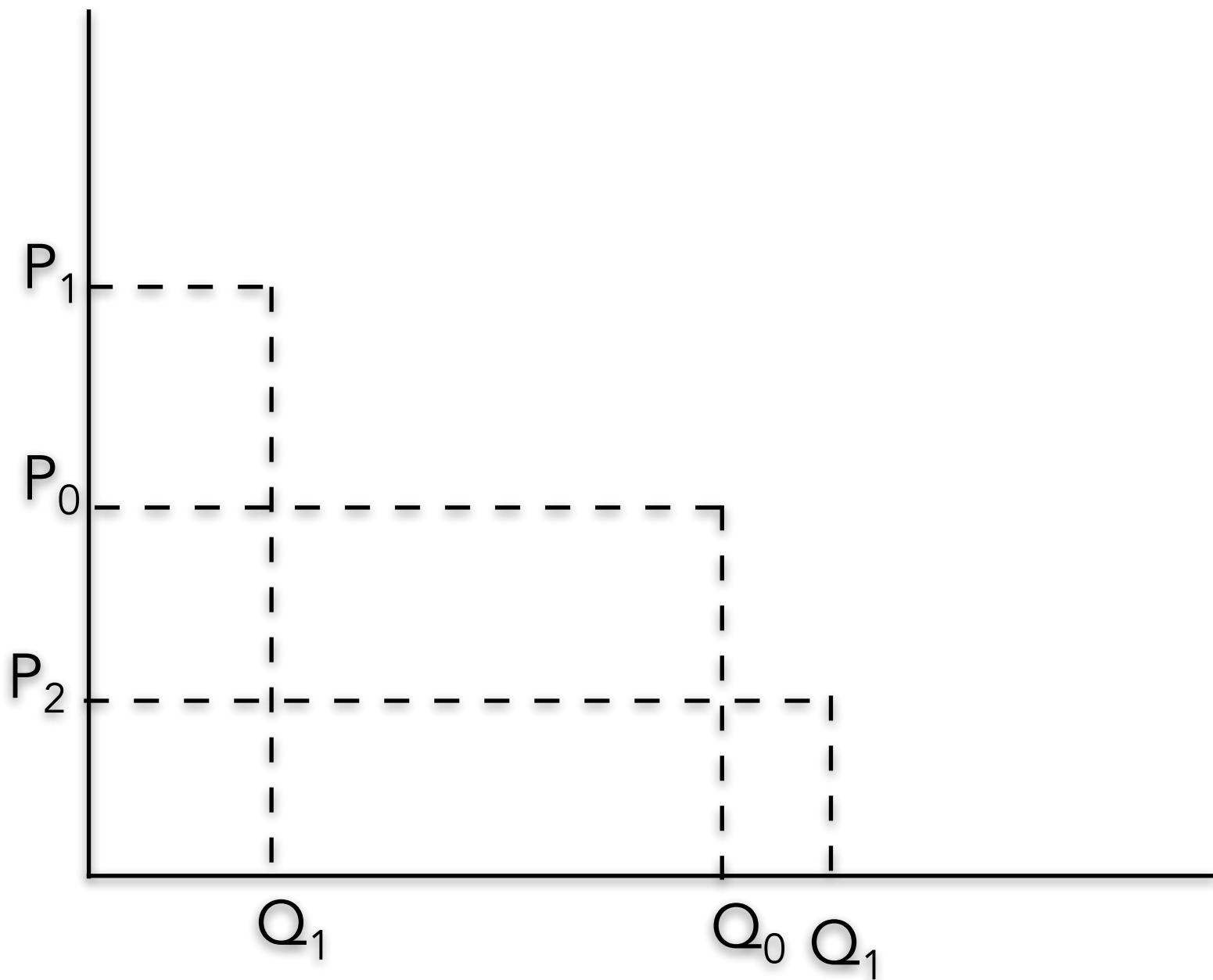


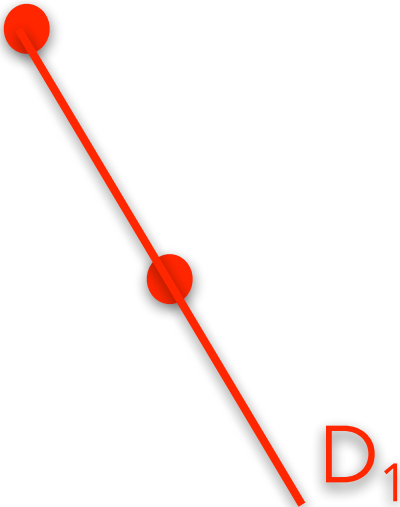
I decrease
price by
10%




Quantity demanded
increase by 5%

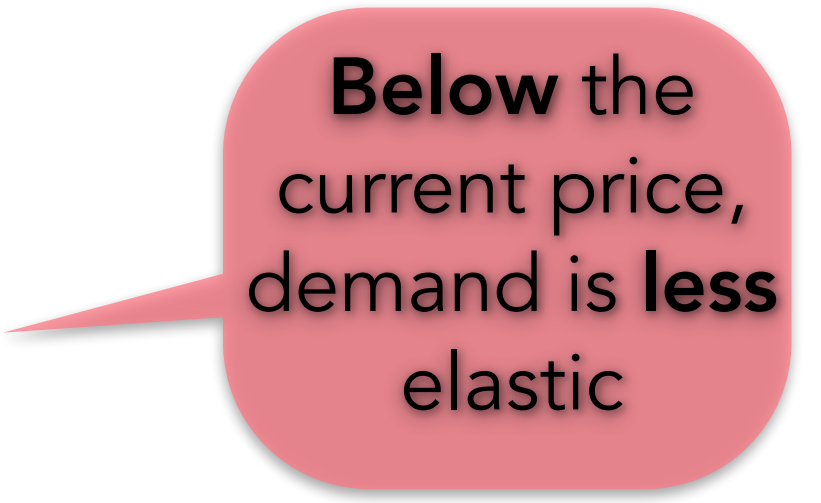








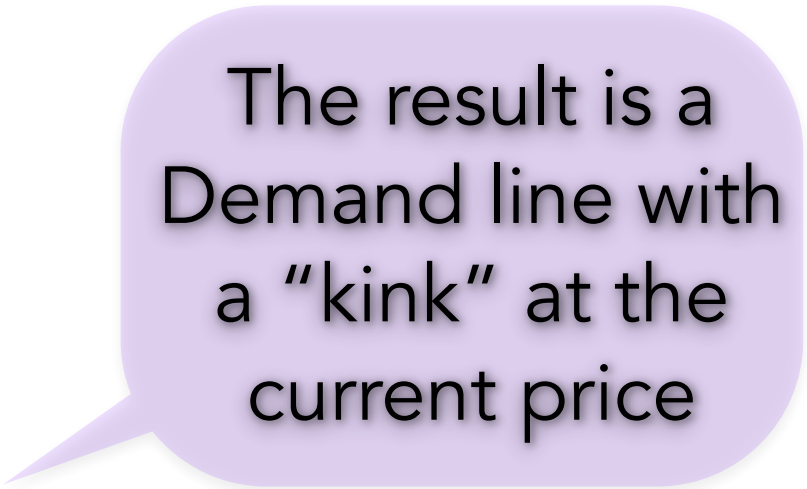
Above the
current price,
demand is
more elastic



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







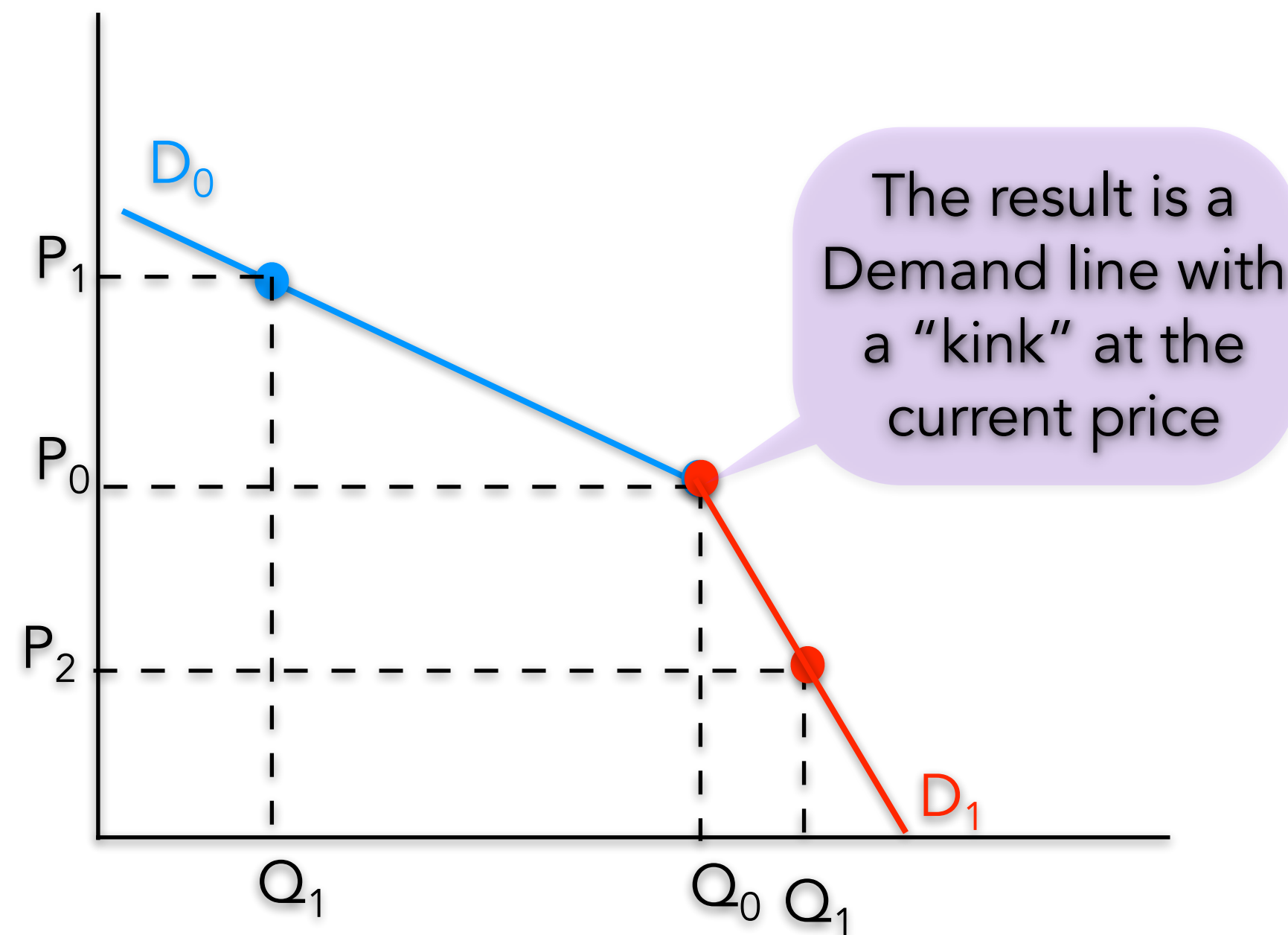
The result is a
Demand line with
a “kink” at the
current price

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

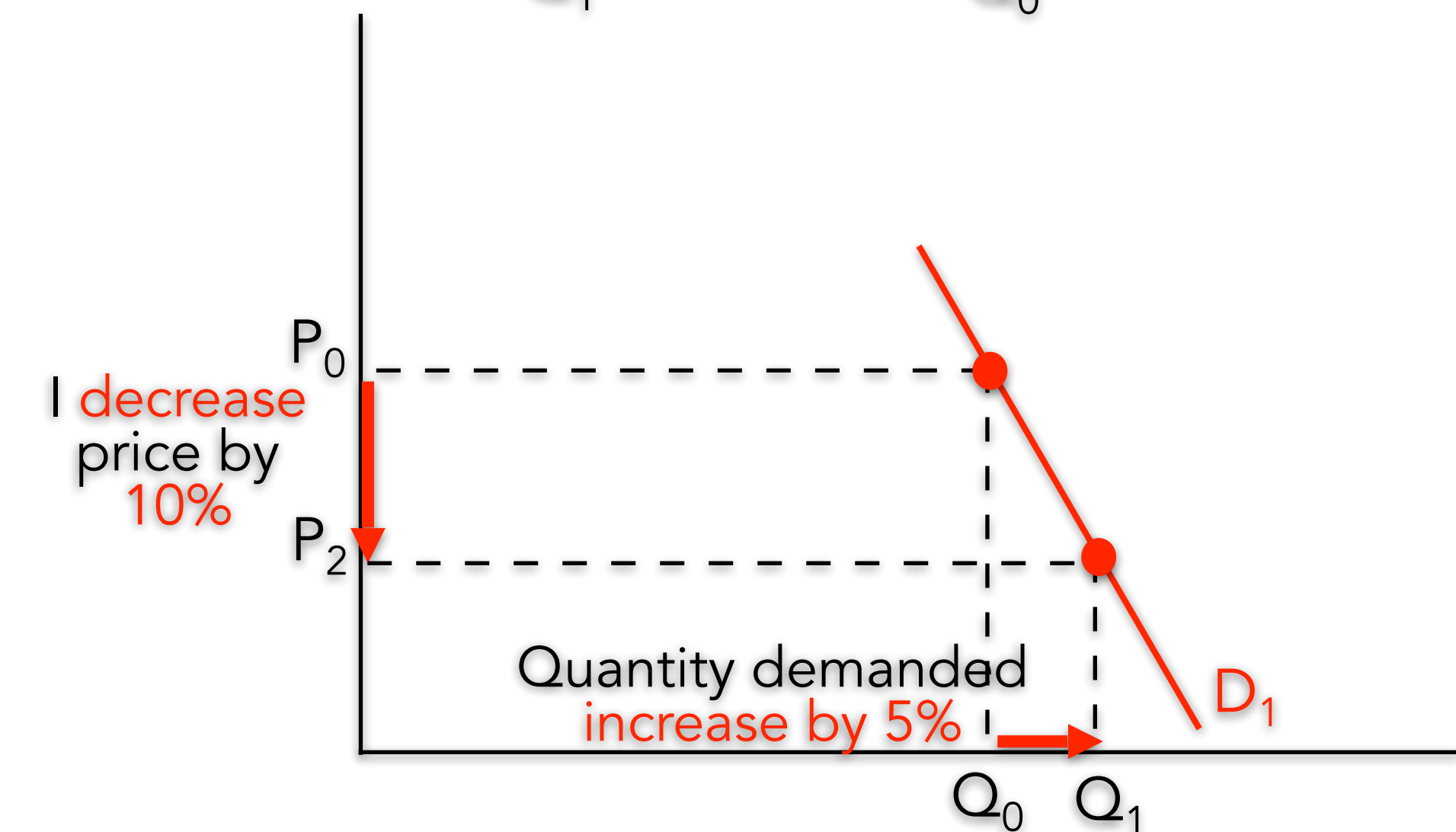
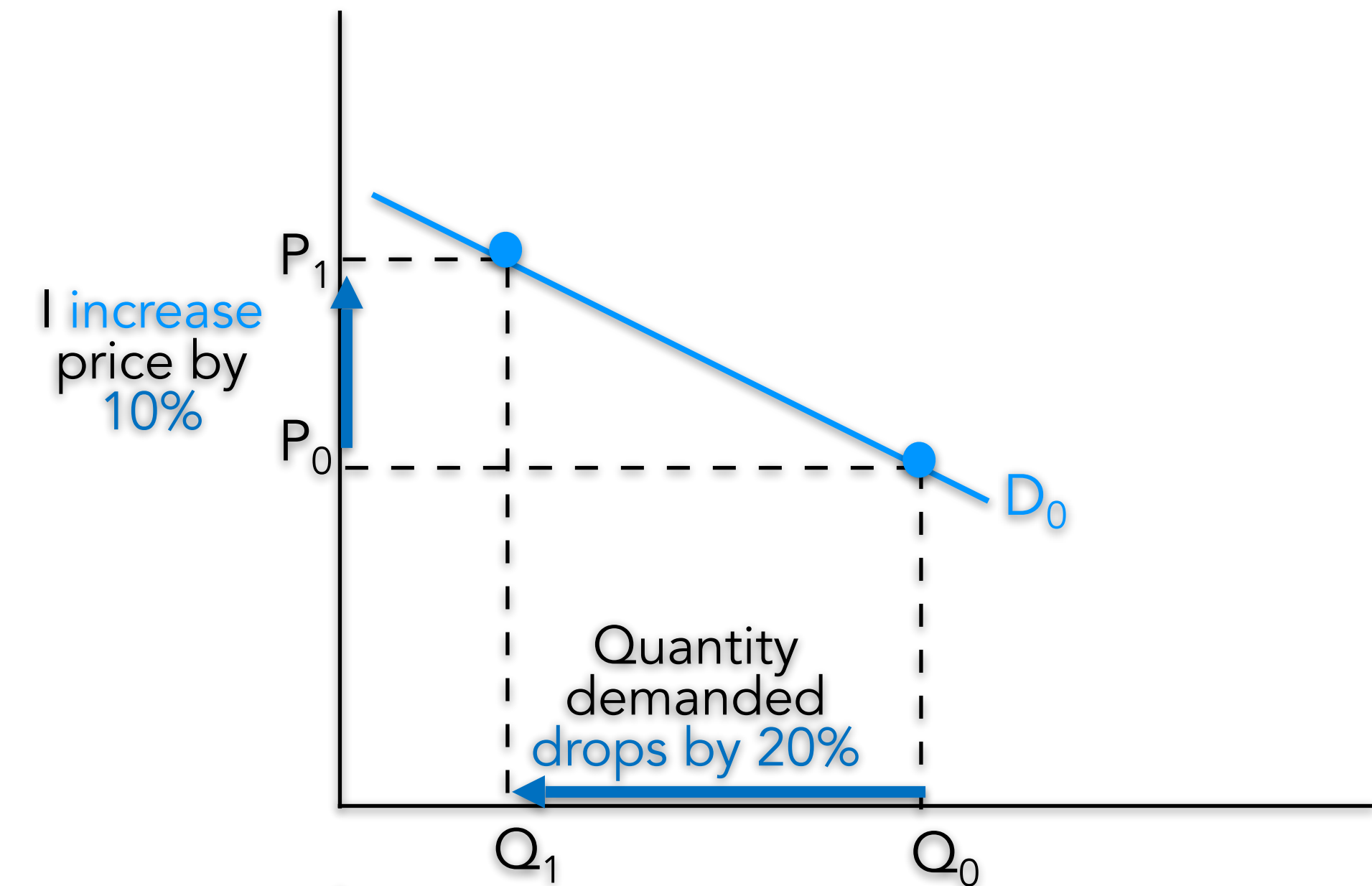
The Kinked Demand Model of Oligopoly

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